Agenda Item	

Report to Property Growth Fund Sub-Committee

Date of Meeting	9th February 2021
Portfolio	Corporate Delivery
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Public/Private Document	Public

Update on Public Works Loan Board Lending Terms

Executive Summary

1.1 This report is to update Members of the Property Growth Fund Sub-Committee of the outcome of the Public Works Loan Board (PWLB) Lending Terms Consultation announced in November 2020, and the implications for the Property Growth Fund going forwards.

1.2 The revised PWLB lending terms implemented in November 2020 restrict access to prudential borrowing for local authorities who have 'debt for yield' schemes in their capital programme.

1.3 Cabinet have been asked to approve an amendment to the current capital programme narrative to reinforce regeneration as the primary aim of the Property Growth Fund, with financial return as a secondary consideration. This will ensure that the Council can continue to access PWLB borrowing to support the current and future years capital programmes. These changes will also be reflected through the future years capital programmes and Capital Investment and Disposal Strategy to be approved at Budget Council on 3rd March 2021.

Recommendation

2. Members are asked to note the change to PWLB lending terms, the proposed changes to the capital programme and Capital Investment and Disposal Strategy, and the resultant effect on future property investments.

Reason for Recommendation

3. The Members of the Property Growth Fund Sub-Committee make decisions regarding the operation of the Property Growth Fund and the property investments that it funds. The Property Growth Fund represents a substantial part of the Council's overall capital programme and as such

affects the Council's capital financing requirement and borrowing requirements. Members should therefore be aware of the changes to the PWLB lending terms to enable the Council's continued access to PWLB borrowing.

Key Points for Consideration

Background

4.1 In a recent report published by the National Audit Office (NAO) it was estimated that local authorities spent £6.6bn on commercial property between 2016/17 and 2018/19, which equated to over 14 times more than in the previous 3 years financial years. This investment was considered to be primarily for yield – as authorities sought to address reductions in funding - and largely financed by prudential borrowing.

4.2 In 2018 the Ministry for Housing, Culture and Local Government (MHCLG) sought to address this issue by issuing statutory guidance, including a requirement for local authorities to publish a capital/investment strategy, quantitative indicators, and reiterating prohibitions around borrowing in advance of need.

4.3 However following the issuing of this guidance borrowing continued to increase as interest rates fell, particularly in the summer of 2019, when £500m was borrowed in a single day. As borrowing was heading towards the statutory limit, in October 2019 HM Treasury announced an immediate 1% PWLB rate rise and an increase to the statutory limit.

4.4 In February 2020 the NAO issued their report, highlighting the issues around authorities using low cost loans from PWLB to buy investment property primarily for rental income. HM Treasury issued a consultation on proposed PWLB future lending terms in March 2020, and CIPFA (the Chartered Institute of Public Finance and Accountancy) published an initial response, which was for local authority Chief Finance Officers to abide by this with immediate effect. In July 2020 CIPFA issued their official response to the consultation, further recommending a review of the Prudential Framework and for the Prudential Code to be made mandatory.

4.5 The PWLB consultation ended in November 2020, and HM Treasury implemented the new PWLB terms with immediate effect, reducing PWLB lending rates to their pre-consultation level at the same time.

Implications

4.6 HM Treasury state that the purpose of PWLB lending is to support public works. The Treasury do not consider 'debt for yield' schemes to fall into this category, and states that such activity presents risks in terms of the stability of the income, puts unmanageable pressure on PWLB, and distorts local and regional markets.

4.7 In light of this, the changes to PWLB lending terms are as follows:

(a) To require authorities that wish to borrow from the PWLB to confirm that they do not plan to buy investment assets primarily for yield;

(b) To publish guidance defining the activity that the PWLB will no longer support, with clear protections for service delivery, regeneration and the re-financing of existing debt; and

(c) To standardise the information currently gathered through the application process for the PWLB Certainty Rate and use this as a primary way to confirm that authority plans conform to the guidance.

4.8 The implications for local authorities therefore are:

- Authorities must provide their high level capital programme to MHCLG

- Authorities must provide assurance from their s.151 Officer that they will not borrow in advance of need, and that the authority has no intention to buy commercial assets primarily for yield

- There will be no access to new PWLB loans in a financial year if an authority has commercial/for yield assets anywhere in its capital programme

- This applies to local authority-owned companies/joint ventures

- Breaches could result in repayment of loans on demand, plus early repayment penalties

4.9 The definition of categories of capital spend will be key in the application of the above changes. The following categories are **allowable** for the purposes of access to PWLB borrowing:

Allowable Capital Spend	
SERVICE SPENDING	Anything captured in the standard central government capital return forms, i.e. education, highways & transport, social care, public health, culture & related services, environmental & regulatory services, police, fire & rescue
HOUSING	Land release, housing delivery, subsidising affordable housing
REGENERATION	Schemes featuring one or more of the following characteristics: • **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

	• **preventing a negative outcome**, including through buying and conserving assets of community value that would otherwise fall into disrepair • **involving or generating significant additional activity** that would not otherwise happen creating jobs and/or social or economic value • **rents are recycled** within the project or applied to related projects with similar objectives, rather than being applied to wider services
REFINANCING	Restructuring or extending existing debt from any source; including internal borrowing. Funding via one source then seeking to refinance via PWLB is 'not something LAs should deliberately do'

4.10 'Investment assets bought primarily for yield' are **not allowable** anywhere in an authority's capital programme for the purposes of accessing PWLB borrowing. HM Treasury considers characteristics of such schemes to be as follows:

Non-Allowable Capital Spend	
INVESTMENT ASSETS BOUGHT PRIMARILY FOR YIELD	One or more of the following: • buying land or existing buildings to let out at market rate • buying land or buildings which were previously operated on a commercial basis which is then continued by the authority without any additional investment or modification • 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

4.11 It is not intended that the changes to PWLB lending terms are applied retrospectively, but will apply to the current and future financial years capital programmes. A review of past PGF acquisitions against the above criteria has been carried out to inform the PGF position going forwards. This indicates that the majority of property investments have been made within the borough and have had regeneration aims alongside a financial return, however a minority of schemes do not fit the characteristics for regeneration and are more likely to have been classified as investment assets bought primarily for yield.

4.12 The aims for the PGF stated in the current capital programme are:

‘…to acquire properties for a commercial, financial return, and to generate revenue savings of 1.5% on the capital invested. To date, all the CIF acquisitions have been within the borough boundaries, although there was no specific prohibition on out-of-borough purchases. In Phase 3 it is proposed to widen the geographical parameters to acquire properties out-of-borough.’

In order to make sure the capital scheme description for the PGF incorporates the regeneration aims of the Council going forwards, and to ensure continued access to PWLB borrowing, a recommendation has been made within the period 8 Finance Update Report considered at Cabinet on 9th February to amend the purpose of the scheme to the following:

‘Acquisition and development of property with the primary aims of strategic regeneration, business growth, job creation and enhancing social or economic value, with secondary aims of portfolio diversification and the achievement of a financial return in order to cover the costs of investment and provide for whole-life asset maintenance costs and future fluctuations in property investment income’.

The proposed capital programme and Capital Investment and Disposal Strategy to be approved at Budget Council on 3rd March will also include this updated description.

4.13 All future PGF investments will need to be made in accordance with the allowable capital spend categories as set out in paragraph 4.9 above.

Alternatives Considered

This report is for information only, there are no alternatives to consider.

Costs and Budget Summary

5. The proposed capital programme for 2021/22 to 2025/26 to be approved at Budget Council on 3rd March is supported by £106.4m of prudential borrowing, which would be put at risk if the changes described in paragraph 4.12 above were not approved. Although alternative lending providers are available, PWLB remains the most cost-effective and accessible form of borrowing available for local authorities.

Risk and Policy Implications

6. This report is for information only; there are no risk and policy implications.

Consultation

7. The Director of Economy, Director of Resources and Chief Finance Officer have been consulted in producing this report.

Background Papers		Place of Inspection
8.	NAO Report – Local Authority Investment in Commercial Property – February 2020	No.1 Riverside
	Public Works Loan Board: Future lending terms consultation	No.1 Riverside

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