HM Treasury

Public Works Loan Board:

future lending terms

March 2020

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Foreword

Local government plays an essential role in delivering public infrastructure across the United Kingdom, investing billions of pounds every year in the construction and maintenance of local roads, parks, schools, the regeneration of their local areas, and other public services.

Local authorities have long owned buildings that could serve a commercial purpose, and they often use commercial structures to advance their core role in delivering public services, housing, and regeneration to the benefit of citizens and taxpayers. The government is committed to continuing to support this valuable investment.

However, a recent report by the National Audit Office (NAO) highlights how a minority of local authorities have started using low-cost loans from the Public Works Loan Board (a public body that lends to local authorities for capital projects) to buy investment property primarily for rental income.

The case for this 'debt-for-yield' activity can be compelling for the individual local authority. But it introduces risks locally and nationally. At the local level, it exposes ratepayers to the risk that the income does not materialise, leaving the local authority with an inflexible commitment to keep up with the repayments on their loans. Within the wider public sector, it diverts money from core services such as schools, hospitals, and roads. And, because local authorities can often access debt more cheaply than the private sector, it becomes hard for businesses to compete. In the wider economy, it could crowd out public investment, and risks distorting property markets.

The government has launched this consultation to work with local authorities, sector representatives, and wider stakeholders to develop a targeted intervention to stop this activity while protecting the crucial work that local government does on service delivery, housing, and regeneration. The government's overall aim in this is to secure the effective operation of the prudential system for local councils, taxpayers and for all of us that rely on local services.

As part of this consultation, the government will run a series of regional roundtables with local authorities in England, Scotland, Wales, with MHCLG, the Scottish Government, the Welsh Government, and CIPFA.

Alongside the publication of this consultation, the government is cutting the interest rate on new loans for social housing and has offered over £1 billion of discounted lending for high-value local infrastructure projects. The government intends to cut the interest on all new loans from the PWLB, subject to market conditions, following the development and implementation of a robust lending framework co-designed with the sector through this consultation.

Executive summary

Local decision-making is a core principle of the local government finance system and offers clear advantages over the more centralised approaches of the past. The government is committed to this localised approach. However, local authority (LA) borrowing has grown substantially in recent years, led by a minority of LAs borrowing from the Public Works Loan Board (PWLB) to buy investment assets primarily for yield.

The government is therefore consulting on a limited intervention to address the specific issue (described in this document as 'debt-for-yield') so that the PWLB can continue to support LA investment in service delivery, regeneration, and housing, without impinging on the powers and freedoms that LAs use to deliver local services in innovative ways.

The government will work with the sector through this consultation and a series of regional workshops to develop a solution that resolves the debt-for-yield issue without impinging on the wider freedoms of the sector. As a starting point, the government proposes:

a. requiring LAs that wish to access the PWLB to confirm that they do not plan to buy investment assets primarily for yield

b. publishing guidance defining the activity that the PWLB will no longer support, with clear protections for service delivery, regeneration, housing, and the refinancing of existing debt

c. standardising the information currently gathered through the application process for the PWLB Certainty Rate and using this as the primary way to confirm with LAs that their plans conform with the guidance

LAs that wish to buy investment assets primarily for yield would remain free to do so but would not be able to take out new loans from the PWLB in the year in which they have bought the asset. Any loans taken out under the old system would not be affected by this change.

This change is only intended to apply to capital spending – treasury management strategies are not affected.

This change would only apply to larger authorities in England, Scotland, and Wales. The government does not propose any change to the PWLB lending arrangements for smaller LAs (used here to mean parishes, town and community councils, and drainage boards) as the debt-for-yield issue seems to be limited to larger authorities.

The government intends to lower the interest rate on new PWLB loans, subject to market conditions, once a new system can be introduced to address the debt-for-yield issue.

The Ministry of Housing, Communities and Local Government (MHCLG) is planning to undertake a project of work to improve its understanding of borrowing and investment activity. This will be done through a planned review which will explore what additional data can be collected in order to develop a more comprehensive understanding of LA borrowing and investment activity. This work will form an evidence base which can be used, in consultation with the sector and working with HM Treasury, to gather further evidence about the wider functioning of the prudential framework.

Responding to this consultation

This consultation will run for twelve weeks, ending on Friday 31 July 2020.

Please submit responses to this consultation via the online tool, available here: gov.uk/government/publications/public-works-loan-board-future-lending-terms-consultation

Responses will also be accepted via email to pwlb.consultation@hmtreasury.gov.uk, or by post to:

PWLB consultation

HM Treasury

One Horse Guards Road

London SW1A 2HQ

Information on how we handle your information is given in Annex C of this document

Chapter 1
Background

1.1 The local government finance system relies on the principle of local decision-making and accountability. Local authorities have broad discretion to determine how they deliver services, on the principle that they are best placed to decide how to invest to support their local communities. These freedoms include:

a. powers introduced in the Local Government Act 1972 that give LAs the ability to acquire land for any of their functions or for the benefit, improvement or development of their area

b. powers introduced in the Local Government Act 2003 that give LAs wide freedoms to borrow without the need to seek government approval, provided it is within the statutory bounds of the principles-based 'Prudential Framework'. Investment decisions must be consistent with the relevant legislative provisions regarding investment powers. LAs can borrow in Sterling from any source, provided the borrowing is within self-determined affordability limits. These freedoms allow LAs to determine how to fund their capital strategies at the local level

c. the General Power of Competence introduced in 2011 allows LAs to do 'anything that individuals generally may do'

1.1. Decisions over which capital projects to pursue and whether to borrow to finance them are the responsibility of the elected Council of each LA. This system of local decision-making is known as the prudential regime.

1.2. In addition, LAs can only borrow for capital and must repay all borrowing from revenue. There is a statutory ban on LAs pledging capital assets such as land or buildings as collateral. These rules put a natural limit on the levels of debt and borrowing each authority can take on.

1.3. The government is supportive of LAs using commercial approaches to deliver public services efficiently or to protect cash balances from the effects of inflation. But LAs should not enter into financial arrangements which serve no direct policy or treasury management purpose.

1.4. In 2018 the MHCLG updated the statutory guidance on local government investments in response to an increase in borrowing and investment by LAs.[1] The aim of the update was to ensure that the control system for LA borrowing and investment activity remained sufficiently robust and relevant to the current landscape. The changes were:

a. a new requirement for councils to prepare an investment strategy and a capital strategy annually

b. a required disclosure around the contribution that investments make to service delivery

c. quantitative indicators to be included in order to enable decision-makers and members of the public to understand the performance of and risks associated with investment activity. (These indicators are not prescribed but some suggestions are included with the guidance)

d. an extension of the requirements on capacity and skills to members and any statutory officers involved in or responsible for signing off investment decisions

e. clarification around borrowing in advance of need

The role of the Public Works Loan Board

1.5. Central government supports local investment in part by offering low cost loans to LAs through the Public Works Loan Board. The PWLB is the main lender to local government, accounting for around two thirds of LA debt.

1.6. The application process is currently deliberately permissive: if the finance director of the applicant authority can confirm that they are acting in line with statute and can afford to repay the loan from their revenues, the PWLB will issue the loan within two working days.

1.7. The PWLB does not ask the intended purpose of a loan, on the basis that local capital projects will already have passed the scrutiny and internal governance processes of the democratically elected Council of the applicant authority. In effect, the government relies on the combination of robust local decision-making and the affordability rule on borrowing to ensure that LAs prioritise projects that offer good value for money. The Council of each LA is accountable to the local electorate for these judgements.

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[1] *Statutory Guidance on Local Government Investments 3rd Edition*, Ministry of Housing, Communities and Local Government, 2018, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/678866/Guidance_on_local_government_investments.pdf

1.8. The government finances PWLB loans by on-lending government borrowing from the capital markets. The interest rate on these loans is set at a fixed margin over the government's cost of borrowing. Any difference between the interest paid by LAs and the interest passed on to the holders of the underlying gilts is applied uniformly to all public spending and reduces the government's external borrowing requirement.

1.9. The terms of the PWLB are designed to maximise capital investment and aim to minimise costs to the public sector as a whole. Loans are offered for durations of up to 50 years, and LAs may fix their interest rates at the outset. The government is not aware of any private lenders offering this combination of speed, price, and certainty.

The role of HM Treasury

1.10. HM Treasury has a duty to Parliament to ensure that public spending represents good value for money to the Exchequer and aligns with the Parliamentary intent of any relevant legislation. This duty applies to all public money, whether it is spent by HM Treasury directly or if it is delegated to Whitehall departments, LAs, or other bodies.

1.11. HM Treasury assures itself that these duties will be met by ensuring that all delegated spending is subject to a system of decision-making and accountability that is robust and proportionate. HM Treasury monitors behaviour within these control frameworks to ensure they continue to work effectively.

1.12. HM Treasury is responsible for PWLB lending, with powers to set both the interest rates and the lending terms. The Permanent Secretary to the Treasury is the Accounting Officer for the National Loans Fund (NLF), which finances PWLB loans. As with all Whitehall departments, HM Treasury can only transfer public resources to an LA if the Accounting Officer is satisfied that the resources will be used in ways that meet the expectations of Parliament. This includes loans through the PWLB.

Chapter 2
Recent developments

The rise of commercial activity by local authorities

1.13. Local authorities have long owned assets that could serve a commercial purpose, and often use commercial structures to advance their core role in service delivery, housing, and regeneration. The government is committed to supporting this valuable investment. But there has been a dramatic increase since 2016 in commercial activity that is motivated primarily for yield rather than for the direct pursuit of policy objectives.

1.14. The National Audit Office estimates that LAs bought £6.6 billion of commercial property between 2016-17 and 2018-19.[1] This coincided with a fall in the price of PWLB loans (reflecting a general fall in borrowing costs for government) relative to the likely return on investment assets. This had made it viable for LAs to use PWLB loans to buy commercial assets that pay enough income to cover their interest costs plus an average annual profit of around 1% to 2%, provided the assets perform as expected. Net lending by the PWLB increased by £12.7 billion over this three-year period.

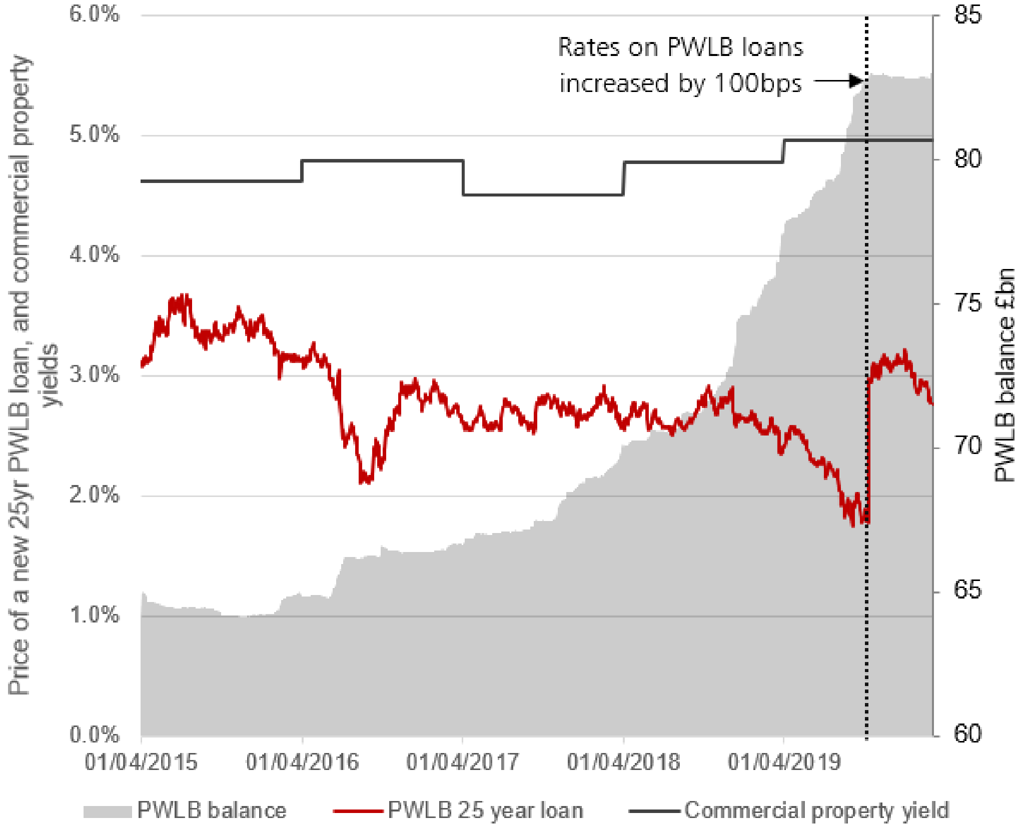
1.15. Borrowing was unusually elevated in the summer of 2019, including £500 million borrowed in a single day, as PWLB rates fell to record lows. This raised the risk that the statutory limit on the total PWLB debt that may be outstanding at one time would be reached, leading to an abrupt halt in lending. In response, the government legislated to increase the statutory limit on PWLB lending from £85 billion to £95 billion and raised interest rates on new PWLB loans by 1 percentage point.

1.16. The intention of raising rates on new PWLB loans was to slow all borrowing from the PWLB, not just borrowing for debt-for-yield activity. But HM Treasury analysis of LA-level data now suggests that while some of this borrowing appears to be related to normal treasury management activity, higher borrowing has coincided with increases

[1] Local authority investment in commercial property, National Audit Office, February 2020, https://www.nao.org.uk/report/local-authority-investment-in-commercial-property/

in investments rather than higher capital spending. This suggests that LAs may have borrowed in advance of need.

Chart 2.A: PWLB balance, PWLB offered rates, and commercial yields



Source: DMO, Savills. The 25y PWLB rate quoted is the Certainty Rate. Property price data is national average prime yield at March in each year, from Savills

Implications of debt-for-yield activity for the effective operation of the financial system

1.17. HM Treasury is satisfied that the prudential system of LA capital finance leads to good outcomes in most areas. The fall in borrowing costs in recent years has allowed LAs to invest more in service delivery, housing, and regeneration. But where it has fallen below the potential return on investment assets, it has destabilised the system, as it removes the natural limit on LAs' borrowing and debt.

1.18. When public money is diverted into assets that serve no direct policy purpose, the value for money of the system is undermined:

a. it is a **low-value use of public resources**. Parliament expects the government to focus finite public resources on the areas of highest return to the nation, and to raise the money to pay for this in a cost-effective way. If an LA puts £1 into a debt-for-yield scheme for a 1% net return per year, that is £1 that cannot be spent on national priorities such as the NHS, police, or schools – in exchange for which the LA only gets 1p to spend on local services

b. the **income is not reliable**. The value of investments can fall as well as rise, and expected income can fail to appear. Causes of this include the long-term credit quality of the underlying tenants and wider trends in the value of asset classes over decades. It is especially risky if authorities have borrowed to take on these investments and need a minimum return to keep up with the repayments on their debt. Should investments not perform as expected, local services could suffer, and the LA would need to find an alternative way of funding their planned services and meeting their repayments. The consequences of this are most extreme for LAs that have taken on debt that is disproportionate to their size

c. it puts **unmanageable pressure on the PWLB**. Parliament has made the PWLB available to support the capital plans of LAs, subject to a statutory limit on the total PWLB debt that may be outstanding at one time. It cannot be assumed that Parliament would continue raising this limit to accommodate ever-increasing levels of commercial investment. The rapid increases in PWLB debt that would accompany continued LA investment in debt-for-yield schemes could push PWLB lending to a level beyond that which Parliament is willing to allow

d. it also risks **distorting local and regional markets** for these assets. The NAO estimates that 18% of all spending on commercial property sold in the South East since 2016 was by LAs. If LAs continue to use the favourable financing terms of the PWLB to undercut private buyers they will bid up prices for each other and for all buyers

1.19. The rise of debt-for-yield activity removes some natural constraints that underpin the prudential system and means it is no longer working as intended, which has led to PWLB loans being used for purposes different to the public works which the PWLB intended to facilitate. In order to allow LAs to continue to borrow for public services, the government is therefore consulting on proposals to stop LAs using PWLB loans to buy commercial assets primarily for yield, without impeding their ability to pursue their core policy objectives of service delivery, housing, and regeneration under the prudential regime as they do now.

1.20. The government intends to lower the cost of new PWLB loans, subject to market conditions, once this issue can be resolved, by lowering the margin charged over gilts.

The primary purpose of the PWLB is to support the construction and maintenance of capital assets, but it has other effects and uses.

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

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

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

Chapter 3

Proposed new PWLB lending terms

1.21. At this Budget the government is cutting the interest rate on new loans for social housing and has offered over £1 billion of discounted lending for high-value local infrastructure projects. The government is able to do this because of the robust frameworks in place to ensure that this money is not diverted into financial investments that serve no direct policy purpose.

1.22. The aim of this consultation is to develop a proportionate and equitable way prevent local authorities from using PWLB loans to buy commercial assets primarily for yield, without impeding their ability to pursue service delivery, housing, and regeneration under the prudential regime as they do now. Once a workable system is designed and implemented, the government intends to cut the interest on all new loans from the PWLB, subject to market conditions.

1.23. The government believes that the changes proposed in this document meet the objectives in paragraph 1.22. But the government wants to work with LAs through the consultation process to develop a targeted reform to strengthen the system while minimising unintended consequences.

Proposed changes to PWLB lending terms

1.24. The government proposes ending access to the PWLB for LAs that wish to buy commercial assets primarily for yield, as assessed by the statutory section 151 officer of the LA against guidance developed through this consultation. LAs that wish to buy commercial assets primarily for yield would remain free to do so but would not be able to take out new loans from the PWLB in that financial year. Any loans taken out under the old system would not be affected by this change.

1.25. In order to avoid inadvertently capturing service delivery, housing, regeneration, or the refinancing of existing debt in this prohibition, the government would ask each LA that wishes to borrow from the PWLB to provide a high-level outline of their capital plan for the year or years ahead, including an assurance from the statutory finance director that the LA is not borrowing in advance of need and does not intend to buy commercial assets primarily for yield. (See paragraphs

1.32 to 1.35 for more detail on how the government proposes that LAs would share their plans with the PWLB).

1.26. From work with the sector to date, the government does not think it is possible to meaningfully link particular financing components to specific projects, on the basis that LAs fund their capital plans as a whole rather than on a project-by-project basis. The government therefore thinks that the restriction of access to new PWLB loans would have to apply if an LA was planning a debt-for-yield scheme anywhere in their capital plan, including through an LA-owned company or a joint venture, regardless of whether their planned PWLB borrowing is notionally tied to that project or to a different project.

1.27. If 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, HM Treasury would reserve the right to require loans in that year to be repaid on demand, subject to the existing early repayment penalties. In practice such an eventuality is highly unlikely and would only occur after extensive discussion with the LA in question – but a safeguard is necessary to protect the taxpayer.

1.28. The government does not intend for this proposal to have any effect on good treasury management strategies, such as investing surplus funds in money market funds to protect their value against inflation.

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?

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?

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

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?

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?

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

Scope and territorial extent

1.29. Local government is a devolved competence, but the PWLB lends to LAs in England, Scotland and Wales. (Districts in Northern Ireland do not borrow from the PWLB). LAs in England, Scotland and Wales already engage directly with the PWLB through the annual application for the Certainty Rate. We therefore propose that this system would apply for larger authorities in England, Scotland, and Wales.

1.30. The government does not propose any change to the PWLB lending arrangements for smaller LAs (parishes, town and community councils, and drainage board) as there is no have evidence that they are engaging in debt-for-yield activity.

1.31. A fuller list of which categories of LA that would be affected by this proposal is in Annex B of this document.

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?

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

Sharing plans with the PWLB

1.32. Most larger LAs already submit high-level capital plans to the PWLB through an online data collection system run by MHCLG, called DELTA, as part of their application for the Certainty Rate of concessionary PWLB lending. The government proposes using that system to manage registrations for the PWLB under the new system, on the basis that DELTA and the Certainty Rate process are familiar to most of the LAs that would be affected by this change.

1.33. The government proposes asking each LA that wishes to borrow from the PWLB to submit a high-level description of their capital spending and financing plans for the year or years ahead, including their expected use of the PWLB. LAs would be able to revise these plans in-year as required.

1.34. The government proposes asking how much the LA would spend in a set of categories, which would be developed through the consultation (we propose four categories – service delivery, housing, regeneration, and refinancing - see paragraphs 1.41 to 1.46). LAs would be asked to provide a short description of the main projects in each of these areas – for example, 'installing LED streetlighting - £3m'. The purpose of this is to improve the government's understanding of the activity the PWLB supports and monitor the effectiveness of this reform.

1.35. The government would also ask for an assurance from the finance director that the LA is not borrowing in advance of need and does not intend to buy commercial assets primarily for yield. When applying for a new loan, the LA would confirm that the plans they have most recently submitted remain current and that these assurances remain valid.

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

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

Defining and categorising activity

1.36. The government fully supports LAs' use of commercial structures to advance core objectives of service delivery, housing and regeneration. The aim of this consultation is to address the relatively narrow subset of capital spending in which LAs use PWLB loans to buy investment assets primarily for yield. Some illustrative examples of the sorts of projects that would and would not be eligible for PWLB support are included in Annex A of this document.

1.37. The government is aiming to develop a definition of debt-for-yield activity that:

a. does not inflexibly rule out service delivery, housing, or regeneration

b. is simple to interpret, so that LAs can confidently determine if a proposed scheme is eligible for PWLB support

c. does not generate a disproportionate administrative burden for LAs or central government

d. cannot be circumvented by restructuring or disguising activity

1.38. The government anticipates that any workable definition would take the form of guidance issued by an appropriate body. To achieve the aims set out in paragraph 1.22 the government would rely on existing definitions and processes as far as possible. The government anticipates that the interpretation of this guidance would rely on the professional judgment of the statutory section 151 officer of the LA.

1.39. The government expects to monitor the impact of this change on the system on a risk-based basis to understand how practice develops.

1.40. In order to give LAs a clear understanding of the activity which the PWLB would or would not support, the government proposes apportioning spending into categories based on the characteristics of the projects covered. These would be service spending, housing, regeneration, and refinancing (all of which the PWLB would continue to support), and investment assets bought primarily for yield, (which the PWLB would no longer support).

Assigning capital projects to categories

1.41. Individual projects and schemes may have characteristics of several different categories. In these cases the s151 officer should use their professional judgment to assess the main objective of the investment and consider which of the four categories is the best fit. Some examples of mixed projects and how they might be categorised are included in Annex A.

1.42. **Service spending** would be activity that would normally captured in the following areas in the MHCLG Capital Outturn Return (COR): education, highways & transport, social care, public health, culture & related services, environmental & regulatory services, police, and fire & rescue services.

1.43. **Housing** would be activity normally captured in the HRA and General Fund housing sections of the COR, or housing delivered through an LA housing company. The government suggests that this should be separated out from the rest of 'service spending' because the relative concentration of cross-subsidy and other innovative financing arrangements in these areas means there could be more projects that have characteristics of the unsupported activity. However, access to the PWLB would in principle be allowed for land release, housing delivery, or subsidising affordable housing.

1.44. **Regeneration** projects would usually have one or more of the following characteristics:

a. the project is addressing an economic or social **market failure** by providing services, facilities, or other amenities that are of value to local people and would not otherwise be provided by the private sector

b. the project **prevents a negative outcome**, including through buying and conserving assets of community value that would otherwise fall into disrepair

c. the LA is making a significant **investment** in the asset beyond the purchase price: developing the assets to improve them and/or change their use, or otherwise making a significant financial investment

d. the project involves or generates significant **additional** activity that would not otherwise happen without the LA's intervention, creating jobs and/or social or economic value

e. while some parts of the project may generate rental income, these rents are **recycled within the project or applied to related projects with similar objectives**, rather than being applied to wider services

1.45. **Refinancing** would cover restructuring or extending existing debt from any source. The government proposes that refinancing should be a stand-alone category separate from the others on the basis that it is not always possible or meaningful to attempt to trace the link between some debt coming due and the spending that the debt originally supported.

1.46. **Investment assets bought primarily for yield** would usually have one or more of the following characteristics:

a. buying land or existing buildings to let out at **market rate**

b. buying land or buildings which were previously operated on a commercial basis which is then continued by the LA without any **additional investment or modification**

c. buying land or existing buildings other than housing which **generate income and are intended to be held indefinitely**, rather than until the achievement of some meaningful trigger such as the completion of land assembly

1.47. The proposals in this consultation would continue to allow LAs to invest capital outside of their area for service delivery, housing, or regeneration, where there is an economic or social rationale. The prohibition on debt-for-yield described in paragraph 1.23 would apply inside and outside the LA's area.

Financial spending

1.48. LAs could in theory borrow privately in one year to support investment in an asset that the PWLB would not support, but then refinance this debt in a future year from the PWLB. This is outside of the intended use of the PWLB and is not something LAs should deliberately do.

1.49. If an LA wishes to on-lend money to deliver objectives in an innovative way, the government would expect that spending to be reported in the most appropriate category (service spending, housing, regeneration, and refinancing) based on the eventual use of the money.

1.50. The changes set out here are not intended to affect normal treasury management practices.

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?

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

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

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

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

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

Impact of these proposals on people with protected characteristics

1.51. When formulating policy, the government is required to have due regard to the Public Sector Equality Duty in the Equality Act 2010. The duty requires public bodies to have due regard to the need to eliminate discrimination, advance equality of opportunity and foster good relations between people with different protected characteristics when carrying out their activities.

1.52. The government would like to know your views as to whether any of the proposals in this document might have differential impacts under the Public Sector Equality Duty.

1.53. The government's view is that the proposed changes to the PWLB lending terms would have a positive impact overall on persons with protected characteristics if implemented:

a. LAs planning commercial investment may have lower than expected income as a result of these changes which could have a negative impact on persons with protected characteristics in those areas, as they are more likely to rely on public services

b. however, the proposed changes would reduce the risk of LA investments failing which would likely have a significant negative impact on public services, and would allow for better targeting of public resources by the government on value for money expenditure

c. lowering rates for local infrastructure and social housing is likely to have a positive impact on persons with protected characteristics

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?

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

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

Chapter 4

The wider PWLB offer

1.54. The government is taking the opportunity offered by the consultation to better understand how local authorities use the PWLB and how the current PWLB lending terms affect their financial plans.

Longer-term impact of loans

1.55. The PWLB offers three repayment methods for fixed rate loans:

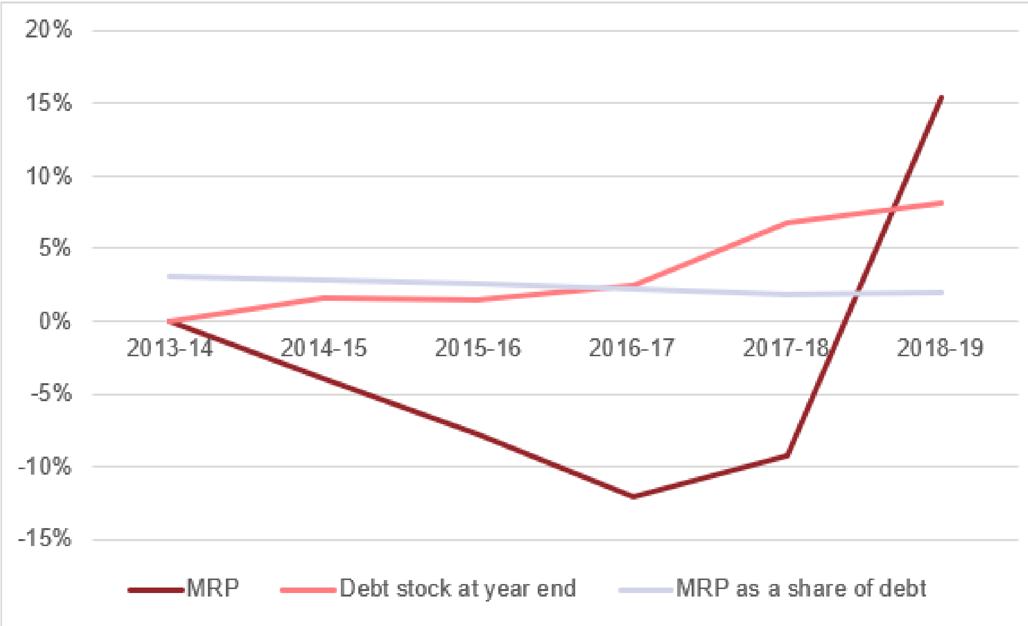
a. Maturity loans, on which the borrower makes regular interest payments over the life of the loan and repays the principal at the end. This is the most common type of PWLB loan. These are also known as bullet loans

b. Equal Instalment of Principal, or EIP loans, on which the borrower makes regular, equal payments of principal plus an interest payment on the balance outstanding at the time

c. Annuity loans, on which the borrower makes regular, equal payments covering an increasing amount of principal and a decreasing amount of interest

1.56. LAs make minimum revenue provision (MRP) each year to cover the cost of repaying loan principals. MRP fell steadily from 3.0% of debt in 2013-14 to 1.9% in 2017-18, even as the stock of debt increased. MHCLG revised the MRP guidance in 2017 to remove flexibility to charge negative MRP, and to introduce a maximum economic life for assets in assessing MRP. MRP grew 13% in 2018-19 to 2% of debt, perhaps in response.

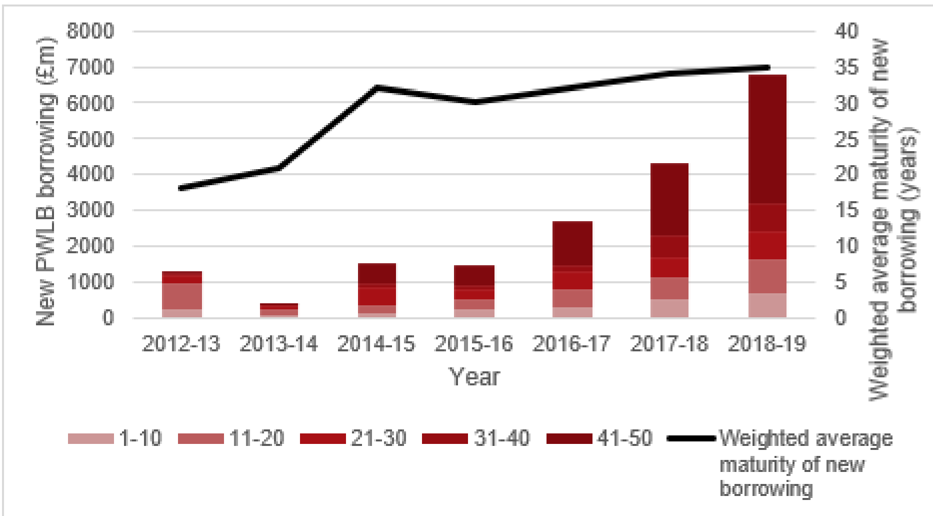
Chart 4.A: Year-on-year change in MRP and debt stock



Source: MHCLG Revenue Outturns; MHCLG Borrowing and investment live tables

1.57. The maximum maturity of PWLB loans is currently 50 years, and an increasing proportion of PWLB loans are being taken out at that maximum 50-year term. The government would not expect the length of loans to exceed the useful life of the underlying assets, and would not generally expect capital assets to have 50-year lifetimes. Some LAs may be choosing these very long tenors as a way to minimise annual borrowing costs.

Chart 4.B: Loan lengths



Source: National Audit Office

1.58. An effect of increasing loan lengths and a preference for Maturity loans over EIPs or Annuities is that the principal repaid to the PWLB each year is falling relative to the volume of new lending. Because the principal is tied up for longer, the PWLB's future lending capacity is reduced and the wider public sector debt burden is extended, meaning that this capital cannot be put to other uses.

1.59. The government wants to better understand the value that the existing combination of repayment methods and loan lengths offers to borrowers.

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

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

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

Application time

1.60. The PWLB currently advances loans two working days after the application is received. The government understands that ready access to the PWLB allows LAs to defer external borrowing. The government is keen to better understand how the existing terms affect LAs.

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

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

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

Early repayment and novation of PWLB debt

1.61. Some LAs have older PWLB loans that they no longer want, but that they feel unable to discharge because of restrictions on the early repayment and transfer of these loans.

1.62. PWLB loans are financed by the National Loans Fund, which is the government's main borrowing account. HM Treasury has a clear legal duty not to lose money on any individual loan financed by the NLF, including the interest the government pays on the underlying external borrowing.[1] The terms of PWLB lending and early repayment reflect this duty. For example, the PWLB would never lend at negative rates.

1.63. Borrowers are generally free to repay PWLB loans early if they want to, provided the PWLB is not left with a shortfall on the interest due. The PWLB will help defray this shortfall by re-lending the principal to a new borrower at prevailing rates. If rates have fallen since the original loan was arranged, this new stream of interest payments would not be enough to cover the interest due, and so the original borrower would have to pay a lump sum to cover the difference. Where rates have fallen significantly since the loan was first issued, this lump sum can be substantial.

1.64. LAs are not currently permitted to transfer PWLB loans between themselves (this is also known as novation).

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?

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

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?

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

Slowing lending in extraordinary circumstances

1.65. Under its existing lending terms, the PWLB will always issue a loan within two working days if the applicant confirms that they are acting in line with statute and that the loan is affordable from their revenues. The non-discretionary nature of the PWLB can in extreme cases enable risks to the ongoing availability of PWLB loans. This was exposed in summer 2019. Borrowing surged as LAs sought to lock in low rates following falls in the benchmark gilt rate – including £500 million borrowed in a single day. This acceleration in borrowing raised the prospect that the PWLB would reach the statutory limit on the total PWLB debt that may be outstanding at one time, and so abruptly become unable to lend.

1.66. In response, HM Treasury used established legal powers to raise the interest rate on all new PWLB loans by one percentage point. This had the effect that the cost of borrowing rose for all borrowers. That was the right decision at that time. But this is an opportunity to establish a

[1] Section 5 of the National Loans Act 1968

process for a more targeted intervention, for example to slow borrowing by individual LAs without affecting terms for borrowers more generally.

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?

Q34: Under what circumstances should this process be applied?

Chapter 5
Other questions

Debt Management Account Deposit Facility

1.67. The Debt Management Account Deposit Facility (DMADF) exists to provide local authorities with a flexible and secure investment option to mitigate the effect of inflation on the value of their cash. DMADF currently offers fixed term holdings for between a day and six months. There are currently substantial deposits in DMADF, but many LAs choose to use private deposit facilities instead.

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

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

Alternative lenders

1.68. LAs can borrow from any willing lender. Most LA borrowing is from PWLB. The use of PWLB has, as expected, fallen since the increase in PWLB rates. Over the last few years, LAs have also increasingly borrowed from each other. The government would like to better understand what factors influence LAs decisions on whether to borrow from PWLB or other sources.

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

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

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

Name of PWLB

1.69. PWLB used to be a Board of Commissioners. Parliament has now abolished the Board and transferred the powers to HM Treasury.

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

Annex A

Examples of recent projects

Example 1: A council purchases a former office block within its area.

1.70. The council purchases the private developer that owns it, and so the property itself, for £6.3 million in total. The property has been empty for 24 years. The developer has already obtained the planning permission to have it turned into 47 apartments with a small shop. The LA plans to own the property long-term.

1.71. A Councillor said they are absolutely ecstatic to have acquired this site and excited to use it to deliver housing opportunities in the heart of the local area whilst demonstrating a commitment to regeneration.

1.72. On the basis of the terms proposed in this consultation and the information set out here about this project, the PWLB **would continue to support** this sort of activity in future because the acquisition and conversion of a derelict building is a clear example of regeneration.

Example 2: A council purchases a major supermarket, outside of the LA area but within the region.

1.73. It costs the council £45 million, funded entirely by loans from the PWLB. The Council Leader says this is primarily to drive income for the LA, though there is potential for redevelopment in the future if desired. The capital strategy states that the LA can sell this asset or find an alternative exit strategy, so there is no need to set aside Minimum Revenue Provision to repay the debt liability in the interim period.

1.74. The Council Leader said 'these are long-term asset investments in order to raise income to support our services.'

1.75. On the basis of the terms proposed in this consultation and the information set out here about this project, the PWLB **would not support** this kind of activity in future. A supermarket in another LA is unlikely to be delivering public services, housing, or regeneration, and is unlikely to be addressing a market failure.

Example 3: A council purchases a town centre within its LA area.

1.76. It costs the LA £47.6 million, financed by borrowing from various sources. Part of the old town centre has been demolished. They plan to build a new leisure development, consisting of a cinema and restaurants. This is part of a regeneration project that has had £80 million of investment from the LA and external sources. This has funded a new health centre, bus station and community library, among other things. The redevelopment of the town centre is expected to give a £14 million boost to the local economy, create 400 jobs and generate another £570,000 in business rates annually.

1.77. The Leader of the Council said the people of the town have waited long enough for this regeneration to begin. The private sector has failed to develop it as promised for over a decade.

1.78. On the basis of the terms proposed in this consultation and the information set out here about this project, the PWLB **would continue to support** this sort of activity in future as it is clearly aimed at regenerating the town centre and includes service delivery in the form of the health centre.

Example 4: A council purchases a business campus within its LA area.

1.79. It costs the LA £126 million, financed by borrowing from various sources. This will generate a financial return of £20 million over the 30-year period. The site has 98% occupancy with many high-profile tenants and 3,500 workers on site. There is potential for new offices to be built on the site's free space.

1.80. The Council Leader says that, alongside an income stream, it gives them ownership of a central site and ensures future development of the site meets the needs of the local area.

1.81. On the basis of the terms proposed in this consultation and the information set out here about this project, the PWLB **would not support** this kind of activity in future. A pre-let office building is unlikely to be delivering services, housing, or regeneration and the high occupancy rate suggests there is not a market failure for this sort of offices in the area.

Example 5: A council purchases a shopping centre and offices within its LA area.

1.82. The centre is on a struggling high street, and has many vacant units. The offices are adjacent to it and have been vacant for several years. It will take up to five years for the office block to be stripped of asbestos and demolished - at which time the authority will also demolish the shopping centre and promote the comprehensive redevelopment of the high street.

1.83. In the meantime, the authority plans a light refurbishment of the shopping centre to encourage existing tenants to stay, and will use vacant units for community and third sector activities on below market terms. The income from the shopping centre will support the social activities and maintain the shopping centre until its demolition. No formal decision has been made about any surplus income, but it could be used to support wider regeneration schemes in the authority area.

1.84. On the basis of the terms proposed in this consultation and the information set out here about this project, the PWLB **would continue to support** this sort of activity in future, as it is clearly aimed at preventing the negative outcome and at regenerating the high street.

Example 6: A council purchases a complex of homes, shops and offices within its LA area.

1.85. It costs the council £78 million, financed by a mixture of capital receipts, internal borrowing and borrowing from the PWLB. A private developer bought the site four years earlier for £37 million and refurbished and rebranded it, before selling it on to the LA. The Council predict it will make a net annual income of £4 million per year.

1.86. A broker working on the sale said the site is a rare opportunity to purchase a site in a vibrant location. It is in a strong-performing submarket, with extremely low supply and high demand that will support rental growth.

1.87. A Councillor says they acquire commercial assets that can be managed to generate revenue. Projects are chosen based on being in the LA area and the size and resilience of their return, which can then be used to support services.

1.88. On the basis of the terms proposed in this consultation and the information set out here about this project, the PWLB **would not support** this sort of activity as there is no evidence of market failure or meaningful investment or change of purpose.

Example 7: A council purchases land in its town centre.

1.89. The council aims to reconnect the town centre to the river by renovating the space between the two, improving the riverbanks and delivering new wayfinding and seating.

1.90. This creates social value, as it encourages active travel such as walking and cycling and makes the town a more pleasant place to live.

1.91. PWLB **would continue to support** this sort of activity in future because the land has been acquired and invested in to increase its social value.

Annex B

Affected borrowers

1.92. This proposal would apply to all LAs that are currently eligible for the certainty rate: (Unitary Authorities, Shire Districts, Metropolitan Districts, London Boroughs, Shire Counties, and certain other bodies). It would not apply to parishes, town and community councils, drainage boards.

1.93. Any queries about the proposed coverage of this should be referred to pwlb.consultation@hmtreasury.gov.uk.

Annex C
Processing of personal data

This notice sets out how HM Treasury will use your personal data for the purposes of this consultation and explains your rights under the General Data Protection Regulation (GDPR) and the Data Protection Act 2018 (DPA).

Your data (Data Subject Categories)

The personal information relates to you as either a member of the public, parliamentarians, and representatives of organisations or companies.

The data we collect (Data Categories)

Information may include your name, address, email address, job title, and employer of the correspondent, as well as your opinions. It is possible that you will volunteer additional identifying information about themselves or third parties.

Legal basis of processing

The processing is necessary for the performance of a task carried out in the public interest or in the exercise of official authority vested in HM Treasury. For the purpose of this consultation the task is consulting on departmental policies or proposals or obtaining opinion data in order to develop good effective government policies.

Special categories data

Any of the categories of special category data may be processed if such data is volunteered by the respondent.

Legal basis for processing special category data

Where special category data is volunteered by you (the data subject), the legal basis relied upon for processing it is: the processing is necessary for reasons of substantial public interest for the exercise of a function of the Crown, a Minister of the Crown, or a government department.

This function is consulting on departmental policies or proposals, or obtaining opinion data, to develop good effective policies.

Purpose

The personal information is processed for the purpose of obtaining the opinions of members of the public and representatives of organisations and companies, about departmental policies, proposals, or generally to obtain public opinion data on an issue of public interest.

Who we share your responses with

Information provided in response to a consultation may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 2018 (DPA) and the Environmental Information Regulations 2004 (EIR).

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence.

In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury.

Where someone submits special category personal data or personal data about third parties, we will endeavour to delete that data before publication takes place.

Where information about respondents is not published, it may be shared with officials within other public bodies involved in this consultation process to assist us in developing the policies to which it relates. Examples of these public bodies appear at: https://www.gov.uk/government/organisations.

As the personal information is stored on our IT infrastructure, it will be accessible to our IT contractor, NTT. NTT will only process this data for our purposes and in fulfilment with the contractual obligations they have with us.

How long we will hold your data (Retention)

Personal information in responses to consultations will generally be published and therefore retained indefinitely as a historic record under the Public Records Act 1958.

Personal information in responses that is not published will be retained for three calendar years after the consultation has concluded.

Your rights

You have the right to request information about how your personal data are processed and to request a copy of that personal data.

You have the right to request that any inaccuracies in your personal data are rectified without delay.

You have the right to request that your personal data are erased if there is no longer a justification for them to be processed.

You have the right, in certain circumstances (for example, where accuracy is contested), to request that the processing of your personal data is restricted.

You have the right to object to the processing of your personal data where it is processed for direct marketing purposes.

You have the right to data portability, which allows your data to be copied or transferred from one IT environment to another.

How to submit a Data Subject Access Request (DSAR)

To request access to personal data that HM Treasury holds about you, contact:

HM Treasury Data Protection Unit
G11 Orange
1 Horse Guards Road
London
SW1A 2HQ
dsar@hmtreasury.gov.uk

Complaints

If you have any concerns about the use of your personal data, please contact us via this mailbox: privacy@hmtreasury.gov.uk.

If we are unable to address your concerns to your satisfaction, you can make a complaint to the Information Commissioner, the UK's independent regulator for data protection. The Information Commissioner can be contacted at:

Information Commissioner's Office
Wycliffe House
Water Lane
Wilmslow
Cheshire
SK9 5AF
0303 123 1113
casework@ico.org.uk

Any complaint to the Information Commissioner is without prejudice to your right to seek redress through the courts.

CONTACT DETAILS

The data controller for any personal data collected as part of this consultation is HM Treasury, the contact details for which are:

HM Treasury
1 Horse Guards Road

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SW1A 2HQ
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public.enquiries@hmtreasury.gov.uk

The contact details for HM Treasury's Data Protection Officer (DPO) are:

The Data Protection Officer
Corporate Governance and Risk Assurance Team
Area 2/15
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privacy@hmtreasury.gov.uk