

Changes to PWLB interest rate structure: an explanatory note

This note explains the background to the changes to the Board's interest rate structure introduced on 1 November 2007.

The measures announced in Circulars 140 and 141 were as follows:

- Maturity brackets with a uniform length of six months
- Rates expressed in increments of one basis point
- A separate set of rates is to be applied to early repayments

The impact of these changes on rates for new advances is illustrated in the attached graph, which uses the interest rates on 2 November as an example.

The first two changes should be advantageous to borrowers. They mean that not only will local authorities continue to be able to borrow at beneficial rates; they will generally be able to do so at rates that are closer to the gilt yield curve and therefore closer to the Government's own cost of borrowing. Under the old system, there were several brackets of 5-year length and so the step-down in rates from one bracket to the next could be substantial. This may have led some local authorities to borrow at sub-optimal maturities purely to take advantage of lower rates. The new structure of half-yearly brackets should enable local authorities to borrow at optimal maturities without effectively being penalised with higher rates.

It is accepted that the third measure, a separate set of early repayment rates, may be perceived by local authorities as raising the cost of debt restructuring. The Board is not seeking to remove opportunities for debt restructuring. It is recognised there are many valid reasons why authorities sometimes need to do this. However, the needs of local authorities must be balanced against the impact on the Exchequer from provision of the PWLB facility, and the judgement was that the previous methodology used to set the Board's rates did not adequately reflect the value of the borrower's option to refinance or the potential impact on the Exchequer of such activity. It was felt that a differential between the borrowing and early-repayment rate would be a realistic way of achieving a balance. It is accepted that the level of adjustment between the new borrowing and EP rates will need to be kept under review. Furthermore, it is reiterated that the new repayment rates need to be seen in the context of generally lower rates for new advances, the provision of which is the main purpose of the PWLB, as a result of the finer pricing.

05 November 2007

PWLB Rates for New Maturity Loans effective for 2 November 2007

