FINANCIAL TIMES

February 1, 2015 7:41 pm

Cash-strapped councils to raise billions with new municipal bonds

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The government's Treasury building in London

Britain's local authorities are on the verge of creating a multibillion-pound municipal bond market, amid growing friction between cash-strapped regions and a persistently belt-tightening central government.

The first bond issue by a new municipal debt agency, expected in April, is set to raise £250m-£300m, with annual issuance likely to ramp up quickly to £2bn-£3bn, according to people close to the project.

The new "munibonds" will be backed jointly by 48 local councils and the Local Government Association and issued by a specially created entity, the Local Capital Finance Company.

Councils have traditionally relied on central government, via the Debt Management Office, an arm of the Treasury, for the vast majority of their £84bn of outstanding funding. But they have become increasingly frustrated about the charges imposed on them by the DMO, especially at a time of deepening cuts to their budgets.

Local authorities in England and Wales will see their main government grant cut by £2.6bn in 2015, taking the total reduction since 2010 to 40 per cent — equivalent to £20bn of spending cuts.

The LGA believes the bonds issued via the pooled LCF vehicle could end up cutting the price they pay for finance by 0.25 percentage points or more — upwards of £5m a year. It could also free up access to European funds. Small local authorities tend to find it hard to tap the European Investment Bank, because of restrictions on the size of lending packages. A larger pooled entity would find it easier to access EIB funds, people close to the new scheme said.

Even if the UK market for council bonds takes off, it has a long way to catch the vast US munibond market, worth $3.7tn, which is particularly attractive to private investors because of their generous tax breaks.

> The scheme will target smaller councils

Some other countries have munibond markets, though in some parts of continental Europe municipal funds are raised via regional banks — an increasingly inefficient mechanism given rising bank capital requirements.

The scheme will target smaller councils in England and Wales that find it hard to raise money in the wider bond markets without paying relatively high fees.

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Meanwhile, Scotland is set to acquire powers to issue its own debt up to a total value of £2.2bn, nicknamed “kilt-edged bonds”. Last October, the government announced it was discussing the possibility of Wales issuing its own bonds for the first time.

The National Institute of Economic and Social Research recently published a call for the same devolution in the rest of the UK.

The munibond plan was first floated in 2011 after the Treasury caused fury in the regions by increasing the cost of local government funds to 1 percentage point over the cost of gilts. The price has since been dropped to 0.8 of a percentage point. But the LGA believes that could be further reduced to 0.5 or 0.6 of a percentage point if they issue their own bonds via the LCF.

LCF, headed by Aidan Brady, a former Deutsche Bank executive, is in the midst of appointing a board ahead of its formal launch. It recently appointed Sir Merrick Cockell, the former LGA boss, as its chairman, with Adrian Bell, a debt capital markets specialist from broker Canaccord Genuity, as his deputy.

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