GREATERLONDONAUTHORITY

REQUEST FOR DIRECTOR DECISION – DD1337

Title: Arrangements for borrowing from Community Finance Company 1 plc for Northern Line Extension

Executive Summary: The GLA has agreed to borrow up to £1bn to finance the Northern Line Extension (NLE) (DD1300). This decision authorises relevant officers to enter into commitment and related loan agreements on behalf of the GLA with Community Finance Company 1 plc ("COFCO1" or the "Issuer") and Lloyds Bank plc ("Lloyds") in respect of part of that borrowing (up to £200m).

Decision:

1. The Executive Director authorises an exemption under the GLA's contract code for the GLA to enter into a loan agreement with COFCO1and to authorise the Assistant Director – Group Finance to :

- execute the final commitment agreement in respect of the loan described in this paper, substantially in the form attached, a final copy of which will be supplied to the Executive Director – Resources for comment before execution;
- authorise on the closing date a private placement of the Notes issued by COFCO by Lloyds following the commitment agreement; and
- subsequently on the closing date execute the loan agreement for the loan described in this paper substantially in the form attached in the commitment agreement, provided that the specific approval of the Executive Director – Resources will be required where the final pricing is expected to exceed the costs of comparable borrowing at the PWLB Project Rate or where the total notional borrowed exceeds £200m, which may be given by telephone and later recorded in writing. For the avoidance of doubt, if the Notes are issued at a premium and such premium would not be counted as additional borrowing for the purpose of this authorisation.

AUTHORISING DIRECTOR

I have reviewed the request and am satisfied it is correct and consistent with the Mayor's plans and priorities. It has my approval.

Name: Martin Clarke

Position: Executive Director - Resources

Signature:

Date:

PART I - NON-CONFIDENTIAL FACTS AND ADVICE

Decision required – supporting report

1. Introduction and background

1.1 The GLA has agreed to borrow up to £1bn to finance the Northern Line Extension (NLE) (DD1300). On present assumptions the GLA proposes to borrow £928m to finance the NLE once the 'dual key' is turned (i.e. an irrevocable commitment is entered into to build the NLE and further contractual commitments are entered into by Battersea Power Station Development Company (BPSDC) to develop at the station site and surrounding area). BPSDC, TfL and the GLA are due to agree these commitments shortly and once the dual key is turned the GLA proposes to start its external borrowing for the NLE.

1.2 The Mayor holds responsibility for the implementation and regular monitoring of the GLA's treasury management policies and practices and delegates responsibility for the execution and administration of treasury management decisions to the Executive Director - Resources. The Executive Director - Resources is responsible for maintaining the Treasury Management Practices (TMPs) and monitoring and managing the strategy, with day to day management of this function delegated to his staff. Under the approved TMPs the Assistant Director – Group Finance has been given delegated powers to approve the most appropriate forms of borrowing from approved sources.

1.3 The GLA has already entered into arrangements with the EIB to drawdown £480m and now intends to raise a further £200m of the commitment from an index linked bond. Such a bond would provide the GLA with some protection if inflation remains low and receipts from business rates from the Enterprise Zone are therefore lower than anticipated.

1.4 The GLA proposes to use the same mechanism as that when it raised its first bond in July 2011 (i.e. a bond is issued by COFCO1, and the funds raised are used solely to loan to the GLA). The utilisation of this structure proved successful in 2011 and represents the most cost effective method of accessing the capital markets.

2. Objectives and expected outcomes

2.1 To secure £200m of the proposed £928m anticipated to be required for the NLE in a manner which provides some protection for the GLA from a continued low inflation environment.

3. Equality comments

3.1 The GLA is obliged by the Public Sector Equality Duty under s149 of the Equality Act 2010 to have due regard to the need to eliminate discrimination, harassment, and victimisation, to advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it, and to foster good relations between persons who share a relevant protected characteristic and persons who do not share it. Protected characteristics are age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, sex and sexual orientation.

3.2 The proposals in this paper are exclusively concerned with financial arrangements for an infrastructure project of general benefit to the public, and it does not appear that the Public Sector Equality Duty is engaged.

4. Other considerations

4.1 As part of the negotiations with HM Treasury, the GLA negotiated the option of being able to raise funds for the NLE from sources other than the Public Works Loan Board (PWLB). Although the GLA has not raised funds from a bond issuance since July 2011, this option is particularly attractive in the present circumstances. A loan, the funds for which are raised from an index linked bond, would provide some protection to the GLA from the risk that in a low inflation environment the proceeds from business rates in the Enterprise Zone would be insufficient to repay the debt taken out (i.e. the cost of servicing the debt would also be lower with an index-linked bond if inflation was low). Further, there is a shortage of index-linked bond issuances and it is likely that such an issuance would be highly competitive. Accordingly, the target set is to at least match the GLA's base option of borrowing from the PWLB at gilts + 60 basis points on an effective interest rate basis, under the higher of NLE model or Bank of England forward inflation assumptions. This ensures that overall the borrowing is not expected to be more expensive than the base alternative while delivering the additional benefit of securing an inflation hedge for the GLA. HM Treasury have set a value for money test for the GLA's borrowing from non-PWLB sources and have indicated that the GLA should be allowed to utilise the sources of funding and finance available to them.

4.2 Following a full review of the alternatives, GLA chose in 2011 to borrow from COFCO1, a vehicle established by Lloyds for the purpose of the 2011 issuance. COFCO1 makes a loan to the GLA with this loan being funded by a corresponding note issue by COFCO1 in the capital markets. The GLA can therefore access funds raised in the capital markets through the Issuer rather than directly.

4.3 The principal reasons for using COFCO1 back in 2011 remain the same as now: it offers an efficient and cost effective means of the GLA accessing the bond markets, compared with the alternatives that are available. In particular, the vehicle allows investors to be paid interest gross of tax due. Officers have reviewed the experience of the first bond issuance and alternative ways available to access the capital markets. They have concluded that COFCO1 would be the more cost effective means for the GLA to raise the funds required. Accordingly, the Executive Director - Resources is asked to authorise an exemption under the GLA's contract code for the GLA to enter into a loan agreement with COFCO1.

4.4 The first COFCO1 bond issuance was by a public auction where market competition and value for money were evident. Following the roadshow conducted in November with GLA officers, feedback from investors has been collected and followed up by both Lloyds and GLA officers. Very competitive feedback has been received from a small number of long term investors looking for significant allocations to match inflation linked commitments. Lloyds and GLA officers have therefore concluded that a private placement by COFCO1 amongst this group of investors is likely to deliver equal or better value for money compared to a public auction, more efficiently and with more flexibility to adapt the bond structure to individual needs.

4.5 A loan agreement is being concluded between COFCO1 and the GLA, with the GLA being advised by Clifford Chance. This agreement is substantively the same as that entered into in 2011 but has been revised to reflect the index-linked nature of the issuance and the circumstances of the NLE, particularly the availability of the re-financing facility with Government.

4.6 The Executive Director is asked to authorise the Assistant Director – Group Finance to :

- execute the final commitment agreement in respect of the loan described in this paper, substantially in the form attached, a final copy of which will be supplied to the Executive Director – Resources for comment before execution;

- authorise a private placement of the transaction by Lloyds following the commitment agreement; and

- subsequently execute the loan agreement for the loan described in this paper substantially in the form attached in the commitment agreement, provided that the specific approval of the Executive Director – Resources will be required where the final pricing is expected to exceed the costs of comparable borrowing at the PWLB Project Rate or where the total notional borrowed exceeds £200m, which may be given by telephone and later recorded in writing.

4.7 The documents appended to this paper are:

- at part II, the Commitment Agreement whereby GLA commits to borrowing a sum of up to £200m from COFCO1 at an interest rate that is linked to the interest rate that is payable on the Notes to be issued by COFCO1; and

- at part I, the programme Memorandum that has been prepared in connection with the listing of the Notes which will fund the loan. It describes the security arrangements relating to the loan to GLA and payments made thereunder, which will be put in place for the benefit of the secured creditors (including the Noteholders). It also sets out certain information relating to local authorities generally, and (included in the Pricing Supplement) the information which will be provided to investors in respect of GLA (as borrower).

4.8 Points of particular note in the Commitment Agreement (which contains the terms of the loan) are:

- COFCO1 is obliged to seek to fulfil the loan to GLA (by issuing the Notes) but is not obliged to fulfil it if, for example, their Notes cannot be issued in sufficient volumes or within the required price parameters;

- GLA is required to give a number of representations and warranties on entering into the Commitment Agreement and it is a condition of COFCO1's obligations to enter into the loan that such representations and warranties are true assuming they are repeated on a daily basis between the date of the Commitment Agreement and the date on which the loan agreement is entered into. These representations and warranties should be satisfied before the agreement is executed and checked daily, as GLA is obliged to notify COFCO1 and Lloyds if they cease to be true. Representations and warranties are also given by GLA on the date it enters into the loan agreement (as set out in the form of the loan agreement);

- GLA is also required to respond to all reasonable queries from COFCO1, including due diligence questions; and

- the terms of the loan include provisions which may at the option of the noteholders require the GLA to prepay the entire loan if there is a change of status of the GLA (such as its ability to raise funds from the PWLB or its successor) and such change leads to a ratings downgrade to below investment grade status. COFCO1 may also require prepayment of the loan if there is an event of default, which includes a failure to pay or comply with its obligations, certain insolvency events or where the GLA ceases to exist (unless there is a statutory successor).

5. Financial comments

5.1 The proposed arrangements set out in this decision are in compliance with the GLA's Treasury Management Strategy.

5.2 Borrowing costs may be higher or lower than the central expectation used for the VFM test because of the exposure to future inflation, which is uncertain. However, should inflation prove to be higher than expected, increased costs will be directly offset by increased inflation-linked income from the NLE enterprise zone. Conversely, if inflation is lower than anticipated, income from the enterprise zone will be reduced but this would be mitigated by a reduction in borrowing costs on any portion of the total debt that is inflation linked.

5.3 Use of this form of borrowing therefore adds to the certainty of overall affordability at the expense of reducing some of the 'upside' of enterprise zone income in a high inflation scenario.

5.4 The costs of issuing the bond and ongoing expenses for maintaining the COFCO1 note programme, including legal costs, are chargeable against the ring-fenced NLE account. The GLA would have to meet Lloyds underwriting fees if the transaction were not to complete. Other financial implications are integral to the previous sections.

6. Legal comments

6.1 Section 1 of the Local Government Act 2003 gives local authorities, including the GLA, "to borrow money -

(a) for any purpose relevant to its functions under any enactment; or
(b) for any purpose of the prudent management of its affairs."

The decisions requested to be taken (as set out in this paper) fall within the scope of these statutory powers.

6.2 Under the GLA's Treasury Management Strategy (approved under MD1490) decisions relating to the GLA's borrowing are delegated to the Executive Director of Resources. Accordingly, he is empowered to make the decisions set out in this paper.

6.3 Borrowing is not a matter that is required by the Public Contracts Regulations 2015 to undergo competition; in any event, this paper describes alternative sources of borrowing that have been considered.

7. Planned delivery approach and next steps

7.1 It is proposed that up to £200m be raised in 2015/16 with timing subject to evolving knowledge of market conditions and project cash flows.

Appendices and supporting papers:

Programme Memorandum at Part I

Public access to information Information in this form (Part 1) is subject to the Freedom of Information Act 2000 (FOI Act) and will be made available on the GLA website within one working day of approval. If immediate publication risks compromising the implementation of the decision (for example, to complete a procurement process), it can be deferred until a specific date. Deferral periods should be kept to the shortest length strictly necessary. **Note**: This form (Part 1) will either be published within one working day after approval or on the defer date.
Part 1 Deferral: **Is the publication of Part 1 of this approval to be deferred? YES** If YES, for what reason: Publish following issuance of the bond Until what date: 30 April 2015
Part 2 Confidentiality: Only the facts or advice considered to be exempt from disclosure under the FOI Act should be in the separate Part 2 form, together with the legal rationale for non-publication. **Is there a part 2 form – YES**

ORIGINATING OFFICER DECLARATION:	Drafting officer to confirm the following (✓)
Drafting officer: David Gallie has drafted this report in accordance with GLA procedures and confirms that:	/
Assistant Director/Head of Service: David Gallie has reviewed the documentation and is satisfied for it to be referred to the Sponsoring Director for approval.	/
Financial and Legal advice: The Finance and Legal teams have commented on this proposal, and this decision reflects their comments.	/

EXECUTIVE DIRECTOR, RESOURCES:

I confirm that financial and legal implications have been appropriately considered in the preparation of this report.

Signature **Date**