

**Society of District Council Treasurers**

**Response to Public Works Loan Board: future lending terms consultation**

Introduction

The Society of District Council Treasurers (SDCT) was formed in 1974 and represents the 188 district council finance functions in England. The Society provides a forum for members to share expertise on financial issues affecting district authorities. It also enables districts to speak with a united voice; as a Treasurers’ Society it is recognised as a key local government stakeholder by central government and the Local Government Association.

The society welcomes the opportunity to feed in to this important consultation. Please find below the response from the SDCT within Appendix 1. In addition, SDCT have contributed to the response of the District Council Network (DCN).

Whilst beyond the control of PWLB (HM Treasury), this consultation has been conducted throughout the period of lockdown, and at a time local councils and particularly their finance teams have been extremely busy dealing with the implications of the Business Grants. Regional round table discussions were planned but have understandably not taken place.

Should government continue to believe that specific actions are required, SDCT also call for an additional consultation prior to their implementation. The SDCT would be open to further discussion to help shape the future for PWLB.

Summary

The society is strongly opposed to any arbitrary intervention targeted at stopping “debt-for-yield” activity. The government’s austerity measures have challenged local authorities to be more innovative and commercial in their approach, in order to replace the cuts in grant funding. Over half of all councils have chosen to seek commercial returns in order to replenish that lost grant. Commercial income has also been used extensively to enable significant regeneration schemes, particularly around High Streets, and to protect and promote quality employment opportunities for communities.

Many councils have approached commercial investment sensibly and prudently, and have commissioned expert external advice, resulting in well balanced portfolios. This may include properties outside of a council’s geographic, or economic boundary as a result of the lack of opportunities within it; a common trait for many rural district councils in particular, and in order to balance risk. The level of due diligence undertaken is critical to the investment; strong locations, tenant covenants and appropriate diversification will lead to more robust investments.

The consultation recognises this is not new; “local authorities have long owned buildings that could serve a commercial purpose”[[1]](#footnote-1). Although SDCT recognise that this has increased over the last few years, it rejects the presumption that this distorts the market; the NAO “estimate that local authorities accounted for 4.9% by value of commercial property acquisitions from 2016-17 to 2018-19 in England”. Furthermore, many councils have adopted a position where it will not bid against other councils, particularly where this is outside of their council boundary.

There is little evidence to prove higher exposure to ratepayers in reality. Arguably, the current Covid-19 pandemic has shown there too is perhaps an over reliance on the main sources of income, namely Council Tax and Business Rates. As with any investment, a council with diversified income is better protected.

The society feels strongly that intervening in a council’s ability to access this funding source undermines the prudential framework and the core principle of local decision making the government is committed to. Using different funding sources will inevitably introduce greater risk than accessing government backed funding as acknowledged in the consultation “the government is not aware of any private lenders offering this combination of speed, price, and certainty.” Government should also be aware of the potential impact on Council’s credit ratings and ‘going concern as the ability to access PWLB funds without restriction is a key underwrite that contributes to these judgements.

Previous arbitrary inventions, particularly the addition of 100 basis points in October 2019, have caused significant issues for many councils, with many regeneration projects postponed or cancelled. The proposal to cut interest rates and inject over £1 billion for such projects is welcomed, but this should not be dependent upon implementing the proposed barring for commercial purposes. Although they may be different usages of the funding, they both provide an essential function for the council – one protects statutory services to residents, one provides growth and opportunities for business and residents.

Removing the ability for a council to generate additional income leads to only one conclusion; more funding will be required from central government.

**Society of District Council Treasurers**

**July 2020**

**Appendix 1**

Responses to Specific Questions

**Q1: Do you use the PWLB to support treasury management, for example by refinancing existing debt, or to externalise internal borrowing?**

Yes. Many councils will have taken the opportunity of the historically low interest rates to externalise internal borrowing. This is a significant element of the increase in borrow during 2019, causing the knee-jerk reaction of the introduction of the additional 100 basis points as the overall £85 billion lending limit was close to being breached.

However, borrowing levels are not universal across local authorities and more sensible interventions could have been introduced. Interventions such as a discount on the cost of repaying existing debt early would encourage other authorities to reduce borrowing.That option remains open and SDCT encourage this to be introduced as this free up borrowing capacity and help the national balance sheet.

**Q2: How far do the lending terms of the PWLB affect the terms offered by private lenders?**

This area is difficult to be precise about in any response, as councils are not setting the terms for either lender. Market borrowing rates and structures will be set against availability, creditworthiness of the borrower and the lenders’ profitability. Access to the PWLB, however, is one of the key tenements supporting local authorities existing credit ratings as it underwrites local authority cash flow management and liquidity.

There is a borrowing interest rate at which the market found it difficult to compete (such as pre-October 2019 PWLB Certainty Rate), hence the difficulties with the Municipal Bond Agency. However, since the arbitrary rate increase many options have become available, many of which outstrip PWLB.

As noted in the consultation, PWLB remains the best combination of speed, price, and certainty.

**Q3: Are there any other effects or uses of the PWLB beyond those described here?**

No, as stated in the consultation, the purpose of PWLB borrowing is to fund capital expenditure.

**Q4: Do you think the proposal described in paragraphs 1.24 to 1.28 would be effective in achieving the aim set out in paragraph 1.22?**

The proposal to restrict PWLB loans to only those local authorities without plans for any commercial investment is draconian and goes against the prudential code and local decision making.

The NAO state “the bulk of commercial property acquisition is undertaken by a relatively small, albeit growing, group of authorities”. This whole approach is aimed at curbing a minority, but actually restricts the majority. The proposals seem out of proportion to the “problem” that they seek to solve (if it is indeed a problem), and there is danger that it will make it difficult for local authorities to continue to access PWLB borrowing for other purposes and have unintended consequences.

Greater evidence needs to be provided to show that these councils have invested poorly, or without sufficient due diligence. SDCT agree that it would be appropriate to prevent such poor investments, but to penalise any authority with plans for commercial investment is inappropriate, inequitable and disproportionate, particularly where they are able to evidence sound strategies based upon expert advice.

It should also be recognised that the measure could have a perverse impact in encouraging poor investment management, in order to actively manage investment portfolios, local authorities need the ability to rebalance existing portfolios between sector, dispose of assets when values are at their peak and reinvest proceeds in new assets to maintain and improve income levels and security, For authorities with existing portfolios the proposals as set out would mean that any authority doing so could not access PWLB lending for that year. It is also unclear whether authorities that had already borrowed from the PWLB would be able to undertake this activity to react to changing market conditions mid-year.

“Debt-for-yield” is not sufficiently defined. Therefore, one small commercial element within a wider capital programme could prevent an authority from accessing PWLB funding for the schemes that the consultation reaffirms it is meant for, i.e. regeneration projects. Such expenditure may deliver a positive contribution to revenue budgets, but it is not the primary purpose. Furthermore, funding for such purposed may not be available from wider markets, to may have restrictions that prevent the scheme progressing, such as loan-to-value ratios, or security requirements. It should also be recognised that, with changes to planning laws, authorities also invest to retain high quality employment opportunities within their wider economic areas, this will become particularly important given the impact of Covid-19.

It is understandable that the lending process be amended to seek greater clarification on the purpose of the borrowing, but SDCT believe it would be fairer to simply say PWLB will not lend for commercial purposes and clarify exactly what it means by “commercial” to ensure ambiguity does not arise unintentionally.

**Q5: Do you agree with the conclusion in paragraph 1.26 that LAs finance their capital requirement in the round, and that it is not therefore possible to meaningfully link PWLB borrowing to specific spending?**

Yes, this is current best practice and adhered to by the vast majority of councils. Treasury Management decisions are not linked to specific capital schemes. Local authorities borrow sums for durations and at interest rates that optimise their view on managing interest rate and financing risk.

**Q6: If you answered ‘no’ to question 5, do you have an alternative suggestion?**

N/A

**Q7: Do you agree that the approach set out in paragraph 1.27 is a reasonable approach to the situation in which an LA borrowed from the PWLB and was subsequently found to have pursued a debt-for-yield scheme despite the assurances given through the application process? If not, how would you recommend that the government addresses this issue?**

Finding an authority to have commercially invested also needs be to better defined. The proposals rely on the judgement of the s.151 as to whether the authority has pursued debt for yield, given that many regeneration, housing and employment support schemes rely on yield to be viable, there will undoubtedly be a fine dividing line in many cases. If this judgement can be arbitrarily challenged at a later date with such a potentially disproportionate impact this could put the s.151 in an impossible position and will invariably lead to some of the innovative schemes that the government should be actively encouraging to be lost. Indeed the biggest impact is likely to be on those very schemes where local authorities are working in partnership with commercial developers resulting in a significant and disproportionate impact on the commercial development sector as precisely the most difficult time in its history.

If there was no plan for it at the point of borrowing, but an opportunity arose, say, 6 months later, why is it appropriate to seek full repayment? That borrowing would be supporting the capital programme at that time, not the new commercial investment.

As per our answer to Q4, it would be appropriate to be clear as to what “commercial” schemes actually means and to avoid ambiguity. As it stands, the control resembles a blunt and arbitrary instrument not aligned to fairness, with the potential to give rise to punitive financial outcomes unintentionally. It may also be difficult to police.

**Q8: Do you think that the proposal set out in paragraphs 1.24 to 1.28 would limit your ability to effectively manage your existing investment portfolio in a year in which you still wish to access PWLB borrowing for ‘accepted’ purposes?**

As previously set out this would have a significant impact on an authority’s ability to manage its existing portfolio and react to market conditions. It is in danger of penalising those authorities who seek to actively manage commercial portfolios whilst rewarding those who are locked into long term illiquid arrangements. It is vital that authorities retain the ability to rebalance portfolios between sectors and areas and divest of poor performing assets at the optimum point in the market whilst maintain income levels that are used to support key local services.

By definition, this should allow a reasonable treasury management approach in accordance with the CIPFA Treasury Management Code of Practice but will clearly be more problematic if any element of the capital programme was deemed to be commercial. As stated above, the definition of commercial is critical.

**Q9: Do you have a view on when in the calendar or financial year this new system should be introduced?**

It is impossible to see how any new measures could be introduced at any time other than well in advance of the financial year to which they will apply. With ever increasing financial pressure it is vital that local authorities are supported in their development of multi-year financial strategies, particularly in respect of capital spending. Most local authorities start their planning and budget processes during the summer preceding the next financial year. It should also be recognised that many of the more innovative joint venture investments can take over a year in development and last for many years. Withdrawal from these arrangements is not an option and would be highly detrimental to our private sector partners in the current climate.

Any restrictions should be based on a financial year as this will coincide with local authority planning cycles.

The introduction of the lower interest rates should be made available as soon as possible. The response to the Covid-19 pandemic will make it particularly important that access to cheaper finance is available soon.

**Q10: Do you agree with the proposal in paragraph 1.29 that these new lending terms should apply uniformly to larger LAs in England, Scotland, and Wales?**

Yes, if these changes are to be applied, they should be applied uniformly across England, Scotland, and Wales.

**Q11: Do you agree with the assessment in paragraph 1.30 that it is not necessary to change the arrangement for smaller authorities?**

No. Such smaller authorities are already benefitting from unrestricted council tax increases and therefore perversely are less likely to undertake commercial investments, yet are more able to afford higher interest charges.

If the aim is to prevent commercial investment, this should be applied across all tiers.

**Q12: The government proposes that you submit your plans for the year or years ahead. Over what period could you provide meaningful plans?**

A detailed submission for the forthcoming year with an indicative submission for the following two financial years would seem appropriate and should be applicable to all. This fits with a three-year prudential indicator planning system, any further forward would not add any value as plans tend to be more unreliable. This is despite the requirement of the capital strategy being required to look out to 10-15 years.

**Q13: This proposal would also require a short description of the projects in each spending area as set out in paragraph 1.34 to improve the government’s understanding of how the PWLB is used, but without putting an unreasonable reporting requirement on LAs. What level of granularity would give this understanding? For example: projects covering 75% of spending? Anything over £5 million per year? Etc**

This may require a different response depending on the class of authority. A district council capital programme will generally be much smaller than a county council. Therefore using a proportion such as 75% may be a reasonable basis. However, perhaps it may be more appropriate to prescribe the minimum value, say £5m, with any schemes above this required. Otherwise the individual schemes will be inconsequential to government.

**Q14: Do you agree with the approach in paragraph 1.38 that the section 151 officer of the applicant authority should assess if the capital plan is eligible for PWLB access, or would it be more suitable for another body to do this?**

This would seem a reasonable approach that the judgement of the s.151 is to be relied upon. The need for as mechanism to challenge this judgement should be reviewed and ideally removed. If there is to be any review mechanism this should be clearly set out along with clear criteria for challenging a judgement to avoid arbitrary challenge of a decision, particularly given the punitive consequences of a successful challenge. Any such mechanism should include a clear independent appeals process.

This is particularly important given that it is the very schemes that government is promoting around partnerships to deliver employment, housing and regeneration that will require the most balanced judgements to be made. There is a danger that the challenge process could disadvantage those schemes where local authorities are working hand in hand alongside private developers at a time when without local authority involvement many of these schemes will be lost.

**Q15: Would you as an s151 officer feel confident categorising spending into the categories proposed here? If not, what would you propose instead?**

Yes so long as there is clarity over what “commercialism” covers.

If one of the categories is to be “investment assets bought primarily for yield” – why is it necessary to prevent the council borrowing for the rest of the categories? As long as the borrowing did not exceed the sum of the other categories, would this not achieve the desired outcome?

**Q16: Would these proposals affect the ability of LAs to pursue innovative financing schemes in service delivery, housing, or regeneration?**

There is a concern that these very schemes are the ones where the finest judgements will need to be made and they could inadvertently be constrained by concerns of s.151 officers that if they were later determined to be for yield they would have to repay other borrowing or refinance these schemes at a less preferential rate thereby making them unviable. An important factor in these schemes is often the ability to tie into long term certainty over financing rates. Particularly where joint venture schemes are co-financed, there could be greater difficulty in making this judgement as private sector partners will inevitably be investing for yield.

It should be recognised that whilst a number of schemes may hold on to assets for longer time periods, a number of schemes sole intention is to seed wider regeneration and that the success of scheme is that assets transfer eventually either into private ownership or RSLs in the case of housing. This is important as this allows reinvestment of returns into subsequent schemes and ongoing renewal and growth.

**Q17: Are there specific examples of out-of-area capital spending for service delivery, housing, or regeneration that support policy aims?**

Specific examples will be provided within individual authorities’ responses, however all investments local authorities make are to support priority service and policy needs. Local authorities do not generate income for any other purpose.

The impact of wider economic areas needs to also be considered as localities do not conveniently end at authority borders.

**Q18: Would these proposals affect your ability to refinance existing debt?**

This may be problematic, as restricting all access to PWLB if you have a commercial scheme planned, would make refinancing maturing, historic PWLB much more difficult. The proposal is also likely to make it harder for authorities to access debt from wider markets and potentially could increase the demands on PWLB.

**Q19: Would these proposals affect your ability to undertake normal treasury management strategies? If so, how, and how might this be avoided?**

The proposals should not directly cause treasury management problems, except where commercial schemes are being considered. Non-PWLB funding is more time consuming and potentially restricted in size and flexibility. It is therefore possible some local authorities would struggle to access alternative funding.

Retrospective requirements to repay PWLB loans would completely disrupt effective treasury management for those authorities affected.

**Q20: Do you have any views about the implications of these proposed changes for people with protected characteristics as defined in section 149 of the Equality Act 2010? What evidence do you have on these matters?**

Para 1.53 a) describes the main risk.

Para 1.53 b) does not mitigate that impact, particularly if appropriate due diligence is undertaken.

Para 1.53 c) SDCT agree this would be beneficial and call for this to be implemented as soon as possible.

**Q21: Is there anything that could be done to mitigate any impact identified?**

Yes, allow councils to continue to borrow from PWLB for non-commercial investments even if they have an element of commercialism within the capital programme.

Whilst it is understood that the criteria for lending is wholly at the discretion of PWLB (HM Treasury), it is unusual to refuse finance in an arbitrary way on all propositions just because there is one aspect to which the lender objects.

**Q22: Is there anything else you would like to add on this issue?**

No

**Q23: Why did MRP fall as debt rose? Was the 2018-19 increase a one-off, or do you expect MRP to continue growing?**

Many authorities have reviewed their Minimum Revenue Provision policies primarily to more accurately reflect the useful asset lives. This means that asset liabilities have been written down too quickly historically. The change is to ensure that the future asset usage is properly charged over the asset life.

Such cash balances were previously used to internally fund investments and capital projects. The historical low interest rates gave CFO’s the opportunity to externalise that internal financing, leading in a large part, to the increase in the borrowing during the summer of 2019. Both of these changes are prudent and aid financial stability and forecasting.

**Q24: Why do you think the average loan length is increasing?**

The shape of the interest rate curve for maturity loans promotes either short term (less than 10 years) or long team borrowing (max 50 years). Also, interest rates for loans in excess of approximately 30 years are lower than EIP or Annuity loans. Combined with the extension to the MRP policies to reflect longer useful asset lives, explains why longer then loans, particularly maturity loans, have increased in recent times. Although more expensive overall, long-term loans can be lower risk and lower annual cost; critical at this time where local authorities are searching to offset the implications of austerity.

It is also quite likely that where PWLB borrowing has been used for “debt –for-yield” purposes, the asset purchased will be sold to repay the loan – therefore a maturity loan is the most appropriate form of borrowing.

As per Q5, it is important to highlight that funding an authority’s CFR is managed on a pooled basis, in line with best practice. The Consultation paper appears to form a linkage between external debt (PWLB) and asset lives. This premise has ceased to be proper professional practice many years ago.

It should also be borne in mind that on average circa 15% of local authorities’ CFR liability is supported by internal, not external, borrowing, and some with PFI/PPP and lease liabilities, so viewing PWLB external debt in isolation is likely to provide an unrepresentative and inaccurate view.

**Q25: What impact would changes to the maximum available length of loan, and/or the existing offer of repayment methods, have on your finances?**

A reduction in the maximum period of loan is likely to increase maturity peaks in the maturity profile and increase refinancing risk in the authority. An unintended consequence may also be that if periods were reduced from 50 years, to say 30 years, then the interest rate on these loans would be relatively higher reducing resources in an already over-stretched local authority sector and jeopardising important place shaping projects.

**Q26: What are the benefits of the existing two-day turnaround time for PWLB loans?**

As stated in the consultation, the two-day turnaround allows authorities to defer the borrowing until it is actually required, reducing the cost of holding even if only for a short period. Accessing funding outside of PWLB is much more time consuming and restrictive.

Therefore, it is perhaps the certainty that PWLB provides, rather than the two day turnaround that is most important; an authority knows that when it needs the funds, it can access them.

**Q27: What would the impact be of increasing the time between loan application and advance – for example, to three or five working days?**

Although this may cause liquidity difficulties in problematic times, in reality it is unlikely to have a material implication; councils will accommodate the additional processing time into their workings.

**Q28: How long could the turnaround time be for a PWLB loan before the PWLB becomes less attractive?**

As stated above, any extension of the current timetable would be less attractive but could be accommodated. If the process become more cumbersome and complex, more akin to an application to the wider market, the attractiveness of the PWLB would be compromised.

**Q29: Do you have any PWLB debt that would you like to repay early? If so, what is the total value of this debt and at what price/discount would this be viable?**

As stated within the answer to Q1, the current differentials between borrowing and premature repayment rates makes efficient management of a debt portfolio more problematical and sub-optimal. Addressing this would aid both councils and the overall PWLB as it would reduce the overall borrowing.

Specific responses will be provided within individual authority responses.

**Q30: How much PWLB debt would you transfer to other LAs if you could?**

Specific responses will be provided within individual authority responses.

Almost certainly this will be the debts with the higher interest rates, or those that are no longer required. Therefore, the sensible solution would appear to be enable them to be repaid to PWLB, rather than enable novation.

**Q31: If novation were permitted, under what circumstances would you take on debt from another LA rather than taking on new borrowing from the PWLB or another source?**

As per Q30 above, it is difficult to understand circumstances where an authority would accept transferring debt at a higher interest rate than it could access through PWLB or the market.

**Q32: Are there any other barriers to discharging unwanted PWLB debt?**

No, the penalties for premature redemption, compared to borrowing rates, makes the early repayment of PWLB loans punitive at present.

**Q33: Should HM Treasury introduce a process by which borrowing by an individual authority might be slowed or stopped without affecting PWLB access or terms for other LAs?**

Although there are facilities in the Local Government Act 2003 allowing such an outcome, it is inappropriate for HM Treasury to interfere in the prudential borrowing framework which the consultation rightly states is based on the principle of local decision-making and accountability. As stated within the answer to Q1, this whole approach is aimed at curbing a minority, but actually restricts the majority.

**Q34: Under what circumstances should this process be applied?**

The Government must much more clearly define what is considered to be inappropriate / disproportionate (however that is measured), and then should consult with that individual council to obtain justification for the activity being undertaken. As the consultation clearly states, it is not the intention to prevent "debt-for-yield” investments and that an authority can seek funding elsewhere – so such an intervention will not necessarily prevent the borrowing, but may bring circumstances where the activity (i.e. place shaping / regeneration) is compromised. That cannot be the intention.

**Q35: Do you use DMADF currently, and if so, why?**

Specific responses will be provided within individual authority responses but the most likely reason is credit quality.

**Q36: What would make you increase your use of DMADF?**

More flexibility on time periods and better deposit rates.

**Q37: Does your LA actively consider borrowing from alternative lenders to finance capital investment?**

Specific responses will be provided within individual authority responses.

**Q38: If you answered ‘yes’ to question 37, what are the reasons that would inform your choice to borrow from other providers?**

Specific responses will be provided within individual authority responses.

Current reasons are likely to be cost against the current PWLB loan rates and deferred facilities.

**Q39: What are the main reasons that you borrow from other LAs and how do these reasons differ to borrowing from the PWLB?**

Specific responses will be provided within individual authority responses.

Usually on a short term basis to manage short term cash flow issues, though some utilise the market for longer term positions. The PWLB rate structure does not favour short term PWLB loans.

**Q40: Following this, is there a case for changing the name of the PWLB?**

No – for what benefit?

1. In 2015-16, the sector had a stock of £10.9 billion in investment properties. – NAO report Local authority investment in commercial property [↑](#footnote-ref-1)