HM Treasury Public Works Loans Board, future lending terms, response to the consultation from Local Government Association

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Local Government Association

Submission

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About the Local Government Association

1. The Local Government Association (LGA) is the national voice of local government. We are a politically-led, cross party membership organisation, representing councils from England and Wales.
2. Our role is to support, promote and improve local government, and raise national awareness of the work of councils. Our ultimate ambition is to support councils to deliver local solutions to national problems.
3. We welcome the opportunity to comment on the Public Works Loan Boards (PWLB) future lending terms.
4. We welcome the extension of the deadline for responses to this consultation from 4 June to 31 July. We would urge that this additional time is used to engage in detail with councils, for example by arranging a series of virtual round tables to discuss the proposals in detail and to develop more helpful approaches given the challenges our country now faces, and to feed this into the review. We would be pleased to help and engage in such a process.
5. This response has been cleared by LGA's Resources Board.

Introduction – immediate response to COVID-19 pandemic

6. The consultation paper was issued before strict measures were implemented to address the COVID-19 pandemic. However, the financial environment for local government has changed so profoundly that we cannot overlook the issue.
7. The COVID-19 pandemic has raised serious questions about the role of the PWLB and how it could be improved to support councils. Many councils have faced cash flow shortfalls as a result of the crisis. In order to meet essential commitments, they face having to take-out short-term loans at expensive rates. Such loans would take resources away from front line services and divert them to financial institutions. The Government has acted quickly to help by paying grants up front and by the deferral of business rates payments centrally. These have provided councils with a breathing space. The PWLB could provide a permanent solution to cash flow problems by offering low-cost short-term loans to local authorities.

8. Councils are also facing extraordinary costs of dealing with the pandemic as well as losing significant income streams and the opportunity to implement planned savings programmes. Further help could be given to councils by PWLB allowing for some loan repayments to be delayed. This would be a temporary measure; the loan would still have to be repaid but at a later date. However, the local government sector has also noted that NHS bodies have been allowed to write off debts as a result of the COVID-19 crisis and several local authorities have called for the same dispensation.
9. We call upon HMT to implement these two schemes quickly and urgently to help councils through the current crisis. This needs to be done as soon as possible and not wait for the outcome of the review or for the Comprehensive Spending Review.

Revised lending arrangements consultation

10. The stated aim of the revised lending arrangements is a "limited intervention to address the specific issue (described in this document as 'debt-for-yield')" of "a minority of local authorities borrowing from the Public Works Loan Board (PWLB) to buy investment assets primarily for yield".
11. The proposals include a number of other minor adjustments to the lending arrangements, but this issue is the core of the consultation.
12. We will answer the specific questions in detail later, but overall 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.
13. The key proposal is that any local authority that undertakes an investment that is classified as a "investment asset primarily for yield" will not be able to access PWLB loans for any projects in the year in which it makes the investment. This is irrespective of how the individual investment "for yield" is funded or how big or small it is. We set out below some of the practical difficulties with this approach, but at the heart of our objection is that, in extending the prohibition on PWLB borrowing to the whole capital programme, it places DMO officials in the position of adjudicating on what can and cannot be financed in that year. Under the Prudential Code, these decisions are a matter for elected Councillors. As a result, these proposals impose 'back door' controls on council spending which have been delegated to councils by Parliament. It is unacceptable that government officials should take this power to themselves. One could take the view that

PWLB, like a commercial lender, is entitled to deny credit on a proposition which does not meet its criteria; what is unusual in this proposal is to refuse finance in an arbitrary way on all propositions just because there is another, separate, activity being undertaken to which the lender objects.

14. There is no accepted definition of an “investment asset primarily for yield”. We assume that the intention here is to consider only investments that are classed as capital expenditure, but this needs to be clear. Councils have always owned and managed properties and many of these have had a rental element to them that can lead them to be seen as being held for “investment for yield” purposes, but that may not be the sole reason. In many cases the distinction is not clear, and an individual property can be held for several different reasons at the same time. Property that is held for service reasons – for example, for place shaping or for economic regeneration such as plans to regenerate high streets by changing and influencing the mix of use of properties, may also generate a commercial rental income, which may or may not more than cover the costs of holding the property and so result in a “yield”. The consultation document does recognise this and includes a few hypothetical case study examples of possible investments; however, while the hypothetical examples may appear to be clear, real life situations are unlikely to be so clear and this is likely to cause considerable confusion. We believe that in adjudicating on these questions, the DMO will be taking powers upon itself that should be taken by elected councillors and that these proposals impose ‘back door’ controls on council spending which have been delegated to councils by Parliament.
15. When the consultation was launched it was stated that it would go hand in and with a series of regional roundtables with stakeholders in the sector. It is particularly disappointing that it has not been possible to hold such events (though it is understandable). Open discussion at such a forum would have allowed detailed exploration of the practical problems posed by the proposals and might have created an opportunity for alternative proposals to be formulated that could address HM Treasury’s concerns, without the need for the drastic action proposed in the consultation.
16. We would urge that now that the consultation has been extended a series of virtual round tables are arranged to discuss the proposals in detail as was originally envisaged, and to feed the comments from these into the review.

Specific questions

Questions 1-3, 12-13, 15, 19, 23-28, and 37-39 are all aimed at individual local authorities and we would refer you to answers from individual councils. We are therefore providing specific answers to the remaining questions.

Question 4: *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?*

17. The aim as stated in para 1.22 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". The proposal in paragraphs 1.24 to 1.28 is to end "access to the PWLB for local authorities that wish to buy commercial assets primarily for yield".
18. The proposal will prevent local authorities from using PWLB loans to buy commercial assets primarily for yield. But the proposal does not appear to be proportionate and in our view it will impede the ability of some local authorities to pursue service delivery, housing and regeneration under the prudential regime. The proposal will create other problems. It is very likely that it will prevent councils from borrowing to invest in service and regeneration schemes that have commercial elements for fear that these will be judged as being "for yield", or to seek to remove these elements from proposed schemes, which may in turn make them unviable or unaffordable.

Question 5: *Do you agree with the conclusion in paragraph 1.26 that local authorities finance their capital requirement in the round, and that it is not therefore possible to meaningfully link PWLB borrowing to specific spending?*

19. This is an over-simplification. If this were the case, then it should also not be possible to state quite so categorically that local authorities have been funding the purchase of investment properties for yield through borrowing from the PWLB over the past few years. The financial appraisal of capital investments will consider the costs of capital and that will assume the source of any borrowing. It should therefore be possible for a council to make a meaningful link between PWLB borrowing and specific spending if it is required to do so.

Question 6*: If you answered 'no' to question 5, do you have an alternative suggestion?*

20. The clear alternative would be to require local authorities to state that individual borrowing is not being used to fund specific debt for yield schemes. However, while this may be a marginally better approach our view is that local councils should be free to make their own decisions on their capital programmes.

Question 7: *Do you agree that the approach set out in paragraph 1.27 is a reasonable approach to the situation in which a local authority 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?*

21. Paragraph 1.27 proposes that councils that have used PWLB loans to fund debt for yield purchases despite assurance to the contrary should be required to repay the loan with penalties. We would hope that such a situation would not arise. It is possible that such a situation would be most likely to arise where there had been a disagreement over whether a scheme qualified or not, therefore it is probable that any council involved will have acted in good faith. In this circumstance, the charging of an early repayment penalty seems to be harsh.
22. We note that this paragraph refers to “debt for yield” purchases whereas other parts of the consultation refer to buying either “commercial assets primarily for yield” or “investments assets primarily for yield” with no reference to funding them by “debt”. This point needs to be clarified as it makes a significant difference. The terminology as a whole needs to be closely defined in order to prevent unintended consequences, particularly with respect to Treasury Management activities. For example, as currently drafted the proposals may prevent councils purchasing units in long term property funds or other funds for the purpose of diversifying an investment portfolio or investing surplus cash with a focus on yield.

Question 8: *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?*

23. This is a question for individual local authorities to answer but the answer is going to be yes for a very large number of councils, if not all. It could certainly restrict their options.

Question 9: *Do you have a view on when in the calendar or financial year this new system should be introduced?*

24. As outlined in the response, we think that modifications should be made to the proposals. The parts of the proposals that would result in a reversion to the interest rate calculations used before October 2019 should be introduced as soon as possible. The wider changes that we are calling for in this review (see paragraphs 5 to 8 above) need to be introduced as a matter of urgency in response to the problems councils are facing due to the current pandemic.

Question 10: *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? and* ***Question 11:*** *Do you agree with the assessment in paragraph 1.30 that it is not necessary to change the arrangement for smaller authorities?*

25. We are not aware of any reason why arrangements should be different in England, Scotland, and Wales, but we would refer you to any response from the Welsh Local Government Association and the Convention of Scottish Local Authorities. We also see no reasons to change the arrangements for smaller authorities.

Question 14: *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?*

26. Should the proposal be implemented, this seems an appropriate role for the section 151 officer.

Question 16: *Would these proposals affect the ability of LAs to pursue innovative financing schemes in service delivery, housing, or regeneration?*

27. As outlined above, yes.

Question 17: *Are there specific examples of out-of-area capital spending for service delivery, housing, or regeneration that support policy aims?*

28. We understand that this is the case in several local authorities.

Question 20: *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?* ***Question 21:*** *Is there anything that could be done to mitigate any impact identified?* ***Question 22:*** *Is there anything else you would like to add on this issue?*

29. We are not aware of examples of the specific implications in these questions.

Question 29: *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?* ***Question 30:*** *How much PWLB debt would you transfer to other LAs if you could?* ***Question 31:*** *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?* ***Question 32:*** *Are there any other barriers to discharging unwanted PWLB debt?*

30. While these questions are largely for individual local authorities to respond to, we are aware that current levels of early repayment penalties are seen as an issue by several councils. If early repayment penalties cannot be withdrawn, and we do understand the need to cover costs of early repayment of corresponding gilts, then a reasonable low or nil cost solution would be the ability to transfer PWLB debt between local authorities by novation. This would be likely to have the advantage for the PWLB of reducing the amount of new borrowing.

Question 33: *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?* ***Question 34:*** *Under what circumstances should this process be applied?*

31. Local Authorities should not have different levels of access to PWLB borrowing.

Question 35: *Do you use DMADF currently, and if so, why?* ***Question 36:*** *What would make you increase your use of DMADF?*

32. These are questions for individual local authorities to answer. However, as outlined in our introduction there is an urgent current need for a short-term lending facility to act as a counterpart to the DMADF.

Question 40: *Is there a case for changing the name of the PWLB?*

33. It is a minor point. The name of the PWLB is widely recognised in the sector.

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