

Appendix Five

Bonds are public debt securities, i.e. loans evidenced by certificates that can be traded on financial markets. Governments are the largest issuers of bonds, with the UK's issuance, known as gilt-edged securities or gilts, having recently topped £1 trillion. Bonds are also issued by supranational entities, companies and local authorities. Pension funds are the largest holders of bonds, although many other public and private bodies, as well as individuals, hold bonds for investment purposes.

Potential Advantages /Benefits				Disadvantages / Risks																								
<p>Interest Rate: Bond yields are often quoted as a spread above the nearest gilt, i.e. the lowest risk bonds. An individual local authority bond would typically trade around 0.75% above the gilt yield. A larger regional issue could trade around 0.60% above the gilt yield. This compares favourably with the margin currently charged by the PWLB (1.00% above the gilt yield) A comparison of PWLB vs Bond issues is displayed below:</p> <table border="1" style="width: 100%; border-collapse: collapse; margin: 10px 0;"> <thead> <tr> <th style="text-align: center;">Borrowing requirement (£m)</th> <th style="text-align: center;">PWLB 25 year loan interest pa (£000's)</th> <th style="text-align: center;">Individual LA Bond interest pa (£000's)</th> <th style="text-align: center;">Regional Issue interest pa (£000's)</th> </tr> </thead> <tbody> <tr> <td style="text-align: center;">300</td> <td style="text-align: center;">16,260</td> <td style="text-align: center;">15,510</td> <td style="text-align: center;">15,060</td> </tr> <tr> <td style="text-align: center;">250</td> <td style="text-align: center;">13,550</td> <td style="text-align: center;">12,925</td> <td style="text-align: center;">12,550</td> </tr> <tr> <td style="text-align: center;">200</td> <td style="text-align: center;">10,840</td> <td style="text-align: center;">10,340</td> <td style="text-align: center;">10,040</td> </tr> <tr> <td style="text-align: center;">150</td> <td style="text-align: center;">8,130</td> <td style="text-align: center;">7,755</td> <td style="text-align: center;">7,530</td> </tr> <tr> <td style="text-align: center;">45</td> <td style="text-align: center;">2,440</td> <td style="text-align: center;">2,327</td> <td style="text-align: center;">2,259</td> </tr> </tbody> </table> <p>Savings of approaching £100k pa could be made.</p>				Borrowing requirement (£m)	PWLB 25 year loan interest pa (£000's)	Individual LA Bond interest pa (£000's)	Regional Issue interest pa (£000's)	300	16,260	15,510	15,060	250	13,550	12,925	12,550	200	10,840	10,340	10,040	150	8,130	7,755	7,530	45	2,440	2,327	2,259	<p>Costs: Bonds are almost always issued in conjunction with an investment bank, which can also underwrite the issue. The bank's fees will be substantial, especially for an underwritten issue. Other costs include: legal fees, printing costs, a listing fee and a depository fee (all can be amortised over the life of the bond) Total fees typically range between 10 and 20 basis points.</p> <p><i>As a lower cost alternative to a publicly listed bond issue, it is possible to arrange a private placement of a bond with a single or small group of investors, such as pension funds. The success and interest rate of placements are entirely dependent upon investor appetite and the distribution ability of the investment bank. In addition, stipulations can be written into such bonds to allow partial buy-back if one or more local authority wished to re-finance its borrowing requirement at a later date. Such stipulations would impact upon the rate quoted.</i></p>
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<p>Early Redemption: Issuers can buy their own (public issue) bonds on the market at the current price, a considerable advantage in comparison to PWLB loans which are repaid at a spread below the gilt yield, i.e. at higher cost. <i>(However, the bond documentation and stock exchange rules often place restrictions on the amount, price and conduct of bond buy-backs.)</i></p>				<p>Credit ratings: investors will accept a lower rate of return from rated bonds, so it is usually cost effective for the issuer to obtain and maintain a rating. Credit ratings for a relatively simple organisation like a local authority may cost between £10,000 and £50,000 per year to obtain and maintain, depending on the agency. (A private placement may not require credit rating.)</p>																								

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