

The University of Sheffield

PhD Thesis

The Application of Municipal Bonds to fund Local authorities projects in England; Barriers and Solutions

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**Abstract**

After the Global Financial Crisis, local authorities in England have suffered drastic cuts in their fundings that comes from the central government. With the ever-growing pressure on local authorities to continue to provide services while being hit hard by various austerity measures, they are ought to look for new sources of income streams. Projects that provide such streams require capital funding that is mostly sourced via borrowing. With the limitations in either lenders variety or products suitability, bond issuance is one of the options that is under researched and underused in England. An investigation into the provisional development of municipal bond market in England is therefore of a significant importance. Different studies and reports have been conducted on municipal bond market development but very few focused on the context of England and little empirical work is done to assess municipal bonds.

This research is exploring the development of municipal bond market in England by analysing its different stakeholders’ positions from an institutional perspective. This research uses qualitative methods, the Historical Institutionalism theory, and subsequently a conceptual framework that guides the inquiry of revealing the key barriers prominent in the bond market and methods to overcome those barriers. This research focuses on the formal and informal rules that influence different stakeholders’ groups behaviour and strategies in the market and the dynamics of the relationships between those groups that affects such market development.

This thesis reveals certain bond market barriers that affects bond market development in England. The barriers revealed are bonds uncertainties, efficiency, transparency, credit rating, and liquidity. The research has found that the process of municipal bond market development in England is multi-dimensional whereby different stakeholders groups need to come together to overcome those barriers. Overcoming such barriers is found to be possible for local authorities when building a long and meaningful relationship with two stakeholders in the market being the UK Municipal Bond Agency and market makers. Another key finding is that issuing thematic bonds, such as green and social impact bonds, is best suited with local authorities and can assist them in overcoming most market barriers. On the theoretical approach of this research, the Historical Institutionalism theory is found to has lent itself well to the analysis of the complexities of bond market development in England. The research suggests a new analytical framework as well for the municipal bond market development for future applications.

**Key Words:** Municipal bonds, UKMBA, Local authorities, PWLB, Central Government.

Table 1 Glossary of Terms and Acronyms

|  |  |
| --- | --- |
| UKMBA | UK Municipal Bond Agency |
| PWLB | The Public Work Loan Board |
| MB | Municipal Bonds |
| LA | Local Authorities |
| HA | Housing Associations |
| CRA | Credit Rating Agency |
| PFM | Public Finance Management |
| Bp | Basis point, equivalent to 0.01% (1/100th of a percent) or 0.0001 in decimal form |
| Notch | The difference between one Rating and the Rating immediately below it. |
| LOBO | Lender Option Borrower Option loans |
| Gilt | Central Government Bonds |

# Chapter one: Research Introduction

# 1.1 Context and Motivation for the Study

After a long period of relative calm in the international financial system, the worldwide financial crises severely tested the capabilities of global financial institutions ([Lane, 2012](#_ENREF_144), [Karger, 2014](#_ENREF_129)) and drove the world economy into minus growth ([NIDS, 2011](#_ENREF_213)). Although it affected all nations around the globe, the financial markets in the EU and USA were hit the hardest ([Davis, 2011](#_ENREF_70)). Consequently, governments were under pressure to lower financial requirements and had to be willing to actively implement rigorous macro-prudential frameworks ([Lane, 2012](#_ENREF_144)). As cuts on investment were seen easier than raising taxes or cutting social and public services, governments were expected to postpone or reduce investment in infrastructure projects ([Brumby and Verhoeven, 2009](#_ENREF_51)).

Unlike central governments, when the economy turns down local governments cannot run deficits to close their budget gap, they have to use combination of spending cuts, use of reserves, or revenue increases. While drawing down reserves does not represent a suitable long-term solution that allows local governments to deal with a significant downturn or recession, cuts in funds continues to be more attractive alternative comparing to tax increases ([Atkins, 2020](#_ENREF_18), [McNichol and Lav, 2008](#_ENREF_202)).

Therefore, at a time when local government ought to be stimulating local demand and investing for the future, its budgets are cut deeply ([Cox and Schmuecker, 2013](#_ENREF_65)). LAs have suffered of the lack of investment while being asked to reduce their spending significantly compared to other sectors such as education, health, work and pension. With the continuous pressure on LAs to protect social care and local environment provision delivers, their financial position is even more likely to undermine their potential growth ([LGA, 2012](#_ENREF_148), [Biais et al., 2006](#_ENREF_28)).

The 2010s represented a profound change to the way English local authorities received their funding. There was a significant reduction in financial contributions, but also by 2019, the funding system changed quite radically as they were highly reliant on local tax revenues as the general-purpose grant from central government was abolished ([Amin-Smith and Phillips, 2019](#_ENREF_13), [Association, 2018](#_ENREF_17)). Between 2009/10 and 2018/19, Central government grants – including retained business rates – were cut 38% from £34.6bn to £24.8bn ([Atkins, 2020](#_ENREF_18)).

With that, an average reduction in their spending since 2010 has fallen by 21% compared to 2019 ([Amin-Smith and Phillips, 2019](#_ENREF_13)). Such long decade of funding cuts left all local authorities in England at a breaking point ([Parliament, 2019](#_ENREF_222)). Even when using their maximum taxing powers, council tax income in England is facing a strong vacuum. In 2017/18 the sum of council tax raised by English LAs stands at just over £23bn, which is less than the social care budget for the same year ([Association, 2018](#_ENREF_17)). Reserves, on the other hand, are a one-off source. The National Audit Office warned that, should LAs continue to spend on social care as they spent in 2016/17, by 2020 one in ten LAs would have totally drained its reserves ([Amin-Smith and Phillips, 2019](#_ENREF_13)).

Between 2010 and 2020, the reduction in central government funding to LAs would be close to £16bn. In real terms, for each £1.00 of funding local authorities received in the last decade, they now only receive £0.40 in 2021. From 2020 onward, 168 LAs will not receive any revenue support grant from the central government at all ([Association, 2018](#_ENREF_17)). This will result in a substantial funding gap for LAs in England. The difference between revenues and expenditures is estimated to be between £3-5bn annually ([Parliament, 2019](#_ENREF_222), [Commons, 2019](#_ENREF_63)), which means that in five years’ time, the funding shortfall will grow to over £19bn, despite the planned increase in council tax ([Sharman, 2020](#_ENREF_267)). Therefore, unless LAs are relieved of some of their duties concerning service delivery, or grants continue to be received from the central government, both of which deemed unsustainable, LAs will need to find additional sources of revenues themselves ([Amin-Smith and Phillips, 2019](#_ENREF_13), [Karger, 2014](#_ENREF_129), [Council of Europe, 2011](#_ENREF_64)).

It is argued that such funding gap could be filled by private investment which already has an increasing role in financing, accounting for two-thirds of all infrastructure investment in the EU, whereas the government’s contribution is around one third ([Sauter et al., 2014a](#_ENREF_257)). Although there is no universal model for local public finance applicable to all EU countries ([Elena, 2014](#_ENREF_89)), it is claimed that, with more fiscal decentralisation, borrowing can provide local and regional authorities in England with strong incentives for improving project design, cost-recovery practices, and budget transparency ([Dirie, 2005](#_ENREF_77)). Borrowing to invest can be a sensible funding source if it is underpinned by evidence based on national and local infrastructure strategies ([O’Brien et al., 2014](#_ENREF_215)). Nevertheless, it is essential that such borrowing enables local authorities to lower costs and provide them with the required flexibility as a response to the consecutive changes in financial conditions ([Cox and Schmuecker, 2013](#_ENREF_65)).

In general, bonds issuance in domestic markets is considered the most efficient funding means for local governments, compared to borrowing from banks and other commercial sources; the borrowing amounts are larger, the maturities longer, and cost lower ([USAID, 2010a](#_ENREF_298)). However, municipal bonds (MB) have been used internationally through different approaches, yet not all led to desirable results. This highlights the fact that there is uncertainty about the extent to which MB can achieve a real difference for the local authorities borrowing in England. The relationship between LAs and the financialization in the bond market is being explored generally, such as in the study done by [Biais et al. (2006)](#_ENREF_28) who studied the impact of liquidity, transparency and efficiency of bonds in the EU context. However, in England, the relationship between local authorities and the financial markets, and more specifically the MBs is still under-researched and under-theorized.

# 1.2 Aims and objectives:

MBs have been used internationally through different approaches. Countries such as the USA, Sweden, and Colombia, despite having some struggles, appear to have a successful municipal bond market performance so far. This resulted mostly in achieving an alternative, flexible and reasonably cheaper source of funds for local authorities that enabled them to fulfil their duties, deliver on their infrastructure projects, and plan well for their future ([Dziobek et al., 2010](#_ENREF_82)).

On the other hand, other utilisation of the municipal bond market such as in India, the Philippines, South Africa, and Greater London Authority in England, did not meet expectations. Those applications were faced with a wide variety of problems, whereby some authorities could not attract the required demand ending up with unsold bonds (India), the high cost of issuance (London, the Philippines, and South Africa), low credit worthiness, and even the lack of expertise and coordination between different governmental bodies ([Dziobek et al., 2010](#_ENREF_82), [Cox and Schmuecker, 2013](#_ENREF_65)).

The above summary denotes some successes and some failures in developing municipal bond markets internationally. This highlights the fact that there is uncertainty about the extent to which municipal bonds can achieve a real difference for English LAs funding.

Given the common uncertainty around the application of the MB market as an alternative source of funding for local authorities, this research aims to address this gap by seeking further understanding how MBs could be used more widely in different governmental contexts in England. This requires an evaluation of the existing MB models in different governmental contexts to highlight their successes and failures.

This overall aim will be achieved by meeting a number of objectives. These include:

* mapping the available different MB models in different governmental contexts.
* developing an understanding of the features, characteristics, advantages and disadvantages of bond applications and the way each has been developed and shaped.
* evaluating what works well and works less well in cases where there has been a successful MB process introduced.
* establishing an understanding of the barriers faced in different MB models, how they act as blocks in the MB market, and identify the way forward to overcome these barriers.
* explore the implications for different stakeholders who may be involved in future application of MBs.

The study will apply historical institutional theory to understanding the use of MBs by local authorities. This conceptual framework is used to develop an analytical framework which views social and institutional interaction between a complex array of stakeholders at different levels ([Healey, 1992](#_ENREF_116)). The first level addresses the main activities and relationships that affects the progress and the outcomes of bond market development. The second level segment covers the analysis of the key actors and stakeholders and their roles in the development of the bond market. The third level carries an in-depth assessment of the municipal bonds’ application barriers and discusses the means to overcome those barriers in the English bond market. Furthermore, this level identifies the municipal bonds’ strengths and weaknesses as well as the formal and informal rules that affect the development of the bond market. The fourth level covers social relations, including rules and ideas that affect the development of the municipal bond market and constitute the strategies and interests of the bond market actors.

This approach lends itself well to the exploration of this phenomena for four reasons. First, this approach allows an analysis of the actors’ behaviour and attitudes towards the bond market using a historical lens rather than predictions. It shows the historical contingence and path dependency of the different actors’ actions and strategies. Secondly, it allows the necessary comparisons between different bond markets on different levels; internationally (Sweden vs England) and nationally (LAs’ bonds vs housing associations’ bonds within England) and, most importantly, local authorities against each other whereby the variance in their strategies in the bond market was explained. Thirdly, it allows the assessment of English local authorities to be carried out in a way that presents the context of the environment in which they function, being restricted by social, political, and economical factors when making their decisions, and not as utility-maximizing entities. Fourthly, the approach serves well in defining the significance of each barrier faced in the bond market and allows exploration of the ways of which each barrier can be overcame. This approach serves well in terms of revealing the role of some bond market actors and institutions as entities that can change other market actors’ views, preferences, and strategies.

The empirical analysis draws on data collected from documents and in-depth (elite) interviews with stakeholders involved in the MB process or with expertise and experience of relevant case studies and examples. A total of 24 interviews were undertaken between January 2018 and March 2019. The participants included two LA officials, two central govt officials, one UKMBA official, one PFM official, two intermediaries/banks representatives, one credit rating representative, one Core Cities Group representative, one strategic advisor for LGA, one GLA official, one urban economic advisor, one academic, two representatives from Sweden (Kommuninvest and local authority representatives), two from the charted institute of housing, four housing associations representatives, and two housing bonds aggregators. The insights were analysed using triangulation methods that helped to identify the key barriers faced in bond market development and practices, and suggested methods that could be used to overcome those barriers. The triangulations applied relied on different sources of data such as documents’ analysis and in-depth interviews all of which was crossed checked with other evidence sources and assured.

The case studies that have been chosen are the Swedish municipal bond market, England housing bond market and England municipal bond market. The first two cases were chosen for this research as they provided an insight on how certain bond markets developed internationally and nationally, what key barriers they faced, and the practices and measures implemented to overcome them. This fed into the third case study (England municipal bond market) that is less developed than and helped to understand the barriers LAs in England face now, and will in the future, and provided a unique insight into how they can overcome these barriers via cross-examining the evidence from all three cases. This helped to bring together the experience not only from the same sector in different environments (municipal bonds) but also across sectors by drawing on the similarities between the local authorities’ sector and the housing association sector in relation to the bond market.

All data from the three case studies was collected using a semi-structured interviews and was thematically analysed in line with the conceptual framework’s four levels. Those levels guided both the collection and analysis of the data; the first level looked at the key activities and relationships dominated and affected the bond market, the second level focused on different stakeholders’ roles within the bond market, the third level assessed the key barriers faced by those stakeholders and the means of which they can be overcome, and the final level evaluated the social relations, rules and ideas dominated the bond market and how it affected different stakeholders behaviour. The research, by maintaining alliance with the conceptual framework in its design and conduct, helped to increase the case study design quality and strengthened the findings of this research.

# 1.3 The structure of the thesis

The remainder of this thesis is structured in eight chapters. The next chapter (chapter two), named Local authorities funding sources and the development of bond markets, provides some background knowledge to understand better the research concern by providing an overview of the local authorities’ financial position in England, as well as a review for the municipal bonds’ applications from different perspectives. It highlights a historical review of the local authorities funding sources post GFC, the changes that took place as a result of austerity measures and evaluates the current and foreseen financial position of local authorities in England (reserves and borrowing). The chapter highlights different applications of bonds in both the local authorities and housing sectors. The chapter then goes to focus on the key players and different stakeholders involved in the bond market, their roles, and interests. It concludes with a review of the key barriers expected to be faced in the development of the bond market in England, and the role of social rules in such development

Chapter 3, named as Theoretical Framework, covers the theoretical review of some important social and political theories applicable for the local authorities’ context, seeking an ontological approach and a conceptual framework for the following empirical analysis. This chapter explains the selection of Historical Institutionalism theory as it can accommodate the complexities associated with developing a municipal bond market in England. Historical institutionalism is found to be useful for this research as it allows the process to provide explanations for what is happening in the bond markets rather than predictions. It further helps in understanding how certain institutions, such as local authorities, bond aggregators and banks, have developed in the lens of path-dependency over their historical junctures. It also helps in assessing the behaviour of those institutions not as benefit maximisers, but their role was seen to be embedded in so many social, economic, and political relationships beyond their control and cognition. This has helped to reveal some key informal rules that affects different stakeholders and actors within the bond market.

Chapter 4, (Research Methodology), covers the research methodology and the methodological design of the case study research. It outlines the multiple case study design and three case studies in this research; the Swedish municipal bond market, English housing sector bond market, and English municipal bond market. Furthermore, this chapter discusses the triangulation approach that helped to cross-examine the evidence from different sources and across the chosen case studies, to strengthen the quality of the analysis and the validity of the findings. The chapter goes then to explain the data collection method (semi-structured interviews), the sampling plan (purposive sampling) and the elite interview approach deemed to be suitable for this research. At the last section, this chapter outlines the research quality issues and how this research answered them. These issues are such as validity, reliability, credibility, and ethical consideration, in addition to data analysis methodology and the use of Nvivo.

Chapters 5, 6, and 7 will cover the empirical fieldwork analysis. Chapter 5(The Environment) covers the first level of the analytical framework. This chapter aims to identify the significant features of the local authorities funding arrangements in England. The chapter, then provides a detailed analysis for the current English local authorities’ financial position. This is followed by assessing local authorities funding sources, the impact of austerity measures, and reliance on lenders such as the Public Work Loan Board and banks. The chapter goes on to provide an evaluation of the sector view on bonds compared to the Public Work Loan Board (PWLB) as the main lender to local authorities. The chapter concludes with an evaluation of the previous applications of municipal bonds in England and where they did or did not work.

Chapter 6 (The Players) covers the second level of the analytical framework. This chapter provides an initial analysis of the key actors, roles and relationships involved within the municipal bond market in England. Here, it discusses actors and their roles from two perspectives; the issuer and the investor. On the issuer side, both banks (market makers) and the central government were found to have the greatest impact. On the investors side, an assessment is carried out of investors’ interest in bonds, their decision making and how to stimulate the demand. The role of UK Municipal Bonds Agency (UKMBA) was explored regarding its impact on the development of the bond market in England. UKMBA’s position and responsibilities towards local authorities, such as clarifying and simplifying bonds, diversifying borrowing sources, providing tailored funding, monitoring, and scrutinizing local authorities borrowing, pooling bonds aiming to achieve efficiencies against PWLB, and the complications of the joint and several guarantees scheme are discussed. Furthermore, an analysis for the UKMBA delayed start is carried out, along with an assessment of UKMBA remits to pool local authorities’ interest and create an active bond market.

Chapter 7 (The Barriers) covers the third level of the analytical framework. This section carries an in-depth assessment of bonds on two dimensions. The first is the advantages/disadvantages associated with bonds considering the market development and the context prevailing in England. The second is the barriers faced by local authorities during the development of the bonds market, and the methods of which such barriers can be overcome using various market mechanisms. The main barriers discussed are, efficiency, transparency, uncertainty, credit rating, and liquidity. Each of those barriers is discussed from different stakeholders’ point of view and followed up with ideas and methods that would help to overcome said barrier.

Chapter 8, (Formal and Informal Rules and Ideas) discusses the formal and informal rules, ideas and norms of municipal bond issuance and trade to identify how it shapes and affects different actors’ roles, and the relationships between them. Furthermore, this chapter goes on to discuss featured bonds, mainly green and social bonds (GaS), to assess their impact of such features on different actors’ behavior. The analysis provides a clear idea of how GaS bonds are perceived by different stakeholders and their impact on stakeholders’ strategies and interests.

Chapter 9 summarizes the thesis. It highlights the key findings, the theoretical lessons and contribution and implications for practice. Specifically, it suggests that the theoretical framework is useful, as it shows that the main barriers faced by local authorities are transparency, certainty, credit rating, efficiency, and liquidity. In addition to summarizing these barriers, the chapter discussed the findings related to the formal and informal ideas and rules prevailing in the bond market and the challenges they pose to policy makers and practitioners, along with a summary of the suggestions.

The next chapter provides an overview of the debate of local authorities’ financial position in England, as well as a review of the MB applications in different governmental contexts. It also highlights the key players and stakeholders in the MB market and provides a background to their roles and social interests. The chapter then moves to review the key foreseen barriers that might hinder the development of the MB market in England.

# Chapter 2: Local authorities funding sources and the development of bond markets

# 2.1 Introduction

In this chapter, a historical review is provided of the local authorities funding sources post GFC, the changes took place as a result of austerity measures, and the adaptation that occurred in terms of LA reserves and borrowing arrangements. This is followed by an evaluation of various bond applications in the local authority and housing sectors to assess the success and failure of different governmental arrangements in different contexts. The first part will weigh the impact of PWLB as a key player in the bond market development in England, its impact on how bonds function, and a comparison between the two borrowing sources. The chapter then goes to discuss the role of the UK Municipal Bond Agency and what it could offer as an aggregator to local authorities in terms of facilitating bond market activities. Next, this chapter goes into drawing a wider discussion around the key advantages and disadvantages the bond market offers and, most importantly, the key barriers that are expected to limit the useability of bonds in England, and what can be done, as described in the literature, to overcome them. Finally, the chapter explores the role of formal and informal ideas and rules for bond market players, and the impact those ideas have on their behaviours in the market.

As discussed in chapter 1, the context of this study is to understand and assess the development of the municipal bond market in England, bonds’ applications and what they can offer to LAs. This is accompanied by drawing lessons from other bond applications in terms of their functions, problems, stakeholders’ attitude. Therefore, this chapter serves the purpose of providing contextual background showing which local authorities funding arrangements work, the changes in such arrangements over the last decade or so, the need for, and suitability of, municipal bonds for English LAs, and the key stakeholders position and attitude towards the development of the bond market. This helped to guide and inform the research aims and objectives, the theoretical approach choice, the research design, and the case studies chosen by way of what they can offer regarding gaining a deeper and a meaningful understanding of the phenomena. The literature review, therefore, provides a close look into the context of municipal bonds, the institutional arrangements in England in relation to local authorities’ sector, lessons from other nations and other sectors, and an approach for choosing the case studies for this research. This chapter will be followed by chapter three that discusses the theoretical position of this research and the choice of a conceptual framework.

# 2.2 Austerity and local funding sources post-Global Financial Crisis

Some policymakers, mainly in the EU zone, believe that the debt crisis was caused by unsustainable levels of governmental spending required to maintain overly generous welfare state programs. Thus, the argument was that most austerity policies target reducing government spending and public debt. This ultimately leads to increase confidence in the country’s financial stability to reduce interest rates in the financial markets for both sovereign and domestic borrowers and enhance investors’ appetite ([Karger, 2014](#_ENREF_129), [Banerji et al., 2013a](#_ENREF_20)).

Consequently, some policy makers like US Federal Reserve, the Bank of England and Poland, avoided austerity programmes. By contrast, they launched a financial stimulus and supported collapsing financial institutions ([Centre, 2009](#_ENREF_55), [USAID, 2010b](#_ENREF_299), [Norman et al., 2015](#_ENREF_214)).

In the EU, unlike the US, despite widespread opposition, austerity has dominated economic policymaking since 2009 ([Banerji et al., 2013b](#_ENREF_21)). To tackle government deficits, the EU proposed the application of a strong austerity plans aiming to reduce government debt exposure by reducing its public spending ([Karger, 2014](#_ENREF_129)). Austerity measures have been pursued by all governments. Nonetheless, the severity of said austerity varied drastically across different nations across Europ. Countries like Germany, Switzerland and Sweden have applied moderate austerity measures. While Germany used its savings to balance the books ([Bennyhoff, 2009](#_ENREF_25)), countries such as France have been more ambivalent as they went towards fiscal consolidation, at the same time seeking to keep their credit rating in order to hold down sovereign government borrowing costs ([Banerji et al., 2013b](#_ENREF_21)). Poland and the UK applied sever measure whereby both had wide-ranging policies to cut public spending. The sharpest austerity programs were applied in countries affects most by the GFC; Italy, Spain and, most notably, Greece. Even funds provided by European Stability Mechanism for EU members were provided subject to commitment to drastic cuts in public expenditures. All of Greece, Ireland, Portugal, and Cyprus have accepted financial support and in return they committed to stronger financial cuts ([Banerji et al., 2013b](#_ENREF_21), [Bennyhoff, 2009](#_ENREF_25)).

On the subnational level, and although the financial and economic crisis has not remodelled the overall architecture of local and regional authorities (LRAs) in the EU, countries have had to adapt a new political and economic context. Many reforms have been made at the subnational levels regarding their practices and functions ([CEMR, 2013](#_ENREF_54)).

Despite wide range of austerity policies applied in different EU countries, figures show that in 2011, LRAs contributed a lion’s share to direct investment in comparison with the central and state governments contribution ([NAWFC, 2012](#_ENREF_212), [Sauter et al., 2014b](#_ENREF_258)). Furthermore, LRAs in EU countries, on average, share almost two-thirds of total government gross capital formation ([Davey, 2011](#_ENREF_68)).

Figure (3) shows that central grants contribution to LRAs revenue varies remarkably between countries. As shown in the figure, in countries like Bulgaria and Romania most of the LRAs revenue comes from central subsidies and transfers. Whereas countries like Finland and Sweden are examples of where LRAs relied less on transfers and subsidies from central governments, and are more autonomous

Figure 1 Subnational Revenue in 2011



Source; ([Boulanger and Vallier, 2012](#_ENREF_34))

## Local authorities’ financial position in England

The funding streams for LAs in England comes from three main sources. The first is the government grants. It represents any money sent from the central government for local services. Government grants to local authorities in England stood for 23% of their overall funding. The second source is council tax which is effectively what the council collects as a property tax charged on residential properties. In 2020, council tax was the biggest source of revenue for 50% of local funding. The third source is the business rates which is similar to council tax but applies to business premises instead. Business rate revenue stood for 27% in 2020.

Although it might seem that an increase in tax would bring more revenue to LAs in England, practically, the latter has very limited powers to raise revenues. When comparing local tax raised by English LAs with other wealthy nations it is found that, in 2014, while English LAs raised 12%, Italian LAs raised 17%, German LAs raised 30%, and Canadian LAs raised 50% of the overall government taxes collection.

The main challenge for LAs in England is that they are prohibited from borrowing to finance their daily spending. This means that they can only act in a way that balance their budget (annual income exceeds or equals annual expenses) or use their reserves to cover the difference between income and expenditure, which is unsustainable on the longer run ([Government, 2022](#_ENREF_105)).

Chart, line chart

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Figure 2: Changes in LAs spending powers

Some have argued that the UK austerity measures could be the strongest across the EU ([Room151, 2015](#_ENREF_242), [Bennyhoff, 2009](#_ENREF_25)). This was shown in the long-term reduction in infrastructure projects and tightening of the existing requirements of delivering projects at the lowest possible costs ([Brumby and Verhoeven, 2009](#_ENREF_51), [McNichol and Lav, 2008](#_ENREF_202)). Peter John, the Chair of London Councils, stated that there is growing evidence of councils in England being faced with an increasingly dangerous financial position ([Twinch, 2019b](#_ENREF_291), [BBC, 2019](#_ENREF_23)). Sir Merrick Cockell, the Chairman of UKMBA, explained that councils have faced a 40% cut in government grants with talks about all central funding to be scrapped in the future ([Cross, 2016](#_ENREF_67)).

As shown in figure (3), although the reduction in government grants was met by an increase in the local tax levied, however, such increase could not close the gap in funding. With the continuous reduction of central government grants, the limitations of council tax and taxing powers, local authorities in England are in essential need to find new sources of income to avoid failure.

Chart

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Figure 3: Income by source for LAs in England.

An analysis done by Grant Thornton UK LLP revealed that more than the third of English LAs are faced with a risk of financial failure in the next decade. The report revealed that in the next 10 years, this risk is found in 78% of London boroughs, 49% of unitary authorities, 50% of metropolitan councils and 21% of district councils the same period ([Marrs, 2019h](#_ENREF_176)).

Just after the publication of 2018 provisional settlement, Local Government Secretary James Brokenshire stated that councils will be able to increase their council tax to 3% again ([Brady, 2018c](#_ENREF_37)). Nevertheless, and despite the 2.99% tax increase in England, according to the County Councils Network, the funding gap will grow to more than £30bn between 2019 and 2025 ([Twinch, 2019b](#_ENREF_291)). This is mainly driven by rising costs and demands that makes this tax increase insufficient to maintain the current services, let alone improving them. This spike in demand could increase from current 40% to 60% of the available revenues for LAs in the next 15 years. This means even further cuts to council spending ([Phillips, 2019](#_ENREF_229)). David Phillips, Associate Director at the IFS, explained that even a 4% increase for council tax over the next 5 years would lag far behind the needed increase in the cost for providing the key social services ([Brady, 2019c](#_ENREF_44)). With the increasing demands of post-Brexit financial pressure, there is an urgent need for more financial devolution ([Room151, 2019c](#_ENREF_247)).

Therefore, it has been suggested that in the long-term, LAs’ capital expenditures cannot continue to solely rely on central government funding or on raised taxes ([Karger, 2014](#_ENREF_129)). It is recognised that public sector dynamics have changed. Moving forward would require more cooperation between LAs whether by sharing services, procurement, negotiation of their audit fees or their ways of raising capital. Therefore, there is more pressure on LAs to be proactive and think differently ([Marrs, 2020g](#_ENREF_196)). Phillip Woolley, Partner and Head of Public Services Insights and Consulting at Grant Thornton, stated that resource reduction has led to more centralized financial functions within LAs and a reduction in finance staff. Although this resulted in better financial literacy for staff and them being engaged with budgeting issues more directly, it made it much harder to corporate financial managers to develop a detailed knowledge of the service provided ([Room151, 2019b](#_ENREF_246)).

## Local Authorities reserves

LAs in England enjoy the freedom of dipping into their reserves when needed to compensate for the gap between their income and expenditure necessary to carry out their projects or service delivery. A recent report explained that more than half of councils in England are planning to use their reserves to cover their expenses in the next year, along with the reliance on council tax and business rates ([Twinch, 2020](#_ENREF_292)).In 2018, it was reported that LA reserves will soon be drained, should they continue to use them at the same rate as they have done in the last three years with counties being at a greater risk ([Brady, 2018d](#_ENREF_38)). Grant Thornton’s annual audit letter to Shropshire Council concluded that *“The current financial strategy projects that reserves will have been fully depleted by 2020/21”* ([Marrs, 2019s](#_ENREF_187)). Another report showed that two thirds of councils’ spending on services exceeds their income. If the trend continues, this imbalance between income and expenditure shows that by 2028, LAs will have reduced their reserves by 84% ([Marrs, 2019h](#_ENREF_176)).

Nevertheless, in 2020, a Ministry of Housing, Communities and Local Government (MHCLG) report on LAs reserves in England showed an increase of 7.4% from 2019 ([Twinch, 2019b](#_ENREF_291)), which is the highest level since the beginning of austerity in 2010 ([Marrs, 2019j](#_ENREF_178)). However, many reports doubted this increase reflected that LAs were in a better financial state. The former Boston Borough Council Chief Executive, Richard Harbord, said *“We have to be cautious about these figures. As local authorities get more desperate; they are making provisions for costs they know are looming… I don’t believe local authorities have money sloshing around. They must be doing it to guard against future losses or adverse business rate appeals”* ([Marrs, 2019j](#_ENREF_178)). Similarly, CIPFA Chief Executive, Rob Whiteman, mentioned that LAs are increasing their reserves levels due to the absence of long-term funding settlements for the sector, and the uncertainty about the spending review, coupled with the expectations that austerity is not going to end soon ([Twinch, 2019b](#_ENREF_291), [Marrs, 2019j](#_ENREF_178), [Smith, 2019a](#_ENREF_272)).

## Local authorities borrowing.

LAs borrowing does not represent a *“new money”*, rather it changes the time at which money becomes available. However, borrowing provides LAs with the needed flexibility and feasibility in how and when they make use of resources.LAs could borrow from different lenders including Central Governments, banks, financial institutions, individuals ([NAWFC, 2012](#_ENREF_212)).

A large number of subnational governments are struggling to access traditional lending sources, either because of the collapse of the monoline insurers that offered the necessary guarantees for borrowing, or poor credit rating and/or indebtedness ([Sauter et al., 2014b](#_ENREF_258)). Furthermore, caps on borrowing might apply and can limit the amount the LAs can borrow, in addition to the limited level of autonomy that most of the local authorities have in their ability to collect their own taxes or other means of revenues ([Scott and Rao, 2011](#_ENREF_263)). Thus, there are serious calls for more financial decentralization and the devolving of more powers and responsibilities towards lower tiers of governments in order to give them the ability and flexibility to plan for their future.

So far, local governments are able to borrow from both their central bank and from international banks. However, both options have some drawbacks. Borrowing from banks is thought to be the easiest means of borrowing but it is often found to be highly inflationary, short term, expensive, and can cause budget distortions ([Dziobek et al., 2010](#_ENREF_82), [USAID, 2010b](#_ENREF_299), [Biais et al., 2006](#_ENREF_28)).

Bank lending presented one of the main funding sources for LAs. In the UK, LOBOs (Lender Option Borrower Option) were widely used. [Maziad et al. (2013)](#_ENREF_200) explained that banks are no longer comfortable in lending to LAs as they did before GFC. Nonetheless, many reports warned about LOBO unfairness and consequences on borrowers. Don Peebles, Head of Policy and Technical at Chartered Institute of Public Finance and Accountancy (CIPFA) explained that in the wider context, previous LOBO loans might look appealing at the first glance. However, more and more complexities are added to said loans, making them less appealing. In one example, 14 LAs using Barclays Bank LOBOs claimed that the loans were fraudulent as its traders had been *“rigging”* Libor (London Interbank Offered Rate). LOBO interest has an inverse relation with long-term interest rates. After LOBOs popularity, long-term interest rates have fallen to record low and stayed there, which meant LAs liability to pay millions to LOBOs as interest. Should they refuse to pay that interest, they have no other option but to pay back the loans in full ([Brady, 2018b](#_ENREF_36)), or incur a break penalty at the very least ([Pickard, 2018](#_ENREF_230)). Similarly, Christian Wall, Director at PFM, and Joel Benjamin, a campaigner for social change and part of the People Vs PFI campaign, both described LOBOs as complicated products with punitive one-sided terms ([Brady, 2018b](#_ENREF_36), [Wall, 2019a](#_ENREF_305)). David Blake, Strategic Director at treasury manager Arlingclose, noted that LAs should avoid such loans as they will come back under different names in the future ([Marrs, 2019a](#_ENREF_169)). Some of these loans were subject to legal action, as despite offering low interest rates compared to PWLB, lenders can change the rate on pre-determined future dates, normally within 5 years. As a result of LOBO products being under media scrutiny, two years after RBS removed its LOBO loan portfolio, Barclays in 2016 also scrapped those loans. The latter even allowed borrowers to pay back the loans earlier than the contracted date, and at a discounted rate as in incentive ([Pickard, 2018](#_ENREF_230)). This shows the limitation of banks’ lending to LAs has been offering less, and often these offerings have been unfair. Therefore, some LAs are reasonably looking for other sources of funding that more aligns with their needs and projects.

In England, LAs have the freedom to borrow any figure from any lender to deliver on their projects, as long as they comply with the prudential Code. This is clarified in the Local Authorities Act (2003) which states that *“A local authority may borrow money (a) for any purpose relevant to its functions under any enactment, or (b) for the purposes of the prudent management of its financial affairs”* ([Parliament, 2003, P7](#_ENREF_223)). At the same time, [Sandford (2016)](#_ENREF_253) explained that the Local Authorities Act puts a limit on each LAs borrowing in line with the prudential code. Such limit is directly linked to the revenue streams available for each authority to enable them to repay their debt. Furthermore, the Act prohibits LAs from using any of their assets to secure their debt.

With such freedom, alongside pressing needs, [Tanner (2018)](#_ENREF_283) explained that LAs’ capital spending requirements are drastically increasing annually by around £700m, and almost doubling every three years. This led to a significant increase in their advance borrowing, some of which is motivated by cheap rates. However, CIPFA warned that LAs should not borrow excessively in advance of their needs just to benefit from savings on the extra sums borrowed ([Brady, 2018e](#_ENREF_39)). Gwyn Llewelyn, a Director in the Infrastructure Advisory Group at KPMG, suggested that in considering non-cost factors, LAs are keen on the idea of raising funds directly from the market and not overly relying in the central government. With the devolution agenda, whereby LAs are becoming more autonomous, such options allow LAs to be more self-sufficient to fund the projects they feel are needed to boost their local economies and communities ([Llewelyn, 2017](#_ENREF_152)).

## Decentralization and fiscal freedom

Decentralization in general is known as *“the transfer of powers from central government to lower levels in a political-administrative and territorial hierarchy”* ([Yuliani, 2004 ,P1](#_ENREF_322)). Some scholars claim that local governments are more efficient than higher levels of government at providing certain public services ([Oates, 1999](#_ENREF_216), [Klugman, 1994](#_ENREF_132)), taking into account the population mobility between different local governments searching for the best delivery of public services. This leads to competition between local governments to meet community and individual preferences. Thus, in response to the various territorial demands, governmental resources could be saved by diverting its outputs ([Tiebout, 1956](#_ENREF_287)).

When it comes to decentralisation, there are various types associated with different traits, effects and preconditions. Decentralisation can be applied in different domains such as political, administrative, fiscal, and market decentralisation ([World Bank, 2016](#_ENREF_313)). Fiscal decentralization is found when the previous centralised taxation rights were at the disposal of the state only and have been delegated to subnational levels of government such as local authorities. This happens when the latter is granted the rights to collect and retain taxes to deliver on their responsibilities and duties ([Yuliani, 2004](#_ENREF_322)). It’s argued that the creating and *“effective and transparent financial management”* is strongly needed to improve the public sector standards, ([UNDP, 1999](#_ENREF_297)), and that it is essential that local government have the ability to raise funds locally and make their own decisions about expenditure ([World Bank, 2016](#_ENREF_313)).

It is claimed that administrative and fiscal decentralisation from national to regional and local governments have a reasonable influence on reducing the impacts of overconcentration of capital and maximising the contribution of local bodies to national competitiveness and welfare ([Parkinson et al., 2012](#_ENREF_221)). The envisaged benefit of fiscal decentralisation is that it would clarify in advance the amount of money that will be available to LAs, which in turn, makes strategic planning possible. In addition to the ability of communities to take autonomous decisions on the use of its limited resources ([UNDP, 1999](#_ENREF_297)), fiscal decentralization can take many forms, including:

**a**) self-financing or cost recovery through user charges;

**b**) co-financing or co-production arrangements through which the users participate in providing services and infrastructure through monetary or labour contributions;

**c**) expansion of local revenues through property or sales taxes, or indirect charges;

**d**) intergovernmental transfers that shift general revenues from taxes collected by the central government to local governments for general or specific uses; and

**e**) authorization of municipal borrowing and the mobilization of either national or local government resources through loan guarantees ([World Bank, 2016](#_ENREF_313)).

Nevertheless, the absolute economic outcomes of fiscal decentralization are still unrevealed. It has been claimed that *“Although decentralization is often associated with increased degrees of policy innovation, greater transparency, and better capacity of governments to adapt policies to local needs, it can be difficult to connect these factors with increased economic performance”* ([Rodríguez‐Pose and Krøijer, 2009, P25](#_ENREF_240)).

In the current scenario, there is an ever-growing gap between what is expected from local authorities and their finance due to the lack of sufficient central governmental contributions that answer to the subnational financial requirements. Hence central governments are gradually embracing the idea of local government borrowing and accessing private financing for investment ([Venkatachalam, 2005](#_ENREF_301)). Bonds are one source of borrowing that could, and have, been used by local authorities to fund their projects and to deliver their services with more financial autonomy. However, efficient bond market access by LAs is thought be subject to them having the right tools and necessary powers to enhance their fiscal position and strengthen their credibility.

## Fiscal decentralization in England

Fiscal decentralization is becoming ever more popular when the subject is the allocation of resources for cities and regions ([Martin et al., 2015](#_ENREF_197)). At the beginning of the 21st century, and along with the emergence of new independent states, a new trend of power transfer to subnational authorities emerged. Even those states that enjoyed a good level of subnational autonomous, they witnessed more power transfer towards regional governments ([Rodríguez-Pose and Gill, 2003](#_ENREF_239)). When it comes to the UK, it is known that, comparing to other developed countries, it has a restricted autonomy on local expenditure despite that most of said expenditure is being handled by subnational authorities ([Alonso and Andrews, 2019](#_ENREF_12)).

Local authorities in England are functioning within one of the most centralized systems across Europe. When compared to their equivalents in Germany, France, and Spain, English local authorities have considerably less control over their finances ([Blöchliger et al., 2010](#_ENREF_32)). The case in England poses a question related to how such top-down imposed fiscal policy works locally and whether it holds back local authorities’ practices in their delivery of public services, urban development, and economic potential. The fiscal devolution deal in England is complicated in its nature as it entails different tools and models applied to subnational fiscal policy. The picture includes different deals and players who add to the picture complexity. In addition to the Prudential code and the existence of PWLB, there is the Community Infrastructure levy, the Regional Growth Fund, The Growing Places Fund, and the Local Growth Fund. Also, there is the Tax Increment Financing (TIF) and special deals for cities like Newcastle and Sheffield and Greater Manchester. In addition to all of that, is the advent of the new UK Municipal Bond Agency ([Muldoon-Smith and Greenhalgh, 2015](#_ENREF_211)).

When comparing English LA to its counterparts in Europe, the former is found to be larger in size and carry much more responsibilities that ranges from Education and social care to environmental and cultural services in addition to housing. Despite the larger size, wider-spectrum of responsibilities they carry, and the highly centralized fiscal environment they work within, LA in England handle around quarter of the overall public sector budget and has proven to be able to adapt and respond to rapid changes. They also vary in terms of their size, responsibilities, and the level of fiscal autonomy that ranges from 7% for some authorities to almost 41% in other LA in England ([Alonso and Andrews, 2019](#_ENREF_12)).

LA in England, since 2010, has been hit hard by the austerity measures, localism agenda, and deficit reduction movement which put them through a process of fundamental reforms resulting in reduction in LA’s size and therefore role in urban development. Hence, they are now more than ever thriving for the right decentralized financial arrangements. One of the key financial arrangements is the retained business rate retention scheme (BRRS) that came to replace the previous Local Government Formula Grant funding in England. The BRRS varied in its application from the typical ring-fenced TIF model in North America. Instead, the BRRS works on a pre-defined return rate that is kept locally and the difference is sent to the central government for reallocation. This meant that unlike the TIF model that aims to benefit the deprived areas, the BRRS benefits the prosperous areas ([Muldoon-Smith and Greenhalgh, 2015](#_ENREF_211)).

Despite the popularity of fiscal decentralization and financial devolution, [Rodríguez-Pose and Gill (2003)](#_ENREF_239) argue that it carries risks associated with less accountability due to the double management and responsibilities as well as corruption. In addition to that, there is a risk associated with LA running into debt trouble and near insolvency hoping for central government rescue deals ([Rodden, 2002](#_ENREF_237)).

The evidence, however, suggests that when governments seek to force some form of resources balancing mechanisms between its subnational governments less efficiency is achieved by both rich and deprived regions ([Widmer and Zweifel, 2012](#_ENREF_311), [Muldoon-Smith and Greenhalgh, 2015](#_ENREF_211))

When it comes to England, fiscal decentralization became ever more important since 2010 and the continuous austerity measures ([MacKinnon, 2015](#_ENREF_159)). Different studies have supported further regional and local fiscal-autonomy as it favours local markets’ development ([Jones et al., 2005](#_ENREF_125)), empower cities and support the efforts to close the gap between regions ([Alldritt, 2014](#_ENREF_11)), improves regions’ accountability and efficiency ([Travers, 2013](#_ENREF_288), [Sow and Razafimahefa, 2015](#_ENREF_277), [Alonso and Andrews, 2019](#_ENREF_12)), and allow LA a better role to self-govern and be more adaptable to changes ([DCLG, 2011](#_ENREF_73), [Pollitt, 2005](#_ENREF_231)).

The argument is that, in England, fiscal decentralization will *“Give power, money and knowledge to those best placed to find the right local solutions; and improve the relationship between government and those being governed”* ([DCLG, 2011 : p9, as cited in Alonso and Andrews, 2019](#_ENREF_73)). [Alonso and Andrews (2019)](#_ENREF_12) continue and argue that decentralization will provide local leaders with the power they were deprived and urgently need at a level that is found in their peers in Europe and North America.

# 2.3 A background on Municipal bonds and their requirements.

With the growing importance of rapid infrastructure services, there are challenges for governments in meeting financial needs posed by these services. Issuing bonds in local markets is considered the most efficient funding means for governments ([USAID, 2010b](#_ENREF_299)). In this light, many countries are trying to develop a sound municipal bond market as an alternative source of funds for LRAs ([Leigland, 1997](#_ENREF_146)). Municipal bonds are defined as *“a promise by state or local government unites (called the issuer) or other qualified issuers to repay to lenders (investors) an amount of money borrowed, called principal, along with interest according to a fixed schedule”* (Temel and Association, 2001: p1). Similarly, [Elmer (2005)](#_ENREF_90) defines bonds as a loan between the borrower or issuer, and the lender or investor.It is similar to a promissory note; a promise by the issuer to repay the investor theprincipal loan amount by the end of a fixed period of time, plus interest. The repayment of municipal bonds (bonds maturity) is subject to each bond terms and can be anywhere between one to forty years from the date of the issuance (Temel and Association, 2001).

More policymakers are drawn into the importance of growing a domestic bond market an what it can offer to subnational governments ([World Bank, 2001](#_ENREF_314)). Both central and local government issue bonds for various aims. This can range from borrowing to provide students loans and pollution control projects, to education, water and gas resources, and economic projects such as industrial and health facilities. Such bonds are paid back by taxes or the income generated out of fees, exactions, and rental ([Elmer, 2005](#_ENREF_90)).Unlike loans that are backed by assets owned by the borrower, MBs are normally backed by the *“faith and credit”* of the issuing entity whether its local or central government ([World Bank, 2001](#_ENREF_314)).

Gaps in timing, and size of revenues and expenditures mean that local government have a lack of funds for both short- and long-term needs. The development of a bond market is normally motivated by matching the demand of issuers who are in need for a long-term loans with investors who are willing to commit for the long term of the bond while receiving interest on those bonds. The development of such bond market and growing it to maturity can pool investors and borrowers needs to fund a wide range of governmental and private sector projects ([USAID, 2010b](#_ENREF_299)). However, the purpose of developing a governmental bond market should not be increasing authorities borrowing, but authorities and taxpayers obtaining the best interest rates ([LGCA, 2012](#_ENREF_149)).

Developing the subnational bond market is a complicated process highly correlated to the financial and market development of each country. Governments might face several kinds of challenges, such as the reliance on a few domestic banks for funding, the absence of sound market infrastructure, the paucity of institutional investors, or low domestic saving rates ([World Bank, 2001](#_ENREF_314)).

Municipal bonds can usually be divided into two categories depending on the funding targets. While the General Obligation bond (GO) aims to fund everyday expenditures, Revenue Bonds (RV) are issued to finance a specific project ([Cocconcelli and Medda, 2012](#_ENREF_61)). Convention of Scottish Local Authorities (COSLA) Infrastructure Task Group’s report in 2014 concluded that issuing bonds would be expensive and administratively and legally burdensome to introduce, and may only be applicable for very large infrastructure projects ([Bibby and Sharma, 2014](#_ENREF_29)). However, the issuance cost varies widely between different bond types. A comparative study in North Carolina for the cost of issuance of different bond types shows that general obligation bonds are associated with lower issuance cost, while revenue bonds have higher issuance cost ([Elmer, 2005](#_ENREF_90)).

In light of the above, it is essential to look at how municipal bonds differ internationally and assess them in relation to the development of each market. The following section attempts to unwrap the reasons behind different bonds applications and discuss various aspects of success and failure.

## 2.3.1 Municipal bonds applications in different countries and sectors.

## United States of America:

In the US, bonds are issued by LAs, regional authority, or their agencies aiming to fund certain public expenditures and projects. Since World War II, both the size and the importance of the municipal bond market have increased noticeably. However, after the 1980’s municipal bonds bankruptcy cases, issuers needed further insurance in order to make bonds more appealing to investors, improve their credit rating, and make bonds more efficient. The bond insurance provider is liable to repay the principal and the interest if the issuer defaults ([Cocconcelli and Medda, 2012](#_ENREF_61)).

In the US, a study highlighted the attractiveness of both demand and issuance of municipal bond as below.

For investors, it as a well-developed market which has an over 200 years of legal and procedural progress, an active secondary market, and enjoy a good level of freedom due to the absence of any governmental control. In addition to that, most of US’s bonds are tax exempted, have a strong credit quality being backed by taxes and revenues, different coupon structures, and a wide range of maturities ([Cocconcelli and Medda, 2012](#_ENREF_61)). Furthermore, it offers a good level of investment risk information and the availability of financial intermediaries who offer assistance in interpreting this information. Also, from the issuers point of view, US municipal bonds have an extended maturity that offer a long debt amortization and have tolerable borrowing costs being the interest rates and associated issuance costs. In addition to the assistance available for small borrowers such as bond banks and pooled borrowing, these features of the US bond market are considered to be positive and therefore attract municipalities in the issuance of bonds ([Leigland, 1997](#_ENREF_146)).

Nevertheless, the US municipal bond market has some negative characteristics, such as low liquidity and high transaction costs which affect municipal bonds pricing and trading. In addition to that, US bonds are traded in a secondary, decentralized, illiquid, and opaque over-the-counter market. This market has numerous relatively small issues of MB which contribute to further opacity, complexity, and fragmentation of this market, all of which put investors in a difficult position due to the limited access to market information and practices ([Cocconcelli and Medda, 2012](#_ENREF_61), [Ang and Green, 2011](#_ENREF_15))

To mitigate the impact of such market challenges, [Ang and Green (2011)](#_ENREF_15) proposed the establishment of CommonMuni, a non-profit and independent advisory firm. The purpose of such establishment is to help municipalities to lower bond costs and to achieve the advantages that economies of scale bring to local authorities by acting together. In addition to that, it would help increase investors’ returns by providing them with advice and information about bond issuers and transaction prices in order to increase transparency. An advantage for both issuers and investors is that this will increase liquidity in both primary and secondary bond markets ([Ang and Green, 2011](#_ENREF_15)).

## Emerging economies

[Leigland (1997)](#_ENREF_146) argued that there is increased evidence of the advantages of initiating the/a municipal bond market in emerging economies. Although such initiative might not be similar to US market characteristics, emerging economies are using the US market as a guide to suggest the type of market that would be attractive enough for investors.

Different emerging economies, such as South Africa, Poland, Thailand, and Philippines, have had varying MB experiences Although most were successful in the goal of securing alternative source of finance, local authorities were confronted with some drawbacks within those markets. For issuers, the uncertainty about the feasibility and cost efficiency led to low attractiveness to investors, resulting in unsold bonds. Investors’ behaviour was led by factors such as the lack of transparency, creditworthiness, or high fees paid to intermediaries. Furthermore, the development of such bond markets suffered from the lack of unified, high-level support for municipal bonds and the paucity of financial expertise and skills to accurately assess the financial situation of each jurisdiction ([Leigland, 1997](#_ENREF_146)).

## Romanian bond market

In Romania, movement towards decentralization and more local autonomy gave local authorities the freedom to access municipal bonds as an alternative source for funding their projects. The Romanian bond market enjoyed the benefits of support provided by international financial institutions, such as European Investment Bank and the European Bank for Reconstruction and Development, especially when the latter decided to list launched bonds in 2007 and 2009 on the Bucharest Stock Exchange ([Mosteanu and Lacatus, 2009](#_ENREF_210)).

The main characteristics of the Romanian municipal bond market presented by [Mosteanu and Lacatus (2009)](#_ENREF_210) are:

1. dematerialised and dominated by local currency
2. many MBs are listed and traded at the Bucharest Stock Exchange, a signal for investors that shows the financial power of the issuer
3. the sale of bonds is usually made by way of banks such as the Romanian Commercial Bank and the Romanian Development Bank
4. the loans are reimbursed in equal half-yearly or quarterly instalments
5. bonds are guaranteed with the local authority’s full taxing power

However, not all bond market characteristics were advantageous. Investors suffered from the lack of transparency and the lack of secondary market development, both of which resulted in low gains when bonds are traded in the secondary market. Thus, investors preferred to buy bonds from a primary market and keep them until maturity ([Vasile and Matei, 2010](#_ENREF_300)).

From an issuers’ viewpoint, there was the uncertainty about cost, the ability to issue bonds, the ability to live up to the responsibilities of issuance, and the differences in municipal bond demand and supply between different city sizes. To overcome those barriers, smaller cities had small issues and they addressed them to the local investors rather than to the national market. By doing that, smaller cities substituted the rating to make savings by avoiding the listing costs. On the other hand, big cities, in order to attract international investors and to achieve higher ratings, chose to list their bonds in the international market, which is reflected by increased issuance cost ([Vasile and Matei, 2010](#_ENREF_300)).

The Romanian municipal bonds market evolved over time and so managed to provide investors with an attractive instrument; it being safe, tax saving, and giving high returns as compared to savings accounts. It is even more attractive for local investors as it has been used for significant local investment, construction projects, hospitals, and schools ([Mosteanu and Lacatus, 2009](#_ENREF_210), [World Bank, 2016](#_ENREF_313)). Due to that, there was a gradual increase in municipal bond values and volumes. As a result, in the medium and long-term, it is claimed that the MB shows more efficiency than other means, such as increasing local taxation. This is mainly because their support effects of the community and they play a role in enhancing the development of self-supporting economic movements ([Mosteanu and Lacatus, 2009](#_ENREF_210)).

## Sweden and Kommuninvest:

The founding of Kommuninvest, a local government funding agency (LGFA) in Sweden in 1986, has transformed approaches to municipal debt finance in Sweden ([Andersson, 2011](#_ENREF_14)). Kommuninvest was founded by nine municipalities, and Orebro County Council, with the aim to improve conditions for local government loan financing ([Kommuninvest.se, n.d.-d](#_ENREF_140), [Standards&poor's, 2015](#_ENREF_278)).

Kommuninvest is a subsidiary of Kommuninvest Cooperative Society (KCS) and works on a non-profit basis ([Kommuninvest.se, n.d.-c](#_ENREF_139)) to provide funding to its members.

The company has experienced continuous growth since its membership was opened for any willing Swedish local authority in 1993. By June 2015, 94% of Swedish local authorities were members of the KCS. As of 2015, the KCS had 280 members and showed a significant growth in local government sector borrowing via Kommuninvest ([Standards&poor's, 2015](#_ENREF_278)).

During 2010, the agency could raise more than £13bn debt to fund Swedish local authorities and other municipal bodies, which account for 54% of all local authority borrowing. Kommuninvest, by borrowing on a large scale on behalf of some municipalities, managed to lower the funding costs for them. Also, by bringing alternative funding sources to the market, the agency increased competition for banks. As it works in the interests of the public and its owners (local authorities), Kommuninvest provides a stable and cost-efficient funding tools in addition to professional advice and skills development. Each member of Kommuninvest, regardless of their size or business volume, vote to determine the general focus of Kommuninvest operations, and bears the ultimate responsibility for the business as well. Kommuninvest has a long history of helping its members to lower borrowing costs and providing them with stable funding tools, regardless of uncertain conditions. In 2014, the cost of municipal bonds through Kommuninvest was 0.15 percentage points lower than the average proprietary funding costs of the five largest member authorities ([Kommuninvest.se, n.d.-a](#_ENREF_137)).

Furthermore, the agency, through monitoring its members and setting the standard even for the non-members, has contributed to the development of the creditworthiness of Swedish municipalities and helped to increase the financial expertise in municipalities either by direct business work or by arranging training seminars. Kommuninvest approach allowed pooling different local authorities borrowing needs to secure lenders from local and international bond markets. The approach of which all pool members guarantee each others debt, Kommuninvest managed to spread and reduce the risk allowing the entity to achieve a AAA credit rating from both S&P and Moody’s rating agencies. This helped Kommuninvest to attract international investors whereby 30% comes from Japan and 20% from USA ([Andersson, 2011](#_ENREF_14)).

[Carr (2011)](#_ENREF_53) argues similarly that as a result of the agency’s success, 267 of the 310 Swedish municipalities had joined the scheme by 2011. Even in the tough financial climate of 2010, Kommuninvest’s lending has risen by 8%. However, there are number of characteristics which account for the Swedish experience that differ in other countries/economies. Firstly, the size of the authority itself is paramount to such a scheme. Kommuninvest works precisely because local municipalities can combine into a larger unit that can therefore offer the required security to gain the prized AAA rating. This view is confirmed by S&P and Kommuninvest’s own evaluation, as they argue that Kommuninvest has established a reliable and credible position in the Swedish financial market thanks to the highest possible rating, backed by a joint and several guarantees agreement. This is led by the fact that none of its members can possibly default on their debt, as they have all agreed to using their taxing power to meet their obligations ([Kommuninvest.se, n.d.-b](#_ENREF_138), [Standards&poor's, 2015](#_ENREF_278))

Secondly, Swedish municipalities have a level of autonomy compared to their equivalents. While Swedish municipalities have unlimited power to set local income taxes, they are also legally unable to default on their debt. That makes the Swedish bonds more attractive for investors since their return is guaranteed ([Carr, 2011](#_ENREF_53)).

Further, Kommuninvest claim that its financial services go beyond achieving benefits for its members as they carry both social and environmental outcomes. This benefits citizens as they have had access to improved public services at local and regional levels ([Society, 2015](#_ENREF_276), [Standards&poor's, 2015](#_ENREF_278)). In addition, Kommuninvest started to offer green loans and green bonds for investment projects with a positive impact on climate and environment. The success of the Kommuninvest model caused many other countries, such as UK, France, and Canada, start or plan to start operations similar to the Kommuninvest’s model ([Kommuninvest.se, n.d.-a](#_ENREF_137)).

## England housing sector bonds

[Aalbers (2016b)](#_ENREF_6) argues that the historical reliance on depository institutions from the housing sector has been witnessing a shift towards non depository institutions. This shift mainly happens by generating loans that can be sold to the financial markets as bonds or mortgage-backed securities. In Europe, bond financing for housing sector increased from 12% in 2000 to 27% in 2011 as a percentage of the overall borrowing. Countries like Denmark went even further whereby almost two thirds of housing sector financings came from bonds ([Mortensen and Seabrooke, 2009](#_ENREF_209)). [Wainwright (2009)](#_ENREF_302) discussed that the housing bond movement, which started in the US, reached the UK by the 1990s. Nonetheless, the way it evolved in the UK differed from the US and therefore left the financial institutions exposed to different credit and market risks.

Since the 1980s, the funding allocated by central government to Housing Associations in the UK has been gradually reduced ([Aalbers, 2016a](#_ENREF_5)). This pushed HAs to start looking for alternatives, such as commercial loans from banks to meet their funding gap, indicating the start of the privatization of HA funding streams. Post GFC, such funding cuts were accelerated and banks increased their lending costs on HAs, prompting them to seek to use the financial market via their bond funding programs ([Wainwright and Manville, 2017](#_ENREF_304)). Although investors demand on HAs bonds declined after the GFC ([Wainwright, 2015](#_ENREF_303)), shortly afterwards the global economic recovery highlighted an increase in the UK’s HA bond market activities, and witnessed rapid growth in terms of demand ([Aalbers, 2016a](#_ENREF_5)). Some global investors, such as pension and insurance funds, started to incorporate HAs bonds into their portfolios, which led to the privatisation of HAs funding ([Wainwright and Manville, 2017](#_ENREF_304)).

Gradually, the HA bond market witnessed an increase in some market actors such and financial institutions ([Clark and Monk, 2014](#_ENREF_58), [Dixon, 2012](#_ENREF_78)), and other intermediaries known as *“the fee-earning capital market intermediaries”* ([Folkman et al., 2007 , P2](#_ENREF_98)). One of the early fee-earning intermediaries in the UK is The Housing Finance Corporation (THFC) established in 1987 *“co-owned by the National Housing Federation, a representative body for HAs, and a regulatory body: The Housing Corporation”* ([Wainwright and Manville, 2017, P10](#_ENREF_304))*.* THFC plays the role of an aggregator who would issue bonds on behalf of HAs to institutional investors, and then lend funds back to individual HAs. This helped HAs to borrow using their assets as loan security and build a new housing units. They would pay back their debt from rent overflows. Thus, THFC played the role of a capital market intermediary connecting investors with HAs and facilitating lending, but it took them a while to establish such bond market ([Wainwright and Manville, 2017](#_ENREF_304)).

Small- or first-time issuers often need the help of specialist consultants to assess the associated costs of a bond program and its repayments. Then, the decision of whether to issue individually or using an aggregator such THFC, can be undertaken. On the other hand, those who have larger size and/or experience in the bond market tend to go with the single lane bond program, with the help of banks to arrange the financial transaction, rating, legal documents, and match it with investor demand. Most housing bonds are bought by insurance funds due to the low return-risk that suits such investors, and due to the similarity between bonds offering of 25-30 years of maturity and investors’ liabilities. Although historically those investors were mainly UK based, the listing of newer bond programs attracted international investors, primarily from Canada and US ([Wainwright and Manville, 2017](#_ENREF_304)). THFC provided HA with good bond pricing although it has fluctuated across the years. While in 2013 it achieved 120BPs pricing ([GCA, 2013](#_ENREF_103)), in 2014 THFC priced its bonds at 37BPs ([Gallagher, 2014](#_ENREF_101))¸ in 2017 at 120BPs above gilts ([Owen, 2017](#_ENREF_220)). Recently, some HA such as ‘Cross Keys’ and ‘A2Dominion’ successfully placed green bond deals in the market, which is believed to have met a high investor demand ([Hay, 2014](#_ENREF_115)).

Considering the preceding experiences, internationally and within England, different bond development and implementations programs in different contexts, and different characteristics that have emerged in various contexts, it is important to assert on the almost unified special features of MB markets related to issuers, investors, and other stakeholders. The next section will explore those stakeholders and their interests in the bond market, mainly the Public Work Loan Board and the UK Municipal Bond Agency.

## 2.3.2 England Bond market development

LAs in England are functioning within a very centralised fiscal environment and are restricted by the lack of powers available to them. Furthermore, unlike the central government, they cannot run deficits when budgeting their revenue and expenditure. Therefore, English LAs have continuously been relying on a mix of spending cuts and draining their reserves. As reserves are not unlimited and using them leaves LAs vulnerable, ever greater cuts in expenditure seemed the only way forward compared to increasing tax ([Atkins, 2020](#_ENREF_18), [McNichol and Lav, 2008](#_ENREF_202)). Such a position limits an LA’s ability to stimulate local demand and or invest in their future ([Cox and Schmuecker, 2013](#_ENREF_65)). While carrying a great burden of various social, economic and environmental agendas, English LAs’ lack of access to income streams undermines their financial position and limits their ability to grow ([LGA, 2012](#_ENREF_148), [Biais et al., 2006](#_ENREF_28)). The funding gap created post GFC kept growing significantly over time leading to LA cutting fifth of their expenditure budget as a result of the abolishment of the central government general-purpose grant in 2019 ([Amin-Smith and Phillips, 2019](#_ENREF_13), [Association, 2018](#_ENREF_17)).

The argument is that , unless LAs are relieved of some of their duties concerning service delivery, or grants continue to be received from the central government, both of which deemed unsustainable, LAs will need to find additional sources of revenues themselves ([Amin-Smith and Phillips, 2019](#_ENREF_13), [Karger, 2014](#_ENREF_129), [Council of Europe, 2011](#_ENREF_64)).

It is argued that the funding gap at the local level could be filled by private investment which already has an increasing role in financing, accounting for two-thirds of all infrastructure investment in the EU, whereas the government’s contribution is around one third ([Sauter et al., 2014a](#_ENREF_257)). Although there is no universal model for local public finance applicable to all EU countries ([Elena, 2014](#_ENREF_89)), it is claimed that, with more fiscal decentralisation, borrowing can provide local and regional authorities in England with strong incentives for improving project design, cost-recovery practices, and budget transparency ([Dirie, 2005](#_ENREF_77)). Borrowing to invest can be a sensible funding source if it is underpinned by evidence based on national and local infrastructure strategies ([O’Brien et al., 2014](#_ENREF_215)). Nevertheless, it is essential that such borrowing enables local authorities to lower costs and provide them with the required flexibility as a response to the consecutive changes in financial conditions ([Cox and Schmuecker, 2013](#_ENREF_65)).

In general, bond issuance in domestic markets is considered the most efficient funding means for local governments, compared to borrowing from banks and other commercial sources; the borrowing amounts are larger, the maturities longer, and cost lower ([USAID, 2010a](#_ENREF_298)).

The successful development of a municipal bond market will rely on some basic conditions underline the conditions relating to issuers, intermediaries, and economic circumstances. In general, those conditions require the demonstration of the following:

1. The issuers’ ability to make regular payments to investors, which in turn depends on the stability of issuers cash flow and revenues as certified by rating agencies;
2. The secondary market liquidity which determines the ease of buying and selling municipal bonds;
3. Macro-economic factors such as inflation, interest rates as well as the return on assets belonging to the similar risk class to bonds ([Banerji et al., 2013b](#_ENREF_21), [USAID, 2010b](#_ENREF_299));
4. An institutional structure that provides well defined roles, responsibilities and delegations for the institutions involved in public debt management;
5. An unobstructed flow of information and reporting lines, monitoring and control policies, and documentation of procedures;
6. In addition to the above, the existence of a well-established banking system is important. All of this should be supported by an appropriate technical and regulatory framework ([USAID, 2010b](#_ENREF_299)).

One of the key requirements for building a functioning local bond market is subject to building a stable yet diversified investor base to create demand for bonds from various sources such as institutional investors such as banks and pension funds, non-financial investors such as retail investors and nonfinancial entities, as well as international investors. Such consideration needs a careful consideration for investors preferences and issuing bond strategically to meet such preferences. Along with that, there is a need for creating the right conditions for sustaining relations between issuers and investors and having the right communication channels that facilitate that. Attracting foreign investors can bring a substantial expansion to the investor base which is associated with enhanced demand and liquidity. Nonetheless, overreliance on them might increase financial stress especially during hight volatile and rapid changes in foreign capital flows. This poses the need for policymakers to create a strategy the answers to the ideal balance and mix of local and international investors in the market ([Maziad et al., 2013](#_ENREF_200)).

Pricewise, the majority of municipal bonds are initially issued in the primary market and so their price will be market driven. For investors, it is mostly more cost-effective to buy these bonds in the primary market, but because of the fact that institutional buyers dominate the market, it is difficult for individual investors to compete with them for the limited bond supply. Therefore, most individual investor trading is limited to the secondary market, whereby they can only buy resold bonds ([Bennyhoff, 2009](#_ENREF_25)). For non-institutional investors, trading in the secondary market for municipal bonds can be very problematic and expensive. The secondary market is usually not transparent enough, especially in pricing and execution. Successful trading in the secondary market requires deep knowledge, understanding, and experience as to how it operates. Therefore, individual investors, see trading in the secondary market as complicated and costly process. ([Bennyhoff, 2009](#_ENREF_25)).In line with that, [Ang and Green (2011)](#_ENREF_15)found evidence that such practice normally results in individual investors paying more than double what institutional investors pay to buy the same bond.

Municipal bond markets are quite different in practice from corporate bond markets, despite some similarities in principles. Those differences are mostly felt by the shareholders and stakeholders. In the corporate bonds market, investors can decide when to invest and if they became unhappy, they have different ways to express that; by election voting, making proposals during meetings, or selling the securities. Such tactics are either unavailable for MB investors, such as voting and proposing changes, or difficult, such as reselling municipal bonds. This is due to the lack of secondary market liquidity. Furthermore, once Municipal bonds’ shareholders, voters, and taxpayers buy-in to the municipal enterprise through the purchase of residential real estate or the use of municipal services, their choices are also limited. They have to pay levies regardless of whether they are satisfied. If the bond issuance is subject to voting, only then will they have the say to vote against the issuance. Therefore, they might have to wait until the next election if they wished to unseat the government. If the taxpayers is unhappy with the states of affair, they might have no choice but to sell their residential property to move out of town, which in turn could involve significant expenses ([Chung, 2012](#_ENREF_57)).

Despite the previous generic review of the preconditions and the requirements of developing a sound municipal bond market that can provide issuers with the required access to the capital markets and attract investors to safe and reliable investments, when it comes to England there is one major player being the PWLB. In the following section, a review of the PWLB and its impact on the development of the municipal bond market in England will be carried out.

## 2.3.3 Municipal bonds VS Public Work Loan Board

The Public Works Loan Board is a statutory body of the UK government. It was Created in 1793 mainly to provide loans to local authorities. Funds are provided by Act of Parliament and drawn from the National Loans Fund, which is HM Government’s main borrowing account, and is administered by HM Treasury. Almost all loans go to local authorities who use those funds towards their capital expenses ([LRD, 2015](#_ENREF_156)).

Local Government in England Capital Finance report in 2016 concluded that the vast majority of loans taken out by LAs have been provided by the PWLB, encouraged by its low rate of interest available to them ([Sandford, 2016](#_ENREF_253)). Most PWLB products provide LAs with a reliable source of funding at a cost between 15-20 basis points above the central government gilts. In 2010, an additional 100 basis points were added to PWLBs interest rates, resulting in many LAs starting to look for different funding sources, including bonds aiming to achieve savings ([Sandford, 2016](#_ENREF_253)). However, this was partially reversed in 2012 when the rate went to 80BPs above gilts, with a further 60BPs discount for borrowing for infrastructure projects ([Sandford, 2016](#_ENREF_253), [Aidan et al., 2014](#_ENREF_9)).

Aidan Brady (UKMBA Chief Executive) stated that PWLB has been the natural first port for council borrowing, which presents a major challenge for any other new market lender ([Marrs, 2019p](#_ENREF_184)). Along with central government funding cuts, LAs reliance on PWLB funding witnessed considerable and increasing growth since 2013; see figure (4) where PWLB lending figures rocketed from £5.2bn in 2018 to £9.1bn in 2019, as well as a 68% growth of the number of loans ([Lorimer, 2019](#_ENREF_155)). An example of how PWLB works perfectly for some LAs might be found in Spelthorne Council. They took loans from PWLB worth of £377m in 2016, and £1bn in 2018, to fund a commercial property project. The results were an investment net income of £7.5m annually, savings against the project budget, a stronger balance sheet and they ceased to receive any core central government funding in 2017-2018 ([Willcox, 2018](#_ENREF_312)).

Figure 4 PWLB lending to LAs in England.

Chart, bar chart

Description automatically generated

source: (Brady, 2019f).

Nonetheless, a critical assessment of the role PWLB plays in LAs funding arrangements is needed in order to understand its characteristics against the bond market potential. Therefore, the next section will look at some PWLB’s features such as its easy access, costs, range of products, and freedom associated with its lending to LAs.

### PWLB easy access compared to bonds

The administrative burden of MBs and the need for running a bond program would make MBs less appealing to LAs compared to a phone call to PWLB ([Room151, 2015](#_ENREF_242)). Also, the need for credit rating to be in place before attempting to go into the financial markets would make MBs unsuitable for all LAs. Therefore, PWLB would still be much more appealing to those LAs who lack the credit quality needed ([Smith, 2019c](#_ENREF_274), [Marrs, 2020g](#_ENREF_196)). Sarah Pickup, Deputy Chief Executive at LGA, expected for the PWLB to continuously be an important source of funding for LAs *“It is a very simple way of borrowing and for some councils who have relatively small borrowing requirements, it probably feels much safer”* ([Marrs, 2020g](#_ENREF_196)). Even with the most recent spike in PWLB’s interest rate, it was predicted that many councils are likely to remain with PWLB due to its convenient lending. David Blake, Strategic Director at treasury adviser Arlingclose told Room 151 that *“Smaller councils that only occasionally need £5m or £10m might not see it as worthwhile spending the time going through the administration involved in accessing that money from the private market and might end up paying more from the PWLB”* ([Marrs, 2019m](#_ENREF_181)).

### Cheaper funding

Christian Wall from PFM, the newly appointed management company for UKMBA, argued that the PWLB is the market maker in England. He explained that many financial institutions would set their interest rates in line with the PWLB rate ([Wall, 2019a](#_ENREF_305)). At the same time, the PWLB rate is the target for LAs’ to decide between different funding sources. A finance officer at the London Borough of Haringey explained that despite the freedom enjoyed by LAs to borrow from different sources, it is not expected for any alternative to PWLB to be popular due the historically low lending costs of PWLB ([Smullian, 2019](#_ENREF_275)). Even if MBs interest rates are cheaper than PWLB, considerable issuance costs might override those savings.

Nonetheless, many argue the potential for bonds to represent an option as good value for money, specifically inflation-linked bonds. Some LAs would even be able to borrow at a negative real yield by taking advantage of the offered cheap funding options available out in the capital markets ([Ore, 2020](#_ENREF_218)). Gwyn Llewelyn, a reporter for Localgov.com, shared the same view in classifying MBs as a good value for money borrowing option. This can be the case when bonds work to achieve a better match between finance costs and income streams available for local authorities over the life of the funded project ([Llewelyn, 2017](#_ENREF_152)).

Practically, the 2011 GLA bonds issuance of £600m worked out to be 0.17% cheaper than funding the same project using the PWLB. Nonetheless, a very high administrative cost was associated with this issuance standing at £50,000.00 ([Cox and Schmuecker, 2013](#_ENREF_65), [Sandford, 2016](#_ENREF_253))

Warrington City Council bonds experience indicates similar savings. The Council’s Corporate Finance Manager, Danny Mather, mentioned that one of the key reasons behind the councils use of bonds is that they represented the best value for money borrowing option; especially considering the further tightened spreads payable on bonds that made it much cheaper for LAs to borrow directly from the capital market and at a cheaper rate compared to PWLB ([Room151, 2015](#_ENREF_242)). Most recently, Aberdeen City Council bonds issuance was described as the “best value” as well along with its feature of being inflation linked bond program ([Room151, 2017](#_ENREF_243)).

### The lack of demand for PWLB alternatives

There are different speculations amongst public sector experts on the potential size of the bonds market. Richard Lloyd-Bithell, Treasury Management and Pensions Adviser at CIPFA, said that £12bn to £18bn that could be funded via capital markets ([Brady, 2020a](#_ENREF_48)). Considering the size of the market and the PWLB features, even in an active bond market, it is predicted that PWLB would continue to play a great role in lending to LAs ([Llewelyn, 2017](#_ENREF_152)), and still be the dominating lender to the LAs sector ([Tanner, 2018](#_ENREF_283)). Some reports linked a growing interest from LAs seeking alternatives to PWLBs products and their associated features. In a 2014 consultation report ‘The UK Municipal Bonds Agency’ indicated that councils might consider MBs as an alternative source of funding even with the existence of PWLB, due to the lack of flexibility and issues around PWLB’s pricing. Part of the report was a survey sent to 132 English LAs, where 90% of the respondents indicated that they would consider using the UKMBA ([Aidan et al., 2014](#_ENREF_9)).

More recently, in late 2019, a sudden spike in the PWLB interest rates prompted many LAs to consider seeking alternatives to PWLB’s products. To better understand LAs position after the increase in PWLB rates, Room 151 did two further surveys asking LAs in England for their plans. While no LA indicated that they are going to scrap their plans completely, 13% of them indicated their plans to scale back their capital projects, only 15% of them saying that they would continue borrowing from PWLB at the increased rate, and significantly, 46% of them indicated that they would seek alternative funding sources to PWLB ([Marrs, 2020g](#_ENREF_196), [Marrs, 2019l](#_ENREF_180)).

The second survey was to explore LAs intention to continue to borrow from the PWLB after the spike in interest rates. The results show that only 13% of LAs indicated that they would continue to borrow from PWLB in the future, 51% were to continue borrowing from PWLB at a smaller scale, and 24% would not borrow at the new rate ([Marrs, 2019l](#_ENREF_180)). This shows that it is not inevitable that PWLB would be the ‘go to’ option, and that a good proportion of LAs would consider reducing their borrowing from PWLB or seeking an alternative source of funding. Therefore, one might conclude that, despite the long-term stability in PWLB lending, even temporary changes might disrupt LAs plans. Hence, the existence of alternatives such as an established MB market would be useful to protect LAs from such changes.

According to Localgov.com, Wandsworth London Borough Council was set to become the first borough in London to issue a 10 year municipal bonds at a lower cost compared to PWLB ([Hailstone, 2011b](#_ENREF_109), [Hailstone, 2011a](#_ENREF_108)). David Blake, Strategic Director at treasury adviser Arlingclose, explained that lenders are trying to match the demand presented by LAs for a simple and straightforward funding alternative at a competitive price to PWLB’s ([Marrs, 2020b](#_ENREF_191)). In line with that, indications exist that many LAs would consider going out to borrow from the financial markets using bonds and, more likely, by using the UKMBA ([Tanner, 2018](#_ENREF_283), [Llewelyn, 2017](#_ENREF_152), [Marrs, 2019n](#_ENREF_182), [Cross, 2016](#_ENREF_67)). The expectations are that after the first bond deal takes place, the annual bonds issuance is likely to *“ramp up quickly”* to £2bn - £3bn ([Jenkins and Pickard, 2015](#_ENREF_122)).

It has been suggested that the inflexibility of PWLBs leave the door open for other alternatives, such as bonds. The two ‘sticking points’ of inflexibility found in PWLB products are the lack of delayed initial payment option and early repayment penalties. Christian Wall, the Director of PFM, explained that compared to PWLB, there are financial products in the market the offers interest rates without the need for immediate payment. Despite the initial interest rate being higher than the current rate, those products are exactly what regeneration and housing projects need ([Wall, 2019a](#_ENREF_305)). Bonds, specifically, are thought to be advantageous to PWLB products as they allow better matching between their repayment profile and the capital project income profile, by offering delayed repayment until the project is generating income. Even in larger infrastructure projects, initial repayment could start low and increase gradually in line with the projected generated income from the funded project. This feature would allow LAs to borrow only what they need, and not borrow extra simply to cover the initial repayment, which is commonplace with PWLB financing ([Llewelyn, 2017](#_ENREF_152), [Gavin-Brown, 2018](#_ENREF_102), [Brady, 2020a](#_ENREF_48)). This was shown in the Aberdeen City Council presentation, which was part of pre-bonds consultations. The figure (5) below shows that debt servicing costs are much lower at the beginning when bonds are used, as compared to PWLB. This allows LAs to benefit from close to no repayments at the early stages, and start paying off the debt after the project in place has started to generate some income.

Figure 5 Aberdeen bond debt servicing cost vs PWLB

Chart, line chart

Description automatically generated

Source; (Whyte and Stewart, 2016)

Early repayment penalties imposed by PWLB products, are the other feature that makes MBs more appealing to LAs. An analysis of LA debt to PWLB was done in 2018 to demonstrate the impact of those penalties on LA borrowing. Up until March 2018, English LA borrowing from PWLB stood at just over £50bn. If all decided to repay the debt in March 2018, before its maturity, an additional cost of £24.4bn would have been needed to be paid back to PWLB. Therefore, Cristian Wall doubted the practicality of PWLB’s products when evaluating the initial costs and the hefty early repayment penalty *“Typically, a lender would receive a reduced interest rate in return for being given such protection by a borrower, not a higher rate. That phone call is starting to look very expensive”* ([Wall, 2019a](#_ENREF_305)).

According to Danny Mather, the Corporate Finance Manager at Warrington Borough Council, the repayment clause included in their bond issuance was one of the reasons they chose bonds over other alternatives. This allowed them the full flexibility to repay the bonds at any time in the future, should they need to do so ([Room151, 2015](#_ENREF_242)). The UK Municipal Bonds Agency report in 2014 noted that the Agency is aiming to provide tailored financial products that fits LA financial needs and overcomes those limitations and inflexibilities which are seen in PWLB lending. The report highlighted that early repayment penalties are of significant concern to LA. Despite suggesting that the Agency should adopt similar principles to PWLB to protect itself, the Agency’s application of the same principle should result in lower penalties ([Aidan et al., 2014](#_ENREF_9))

### PWLB vs bonds’ empowerment

[Sandford (2016)](#_ENREF_253) explained that LA have always had the power to issue bonds. Some LA used bonds in early and mid-20th century, but the introduction of PWLB during the 70s and 80s led to bonds being almost abandoned by LAs. The initial calls for the UKMBA came as a result of LGA aiming to free LA from Treasury control by creating an alternative funding source to PWLB. However, it was reported that the Treasury is *“less than keen”* on the idea of LA setting up the UKMBA ([Peters, 2013a](#_ENREF_226), [Peters, 2013b](#_ENREF_227)). According to [Moore (2016; no page)](#_ENREF_207), the Treasury denied taking any steps to undermine the creation of UKMBA *“Local authorities can borrow from any willing lender, provided it is in sterling …”and they have longstanding powers to borrow from financial markets”*. The central government and Treasury view of PWLB is that it allows them to monitor and control borrowing in accordance with the national policy, to prevent LAs from being engaged in excessive risk ([Wall, 2019b](#_ENREF_306), [Green, 2019](#_ENREF_106)). Therefore, PWLB makes central government interventions possible, in central government seeking to address concerns regarding the scale of LA borrowing, and thus undo the commercial risk associated with that borrowing.

However, the main concern is that a one-size-fits-all approach of PWLB is not fair to all LAs. Those who neither took significant risk nor borrowed excessively to invest in commercial properties, would be treated same as those LAs who did. As a result, both will be paying the increased interest rate using the taxpayers’ money ([Wall, 2019b](#_ENREF_306)). An example of central government aiming to slow down the rate of borrowing is a significant spike in the PWLB interest rate for all LAs to 2.82% that was implemented in 2019 ([Brady, 2019b](#_ENREF_43)).

Therefore, the existence of a well-developed bond market has increasingly been perceived as an empowering option for LAs. Mike Jensen, Director for Investment at Lancashire County Council said that UKMBA is perceived as a great step to allow the sector to take more control of its financial activities, being independent from central government imposed debt costs and structure ([Brady, 2020b](#_ENREF_49)). Jenson saw the latest MB issuance undertaken by Lancashire Council as a good step towards more control over the LA financial destiny ([Brady, 2020a](#_ENREF_48)). Similarly, a report from the Institute for Public Policy Research asserted the need for the north to take back control over its transport spending, especially when viewing the disparity in funding between London and the north. The report concluded that MB can unlock infrastructure projects potential in the north, and help to raise the vital funds from long term investors similar to the US practice ([Eichler, 2017](#_ENREF_86)).

## 2.3.4 UK Municipal Bonds Agency function

The UKMBA initiation came out of the desire to empower LAs with the option of an additional source of funding that can potentially achieve a number of useful market practices. Such body aimed to enhance the debt range of LAs by offering another option to diversify their portfolios, offer financial products that suits LAs more, enhancing sector credibility by joining forces together, and offer a better level of scrutiny of LAs’ borrowing. The following section will discuss such benefits of creating the UKMBA and the reasons behind the delays in its first issuance.

### Diversification

Diversifying funding sources is seen as one of the key corporate risk management aspects in English Councils ([Room151, 2015](#_ENREF_242)). Richard Lloyd-Bithell, Treasury Management and Pensions Adviser at CIPFA, argued that councils with big capital requirements should consider the bonds market to address the important aspect of diversifying their borrowing sources ([Brady, 2020a](#_ENREF_48)). Danny Mather, Warrington Borough Council’s Corporate Finance Manager, explained that one of the key reasons behind Warrington’s bond issuance was to diversify their loan portfolio.

Previously, LOBO loans were seen as a good option to diversify the debt portfolio for LAs ([Marrs, 2018a](#_ENREF_166)). However, they received a lot of criticism recently from experts due to being overcomplicated and unfair on the borrower ([Brady, 2018b](#_ENREF_36), [Wall, 2019a](#_ENREF_305), [Pickard, 2018](#_ENREF_230), [Marrs, 2019l](#_ENREF_180), [Marrs, 2020b](#_ENREF_191)). PWLB, on the other hand, has witnessed a lot of dramatic fluctuations in its interest rates. While most LAs were able to take advantage when interest rates fell, many found themselves unable to take further loans to pursue their capital programs when the rate increased sharply. In August 2019, LAs took advantage of the low interest rates and borrowed from PWLB close to £2bn – the highest monthly borrowing for seven years ([Marrs, 2019g](#_ENREF_175), [Marrs, 2019i](#_ENREF_177)). A couple of months later in November, as a result of the Treasury’s decision to add 1% to its existing PWLB’s interest rates, a drastic drop in LA borrowing to £469m occurred, followed by £80m December, a drop to only 4% of August’s borrowing figures ([Marrs, 2019a](#_ENREF_169)).

The risk of the overreliance on the PWLB was highlighted in the 2014 report of the UKMBA. The significant regulatory risk was noted as a result of PWLB rates being influenced by political considerations. In 1995, PWLB switched from an open access policy, to a lender of last resort, which required rapid and costly changes in LAs borrowing practices, requiring some LAs to consider other costly borrowing sources to protect themselves against sudden cash shortages ([Aidan et al., 2014](#_ENREF_9)). The expectations are that LAs’ annual borrowing requirements would be to around £5bn. UKMBA Chief Executive said that the Agency aims to supply between 15%-25% of such requirements ([Marrs, 2014](#_ENREF_164), [Marrs, 2019b](#_ENREF_170)). In addition to the access to the financial markets, UKMBA can act as a platform for intra-lending between LAs themselves, as well as facilitating funding from third parties such as the European Investment Bank (EIB) ([Cross, 2016](#_ENREF_67)). When looking at Kommuninvest practices, their funding strategy follows the rule that their funding must be 15% - 35% more that their lending amount. This extra liquidity allows them to supply the public sector with credit even when markets are illiquid ([Knezevic, 2020](#_ENREF_135)).

### Products that suit local authorities’ needs.

In the 2014 report from the UKMBA, LA debt maturity mismatch was discussed. At the time of the report, it was stated that LA long-term liabilities stood at £84bn, while their short dated assets were £37bn. The UKMBA should be able to ease the risk and the maturity mismatch by developing a more tailored lending services and facilitating intra-lending across LAs ([Aidan et al., 2014](#_ENREF_9)). Aidan Brady, Chief Executive of UKMBA, promised that with more time, UKMBA should be capable of providing more tailored funding arrangements to LAs ([Marrs, 2014](#_ENREF_164)), whereby both the size of the issuance and the type of deals will be driven by borrowers’ needs. This could be in a shape of smaller deals rather than being limited to a benchmark size deals ([Cross, 2016](#_ENREF_67)).

Other reports mentioned that UKMBA had been approached by institutions interested in lending LAs via the Agency, as well as some LAs with excess liquidity that could lend to other LAs ([Marrs, 2015](#_ENREF_165)). The first bonds issuance via the UKMBA was for Lancashire Council in February 2020. This deal was done on a single lane route using UKMBA. The following deal is believed to be pooled issuance for several councils ([UKMBA, 2020a](#_ENREF_294)). This shows that the Agency can tailor its services to include not only borrowers who lack the debt size, but those who need the market knowledge, connections, and services.

### Joint and several guarantee scheme

A considerable part of UKMBA’s function relied on the joint and several guarantee agreement (JAS) that each member LA need to sign in order to be part of the pooled issuance. Under the JAS, all LAs part of a pooled issuance takes a legal responsibility to bail out any other member in the pool, in the case of their default on repayment. UKMBA chairman, Sir Merrick Cockell stated that the JAS, at the time it was designed, aimed to achieve the highest possible credit rating ([Marrs, 2019d](#_ENREF_172)). Despite the intention of the UKMBA of making the JAS guarantee a *“last port of call”* ([Cross, 2016](#_ENREF_67)), this meant that it was possible for a single council to be liable for the overall defaulted debt amount which could represent a limitless liability ([Marrs, 2019e](#_ENREF_173)). Therefore, in addition to the adverse market conditions, some LA concerns about the JAS guarantee were considered the main factor behind the delays in UKMBA getting its first issuance off the ground ([Marrs, 2020a](#_ENREF_190)).

As a response, in March 2019, the Agency announced its intention to drop the JAS model. There were calls for a model that would allow a more limited liability to enable LA financial officers to be more comfortable with the level of commitment ([Marrs, 2019e](#_ENREF_173)). This led to the new optional guarantee scheme in 2019, that meant borrowers will only be liable for their own share of borrowing ([Marrs, 2019d](#_ENREF_172), [Marrs, 2019e](#_ENREF_173), [Marrs, 2020a](#_ENREF_190)). Such change seemed to have an immediate impact on LA approach towards the UKMBA, which was reflected clearly in their response to a survey done by Room 51, sent to LA financial officers asking about the replacement of the JAS. The results showed that 58% of respondents indicated that they are more likely or much more likely to consider borrowing from the UKMBA ([Marrs, 2019e](#_ENREF_173)).

Due to the change in the guarantee scheme, UKMBA will need to seek a new credit rating, as the JAS was a key factor in their AA3 rating given by Moody’s ([Marrs, 2019q](#_ENREF_185)). The Agency’s Chairman, Merrick Cockell, commented *“We have had discussions with industry experts, and we believe that it would be possible to aggregate borrowing and achieve a competitive rate without the need for a joint and several guarantee”* ([Marrs, 2019d](#_ENREF_172)). However, the Director at treasury adviser Arlingclose warned that pricing is determined by demand and supply and in the absence of the JAS, it might be difficult for the price to be as attractive to LAs compared to PWLB. Although the advice given by Arlingclose to LAs was not to borrow from the UKMBA whilst JAS was in existence, they warned that the removal of JAS could improve LA appetite for borrowing, but would conversely reduce the investors’ appetite to buy the bonds ([Marrs, 2019d](#_ENREF_172)).

### UKMBA delayed start.

Initially, in 2014, 48 town halls, cities, counties, and districts signed up to invest in the UKMBA. This reflected a great appetite among LAs for the Agency to happen ([Bridge, 2014](#_ENREF_50)). Aidan Brady, UKMBA’s Chief Executive, hoped that the first bonds issuance should by in the market by late 2014/early 2015 ([Marrs, 2014](#_ENREF_164)). However, the plan did not go as hoped for various reasons. [Cross (2016)](#_ENREF_67) linked the failure to launch the first MBs issuance to both the general election results in 2015 and the following budget, as well as the UKMBA board recruitment and the time took it to finalise its framework agreement. Others related the delayed start to both market conditions ([Marrs, 2020a](#_ENREF_190)) and the fears over the JAS guarantee ([Marrs, 2020a](#_ENREF_190), [Marrs, 2019q](#_ENREF_185)).

The fears of the JAS guarantee may well have been amplified by the default of Northamptonshire County Council causing a rethink by other LAs. London Borough of Brent’s representative explained that, along with the awareness of the risks involved in the JAS, should they have joined the agency several years ago, they would have been exposed to Northamptonshire’s default risk. Contrarily, Christian Wall, director at PFM, disagreed with the perceived risks arguing that, if anything, Northamptonshire is an evidence that the central government will not allow a large LA to go bankrupt ([Marrs, 2019c](#_ENREF_171)).

Nonetheless, such hesitation and delays in launching UKMBA’s first bonds program came at a cost for both UKMBA and its shareholders. In 2018, 4 years after its inception, the Agency suffered significant expense with total losses of £3.7m over just two years ([Peters, 2018](#_ENREF_228)). Some saw this loss as a strong sign that, all being equal, PWLB’s low administrative costs and easiness of access seemed much more appealing to LAs ([Peters, 2018](#_ENREF_228), [Smullian, 2019](#_ENREF_275)).

### UKMBA moving forward.

Different reports spoke about the UKMBA taking some proactive steps to contact LAs and to shareholders. In 2015, Aidan Brady, UKMBA’s Chief Executive visited LAs who showed interest in the Agency and explained how plans were progressing ([Marrs, 2015](#_ENREF_165)). In August 2019, Merrick Cockell, the Chairman of UKMBA, sent a letter to shareholders asking them to have their say on reshaping the offer and the operational model of the UKMBA. The councils’ response highlighted key aspects that they wanted to see changed. Demands were mainly for more flexibility in early redemption, lower early repayment penalties, risk-balance between different borrowers within the issue, a guarantee structure that is more appropriate to the LAs, different maturity terms, and a rigorous credit process when pooled issuance is in place ([Marrs, 2019q](#_ENREF_185)). UKMBA took on board the suggestions from the councils whereby the new PFM plans to included new flexibilities to the bonds proposal that avoids early repayment penalties ([Marrs, 2019f](#_ENREF_174)). This came after the March 2019 announcement that the Agency was planning to drop the JAS guarantee scheme.

Danny Mather, Warrington Borough Council’s Head of Corporate Finance, argued that despite JAS being an issue, it is not the main reason that bonds were not working. The main reason, he posited, is that for bonds to be successful, they have to be cheaper than PWLB which was not the case ([Marrs, 2019c](#_ENREF_171)). Following the increase in PWLB’s interest rate in November 2019, Moody’s representative stated that this increase may stimulate demand for alternative funding sources, including bonds ([Brady, 2019e](#_ENREF_46)). A combination of the replacement of JAS and the 1% increase in the PWLB interest rates made it possible for the UKMBA to take the first step towards its first two issuances, scheduled to be before the end of the 2019/2020 financial year ([Marrs, 2019a](#_ENREF_169), [Brady, 2020a](#_ENREF_48), [Marrs, 2020a](#_ENREF_190)). The first is issuance was believed to be for Lancashire Council at a cost of 80 basis points a step that might mark a big shift away from the PWLB. The Lancashire Council deal is seeking investment for £350m worth of bonds with HSBC and Barclays to be joint book runners on the bonds. Even with the considerable upfront costs, including banks and credit rating, at 80 basis points over the gilts, Lancashire Council bonds should come at a much cheaper price to the existing 2.82% interest rate the PWLB is asking. This is believed to shortly followed by a second deal on the basis of a pooled issuance ([UKMBA, 2020b](#_ENREF_295), [Marrs, 2020c](#_ENREF_192)).

# 2.4 Municipal bonds advantages and disadvantages.

By evaluating different aspects of the bond market in England, and the potential of developing such market, a number of advantages and disadvantages have been argued by different reports. The below section presents a review of the key advantages and disadvantages associated with MBs.

## 2.4.1 Municipal bonds advantages.

### Better discipline and risk management.

In addition to the empowerment of the public sector and the ability of LAs to decide which source and method of funding is most suitable for their needs ([Brady, 2020a](#_ENREF_48)), bonds would reduce the risk associated with the overreliance on the PWLB ([Aidan et al., 2014](#_ENREF_9)). It was seen that an active bonds market and UKMBA would result in reduced risks borne by the sector, as it would increase the competition in the market and protect LAs against the sudden changes in PWLB’s practices, conditions, and prices ([Aidan et al., 2014](#_ENREF_9), [Bridge, 2014](#_ENREF_50)).

Along with that, it had been widely agreed that more financial discipline could be achieved by exposure to financial markets ([Dehn, 2014](#_ENREF_75), [Green, 2019](#_ENREF_106)). Similarly, Andrew Gwynne, the Shadow Communities’ Secretary, called for more scrutiny bodies for public finance run by LAs ([Brady, 2018a](#_ENREF_35)).

As an example of the lack of monitoring done by the PWLB, [Green (2019)](#_ENREF_106) mentioned that the increase in PWLB rates took place in October 2019 was to discourage LAs excessive borrowing to finance commercial properties. But the problem lies in the fact that the government does not collect statistics on those activities, which makes it harder to know exactly what the situation is. With the existence of the easinessof PWLB, and in the absence of scrutiny in place ([Green, 2019](#_ENREF_106)), many Councils abused their borrowings to invest in commercial properties that exposed the sector to unnecessary risks ([Brady, 2018f](#_ENREF_40), [Brady, 2018c](#_ENREF_37), [Marrs, 2020g](#_ENREF_196), [Wall, 2019b](#_ENREF_306), [Marrs, 2019f](#_ENREF_174)).

The problem that arises from these practices is that when the Treasury attempts to control the risk taken by LAs, it must apply a one size fits all measure. The 2019 interest rate increase for PWLB products of 1% meant that all LAs, regardless of their risk management soundness, had to pay more to get the funds needed for their projects ([Green, 2019](#_ENREF_106)). The argument is that if LAs were exposed to the financial markets, lenders would always request information on where the money is going to be spent on ([Marrs, 2019m](#_ENREF_181)). Therefore, the market discipline would have either blocked those risky investments, or changed the investment nature into something that does not risk taxpayer money ([Wall, 2019b](#_ENREF_306)).

The UKMBA has a significant role to pay in reducing LA exposure to risk as they have existing measures in place that would check the credibility of the borrower. Therefore, even in the pooled issuance, the risk would be close to eliminated as the Agency would run continuous checks to keep any LA with weak credit out of the pool ([Aidan et al., 2014](#_ENREF_9), [Marrs, 2019c](#_ENREF_171)). However, enhancing scrutiny and risk management is not dependent only on the UKMBA practices. LAs would need to work with the Agency to engage in the credit rating process and work to provide the best structure their bonds, which will ultimately enhance LA practices and scrutiny levels ([Blakeley, 2017](#_ENREF_31)).

### Flexibility

When compared to other sources of finance available to LA, MBs were found to offer various sorts of flexibilities. With bonds, the potential of buying back the debt from the secondary market in the future is one of those flexibilities ([Room151, 2017](#_ENREF_243)). The Warrington Council experience shows that the early repayment flexibility associated with bonds is one of the key reasons behind them choosing to issue bonds over other sources of funding ([Room151, 2015](#_ENREF_242)). Compared to bank loans and PWLB, MBs offer flexibilities related to maturity as well as both refinancing and shorter dated funding loans ([Cross, 2016](#_ENREF_67)). Steven Whyte, Aberdeen City Councils Head of Finance, stated that bond repayment works better for them compared to PWLB loans, and argued that bonds complimented their existing debt maturity profile. Similarly, Ore (2020) explains that LAs can benefit from tailoring bonds to fit with their capital programs and budget projections. This makes bonds more suitable for LAs as they offer the potential of being adjusted to fit with each project’s income stream ([Ore, 2020](#_ENREF_218), [Gavin-Brown, 2018](#_ENREF_102)). A number of years as, often called a repayment holiday, can be achieved via bonds to allow the project to generate money before repayments are due ([Room151, 2017](#_ENREF_243)). This allows borrowers to deliver on their large infrastructure projects, as their repayment could be delayed or start at a low level and increase gradually to match the income from the funded project ([Llewelyn, 2017](#_ENREF_152), [Gavin-Brown, 2018](#_ENREF_102), [Brady, 2020a](#_ENREF_48)).

Another flexibility specifically offered by inflation-linked bonds is that they offer good value for money to LAs who can borrow at a negative real yield. This can happen when the increase in yield is the same or lower than inflation. Consequently, if LAs soundly forecasted their financial needs at early stages, they can take advantage of what MBs and the financial markets can offer ([Ore, 2020](#_ENREF_218), [Llewelyn, 2017](#_ENREF_152)). A good example of inflation linked bonds is found in Aberdeen City Council’s bonds that offered a very good level of income match. Compared to PWLB products, bonds provided Aberdeen City Council with a good inflation hedge to the project income, especially that the project income would potentially increase in line with the inflation over the terms of the loan ([Room151, 2017](#_ENREF_243)). Furthermore, the spread of debt maturity in Aberdeen’s bond launch allows them to pay off the debt gradually and increasingly, in line with the increase of the project income as per figures 6 and 7 below that explain the change in Aberdeen’s debt maturity profile pre and post bonds.

Figure 6 Aberdeen's debt maturity before bonds PWLB maturity

Chart, histogram

Description automatically generated

Source; (Whyte and Stewart, 2016)

Figure 7 Aberdeen's debt maturity after bonds PWLB maturity

Chart, bar chart

Description automatically generated

Source: (Whyte and Stewart, 2016)

## 2.4.2 Municipal bonds disadvantages

One of the main disadvantages of bonds was explained by Neil Stewart, a Treasury Officer at Aberdeen City Council. Stewart told Room 51 that bonds require an intensive administrative workload on top of the associated risks, which mean that bonds might not necessarily suit every LA. For Aberdeen, considering the potential rewards, the process was worth it. However, he noted that the administrative work did not stop there, as it needed to be followed up with a post bond team that was established to do the reporting and governance required for the listing ([Room151, 2017](#_ENREF_243)).

Luke Webster, Chief Investment Officer at the Greater London Authority, addressed the level of complexity associated with bonds, as they consume a lot of time and resources, such as administrative and legal, that cannot be underestimated ([Marrs, 2019r](#_ENREF_186)). These administrative and human resource burdens were noted by both Aberdeen and Warrington’s bonds issuance. However, both councils stated that they have relied on their internal financial and legal expertise to prepare the paperwork and worked closely with their investors legal teams to finalise the deal. Similarly, Danny Mather, Warrington Borough Council’s Corporate Finance Manager, said to Room 151 that bonds require *“Considerable treasury management and legal expertise exist in most local authorities that can be used to keep the consultancy costs to a minimum”* ([Room151, 2015](#_ENREF_242)). Therefore, Jonathan Werran, the Chief Executive of Local Government Association said, *“You have to do what’s best for your own conditions rather than slavishly following the herd for fear of missing out on a road to great financial nirvana”* ([Willcox, 2018](#_ENREF_312)).

Nevertheless, UKMBA is there for those smaller LAs who may not be capable of, or necessarily have the required in-house resources to prepare for a bond launch and to manage the post launch reporting requirements. With the existence of UKMBA, the hope is that it would help to ease the administrative workload on borrowers. But, the Agency services come at a cost, estimated at 10 basis points for its members and 15 basis points for non-members ([Sandford, 2016](#_ENREF_253)). Therefore, Luke Webster from GLA warned that the financial benefits as against the PWLB are likely to be *“marginal”* ([Marrs, 2019r](#_ENREF_186)).

Initially, [Aidan et al. (2014)](#_ENREF_9) and ([Hartley, 2014](#_ENREF_113)) as per figure 8, anticipated that the Agency would not break even until its book has reached £2bn of bonds issuance, which was expected to take more than 3 years after the launch. In 2019, and as it has not done any issuance, Gary Porter, Chair of the Local Government Association warned that the Agency was running out of cash. This meant that there was an increasing risk that the Agency might not be able to attract enough borrowers to break even ([Pickard, 2018](#_ENREF_230)). This might mean that the Agency would not, at least on the short term, be able to lower its charges in return for providing LAs with the administrative and legal support needed.

Figure 8 UKMBA revenue vs costs expectations

Chart

Description automatically generated

Source: (Hartley, 2014)

Experts warned that any alternative to PWLB products and specifically financial markets, are far more complicated and take much more time than accessing PWLB funds ([Gavin-Brown, 2018](#_ENREF_102), [Marrs, 2019r](#_ENREF_186)). Carol Culley, the Deputy Chief Executive and City Treasurer at Manchester City Council, explained that any alternative source of funding should always be weighed against PWLB costs and risks ([Marrs, 2020b](#_ENREF_191)). Similarly, [Llewelyn (2017)](#_ENREF_152) argued that the decision between different borrowing sources should be assessed carefully in line with the project economic life, and the trade-off between benefits and costs.

Another disadvantage associated with bonds is the timeframe, as bonds require a much longer timescale as compared with other lenders. The time frame for issuing bonds is expected to be around four months versus weeks, or even days, for PWLB ([Llewelyn, 2017](#_ENREF_152)). In the Aberdeen Council case, it was reported that it took six months to complete the bonds project, with the expectation that should the Council revert to bonds, then the timescale would be reduced to five months ([Room151, 2017](#_ENREF_243)). The long timeframe brings further complications when it comes to the pricing or the cost of issuance. Estimates at early stages may well differ from what the market would offer six months later, as the price at which bonds can be issued and their interest rates will be driven by the market at the time of the issue ([Aidan et al., 2014](#_ENREF_9)). Even Aberdeen Council, just after their issuance, in 2019 they took two loans from the PWLB, each worth £20m, bringing their overall debt to PWLB close to £400m. This means that even large LAs who have issued bonds can still see PWLB as a useful source of funding for loans that are not viable via bonds ([Lorimer, 2019](#_ENREF_155)). Furthermore, [Smullian (2019)](#_ENREF_275) reported fears from London Borough of Haringey that when the PWLB increases its rates to make bonds more appealing, the market would adjust accordingly to make bonds uneconomical again. As PWLB is seen as a market maker, a lender who was previously willing to lend to LAs close to PWLB rate would adjust its lending price to match, or come close to, the new PWLB rate.

# 2.5 Municipal bonds barriers

The international experiences of the municipal bond market reveal a number of barriers that mainly affect the issuers. Such barriers either blocked the access to bonds or reduced their preferred outcomes. Efficiency, uncertainty, credit rating, transparency, and liquidity are common barriers that are highlighted by both academic and industrial literature. The following section will review each of them generally, and in relation to the context in England.

## 2.5.1 Municipal bonds efficiency and associated costs

When looking at the purpose of developing a municipal bond market, it is majorly focused on facilitating LA access to debt at the best possible interest rates, along with reducing their long-term borrowing costs. Nevertheless, there are significant risks in the business case for the bond market, even in achieving savings as compared to other borrowing sources ([Hartley, 2014](#_ENREF_113), [LGCA, 2012](#_ENREF_149)). [Dehn (2014)](#_ENREF_75) anticipated an increase of borrowing costs when LAs attempt to borrow directly from the financial market via bonds, due to the burden of facing the market discipline and its associated costs. [Cox and Schmuecker (2013)](#_ENREF_65) described entering the bond market as an expensive process that might prove to be difficult or unviable for those LAs who lack the scale needed to place debt directly in the financial markets.

According to the Corporate Finance Manager at Warrington Borough Council, the cost and effort required for managing a bond program might put off some LAs especially when considering the “phone call” to PWLB ([Room151, 2015](#_ENREF_242)). Therefore, PWLB would still be the main source of funding for LAs especially for those with poor credit rating ([Marrs, 2020g](#_ENREF_196), [Llewelyn, 2017](#_ENREF_152), [Gavin-Brown, 2018](#_ENREF_102)). As it stands, considering the administrative costs both before and post issuance, it might prove hard for bonds to beat the PWLB rate. Hence, it is anticipated that, for a considerable time, price-risk will prevail until the bond market is developed to a level where it can compete with PWLB. Once that is achieved, the PLWB option will not be justifiable for most LAs to use just because it is an easy option ([Brady, 2020a](#_ENREF_48)). In fact, Councils are believed to have been paying a premium for the PWLB’s certainty rate as it guarantees a fixed rate on a predetermined future date ([Brady, 2018b](#_ENREF_36)).

Furthermore, using PWLB’s rate as a benchmark or a target is not the right option every time. Many public sector financial experts agreed that PWLB’s rate is arbitrary and lacks clear justification. An example of that can be found in a spike of 1% that took place in 2019 ([Wall, 2019b](#_ENREF_306), [Marrs, 2019q](#_ENREF_185)).

Practically, the Aberdeen City Council bond program resulted in savings close to £100m over the loan life. Such savings represent a strong justification for their bond issuance ([Room151, 2017](#_ENREF_243)). Similarly, GLA bond issuance in 2011 was 17 BPs cheaper than if the same loan was financed by PWLB ([Cox and Schmuecker, 2013](#_ENREF_65)). [Ore (2020)](#_ENREF_218) outlined the potential savings for bonds compared to the prevailing PWLB rate, explaining that the annual servicing costs for a £100m loan over 25 years would be close to £5.6m. The same loan could be serviced via bonds at a servicing cost of close to £3.5m annually, rising by inflations. These savings would make many projects viable, especially as project income is expected to increase in line with inflation over time.

### UKMBA and bonds efficiency

It is claimed that to drive the cost down, LA are in need for aggregators or bond agencies which, in turn, could bring more attention to LAs from the private sector and provide the architecture for a variety of different types of investment. All of that would increase the competition in the sector and be reflected in the driving down of the costs ([LRD, 2015](#_ENREF_156)). Similarly, the LGA produced a report to understand the impact of bond agencies in pooling bond issuance in England. The report concluded that UKMBA would be able to allow LAs access to debt at a rate of 70-80 BPs over gilts or 20-30 BPs below the PWLB rate ([LGCA, 2012](#_ENREF_149)).

The UK Municipal Bonds Agency report in (2014) anticipated savings, although also anticipated potential variance in said savings, and referred to the difference between bond issuance programs, rating structure, and maturities ([Aidan et al., 2014](#_ENREF_9)).

The way for the UKMBA to be efficient is by bringing LA credit ratings close to the central governments rating. The early expectations were that UKMBA, compared to PWLB**,** would potentially offer savings that are between 30 - 58 basis points ([Cross, 2016](#_ENREF_67)) or 20 - 25 basis points ([Aidan et al., 2014](#_ENREF_9)). Furthermore, the UKMBA’s ultimate aim would be to grow the market volume over time, which in turn would help to bring the pricing down, so it would be feasible for most LA to be able to access bonds in a similar manner to their US counterparts ([Wall, 2019a](#_ENREF_305)).

Another key role for the Agency is that it would potentially offer a pool where stronger LAs would be partially able to subsidise the cost of borrowing for weaker ones ([Brady, 2020a](#_ENREF_48), [Marrs, 2020a](#_ENREF_190), [Marrs, 2020d](#_ENREF_193)). Furthermore, many experts noted the significant paperwork, administrative and legal efforts needed to deliver any bond project for LAs. The work involved in these areas starts from day one and goes beyond the issuance date ([Room151, 2015](#_ENREF_242), [Room151, 2017](#_ENREF_243), [Whyte and Stewart, 2016](#_ENREF_310)). The role of the UKMBA could be extended here to offer standardised documentation, and advice, that would result in reducing the overall cost of the bond program. Mike Jensen, Director for Investment at Lancashire County Council, noted role the Agency can undertake to reduce the burden of ongoing legal and maintenance costs is not limited to the pooled issuance, but also for single lane issuances *“I also see a much broader role for the agency in the future covering both debt financing, asset liability management, investment management and other functions, which would benefit Lancashire, as well as the whole sector"* ([Brady, 2020b](#_ENREF_49)).

The overall savings that could be achieved by using UKMBA, compared to PWLB, are not limited to simply issuance and administrative costs. The early repayment penalties set by the UKMBA is another source of saving for LAs, should they need to settle the debt before maturity ([Wall, 2019a](#_ENREF_305), [Aidan et al., 2014](#_ENREF_9), [Marrs, 2019f](#_ENREF_174)).

On the other hand, the UKMBA poses some cost related risks due to its business model. One of early reasons for using the JAS guarantee was to boost the pool credit, and therefore reduce the borrowing costs between 2-25 basis points. As the JAS has been replaced by the Proportionate Guarantee Scheme, the question in place is whether the same savings projection is still achievable. The UKMBA savings is linked to its ability to issue in benchmark size, with value of somewhere between £250m to £300m. Failure to achieve that would result in adding 20 basis points to the original bond price and thus offsetting the potential savings ([Aidan et al., 2014](#_ENREF_9)). Therefore, efficient bonds placement might be an option mainly for local authorities wanting to borrow sums of £100m and more ([Ore, 2020](#_ENREF_218)).

The UKMBA service is not free even for its shareholders. The service cost is at a 10 basis points for members and 15 basis points for non-members of any bond issue ([Sandford, 2016](#_ENREF_253)). Initially, the UKMBA asked its shareholders to invest over £6m to set the Agency up. The investments varied across its shareholders from £10,000 to £500,000 ([Cross, 2016](#_ENREF_67)). This wouldn't have caused any problems if the first bonds issuance ran to time. Due to the delays in getting its first bonds issuance off the ground, the Agency is at risk of running out of money ([Pickard, 2018](#_ENREF_230)). To reduce its costs, UKMBA had to cut its operating expenditure by close to 34%. This was done by not replacing staff who left and moving its operations from serviced office space to LGA headquarter ([Marrs, 2019q](#_ENREF_185), [Marrs, 2019c](#_ENREF_171)).

## 2.5.2 Uncertainties associated with bonds

As the municipal bond market is yet to be thoroughly tested in England, uncertainties around it arise on different levels. For some local authorities, it is the lack of scale necessary to enter into public offerings or private placements, and even if they had the scale, not all LAs have the ability to issue regularly in benchmark sizes ([Aidan et al., 2014](#_ENREF_9), [Cox and Schmuecker, 2013](#_ENREF_65)). Other uncertainties are related to doubts about market demand, or the market price of any bond issuance may not be attractive enough to issuers ([Aidan et al., 2014](#_ENREF_9)).

Those uncertainties were shown in the most recent bond issuances in the UK. The relatively long timeframe needed to place bonds in the market can represent an obstacle, as it means that market conditions might change from what they originally indicated. For both Aberdeen City Council and Warrington City Council, it took six months for them to complete each deal ([Room151, 2015](#_ENREF_242)). The general expectations are that, should they seek to issue bonds again, the timescale can be significantly reduced to three months. But even when less time is needed, and with the support of market makers and banks, the market conditions might well play greater role in what councils can hope to obtain on the day ([Room151, 2017](#_ENREF_243)). For Aberdeen City Council, despite receiving very positive feedback from investors, were warned by its book-runner that market uncertainty might override the present investors’ strong interest ([Room151, 2017](#_ENREF_243)). Likewise, for Lancashire County Council bonds deal, and despite having a credit rating in place and the support of both UKMBA and PFM, it wasn’t until late February 2020 that the book runner had announced his indicative pricing ([Marrs, 2020c](#_ENREF_192)).

The argument is that club placement (or pooled issuance) becomes important here. The use of a vehicle that issues bonds on behalf of a number of LAs, and then lends them back, it permits LAs access to the debt market for smaller sums; this would benefit smaller authorities who either lack the debt size or that their projects are not large enough for a single route bond issuance. Furthermore, pooling bonds has the potential of securing funds for a sizable project that are important to a whole city or even a region benefiting multiple local authorities at the same time. An example of that could be the Combined Authority in Greater Manchester ([Cox and Schmuecker, 2013](#_ENREF_65)). The creation a pool for bonds issuance that goes beyond certain local authorities’ frontiers, a reduction in the conflict of interest will be mitigated and collectively different authorities will be able to present a more attractive investment proposal ([LRD, 2015](#_ENREF_156)).

Even when looking at the EIB funds, the conditions associated with the scale required for such lending makes it difficult for most single local authorities to access EIB funding. When pooling individual local authorities capital needs together via UKMBA, they can meet the scale required by the EIB making the access to such funds easier and cheaper then doing so individually ([World Bank, 2016](#_ENREF_313)).

Despite all the arguments about the uncertainty associated with bonds, [Brady (2018b)](#_ENREF_36) pointed out that financial certainty is a *“rare commodity”* for local authorities. One reason for this may be the change in political leadership at a LA. This is seen in South Oxfordshire Council who had to withdraw one of its local plans blueprint until it included more sustainability measures, following a change in the leadership from Conservative to Liberal Democrat and Green ([Dunton, 2019b](#_ENREF_81)). Similarly, a lot of uncertainty is associated with the changes in financial products available for LAs, such as the fluctuations in LOBO popularity as well as PWLB rates ([Brady, 2018b](#_ENREF_36)). The most recent increase in PWLB interest rates in 2019 put a lot of projects planned by LAs, such as housing, into great uncertainty. As a result, LA projects might not be viable, and thus they may end up ceasing them altogether, or bear higher interest rates costs. Such change affected the sector credit rating whereby Moody’s had issued *“credit-negative”* judgment ([Marrs, 2019m](#_ENREF_181)). The impact of the change in PWLB’s interest rates was evident by the drop of nearly 75% in LA borrowing from PWLB in the months following the change ([Brady, 2020a](#_ENREF_48)). Therefore, the argument that the uncertainty associated with bonds might increase their dependence on the PWLB seems to have been reversed, due to uncertainties of PWLB offering as well. Instead, the change in PWLB interests is seen as a way of boosting LA interest in bonds and therefore encouraging the UKMBA’s first bond issuance ([Marrs, 2020a](#_ENREF_190), [Smullian, 2019](#_ENREF_275)).

### Evaluating investors demand

In 2014, the UK Municipal Bonds Agency report, upon meeting with ten leading Sterling syndicate banks, suggested it is likely that a significant demand for the UKMBA bonds will develop ([Aidan et al., 2014](#_ENREF_9)). Similarly, Lee Cumbes, the Head of Public Sector at Barclays in London commented *“Investors need high quality bonds”* ([GlobalCapital, 2016 ,P1](#_ENREF_104)). Another report by [Blakeley (2017)](#_ENREF_31) concluded as well that capital markets are keen to specifically buy LA issued debt ([Blakeley, 2017](#_ENREF_31)).

Practically, both Aberdeen City Council and Warrington Borough Council reported their extensive efforts, boosted by banks and market makers, to communicate their vision and financial resilience to investors. This was done in the form of investors’ presentations held in different cities across the UK. The role of this practice was identified by both councils as key to their bond programs success ([Room151, 2015](#_ENREF_242), [Room151, 2017](#_ENREF_243)). June Matte, a Managing Director at PFM, asserted that those practices had an important role in attracting investors, and stressed the importance of telling the financial story behind the actions in a clear and simple manner, that will be easily understood by the residents, media, and MPs ([Room151, 2018](#_ENREF_244)). Therefore, arguably, the certainty about investor demand sits largely in LA hands. Road mapping investors, presenting to them, and explaining the sector strengths are key duties for LAs who wish to go down the bond issuance route.

Most market participants agree that investors would support the issuance of bonds by UKMBA. Ulrik Ross, Global Head of Public Sector and Sustainable Financing at HSBC said *“There will definitely be demand for MBA paper… plenty of investors are looking for safe haven paper right now and the whole SSA (Sovereign, Supranational and Agency Bonds) space has been having a very good reception in the market”(*[*GlobalCapital, 2016 ,P3*](#_ENREF_104)*)*. Five bond issuances in 2015 and 2016 by the public sector met a very encouraging demand from investors. Two of those issues were by the Metropolitan Housing Trust and London & Quadrant (L&Q), and three issues by different universities, being University of Liverpool, Cardiff University and Leeds University, all of which received a warm welcome from investors despite the challenging market conditions ([GlobalCapital, 2016](#_ENREF_104)). When evaluating the investor demand on Aberdeen Council’s bond issuance, it can be noted that they received seven bids from different investors. According to their official presentation, Aberdeen Council’s decision makers had to increase their borrowing sum to accommodate the demand received from various investors. See figure (8).

Figure 9 Investors' bid for Aberdeen bond program

Graphical user interface

Description automatically generated

Source: (Steven Whyte, 2016)

## 2.5.3 The impact of Credit rating on bonds issuance in England.

Most of the municipal bonds are rated by rating agencies in order to reduce the municipalities borrowing costs ([Jaffray, 2005](#_ENREF_121)), and to tell the investors about the portability to default ([Yinger, 2007](#_ENREF_321), [Joffe, 2012](#_ENREF_124)). Strong credit ratings mean investors are taking less risk, and they receive a lower rate of interest on their bonds. On the other hand, lower credit ratings indicate higher credit risk, and investors receive a higher rate of interest as compensation for assuming the risk ([Jaffray, 2005](#_ENREF_121)). Therefore, credit rating is considered an important public interest due to its ability to alter the cost of public infrastructure ([Yinger, 2007](#_ENREF_321)).

That being said, credit rating is not necessarily undertaken by all bond issuers. Some municipalities might issue non-rated bonds for different reasons. Firstly, the issuer might well be robust financially, but the size of the placement makes it uneconomical to pay for the rating. Secondly, many non-rated bonds would not meet the rating criteria of the rating agencies, or, if rated, would fall below the required investment grade (BBB) ([Jaffray, 2005](#_ENREF_121)).

Nonetheless, credit rating agencies and their practices have been subject to criticism when it comes to municipal bonds. The [SEC (2012)](#_ENREF_265) report criticised the validity of MB credit ratings, as credit rating agencies are assessing the credit risk at a particular point intime. Furthermore, each credit rating agency evaluates credit risk based on its own standards, applies its own rating methodology, and weighs the various factors in the methodology differently resulting in a highly subjective rating that differs from agency to agency. Similarly, [Yinger (2007)](#_ENREF_321) argued that the rating granted is based on factors that the rating agency believes are linked to the creditworthiness of the bonds for either the issuance itself or the issuer body. The rating assessment for revenue bonds is connected to its own revenue stream, and so bonds receive their own rating. On the other hand, the general obligation bonds are backed by the municipality’s full taxing power, therefore they receive the rating of the issuing body.

Another criticism is found in the similarity in the rating scale of MB with corporate bonds. The issue lies in the fact that investors cannot undertake a direct comparison between MB and corporate bonds because the rating criteria is different in each case. For example, a MB which is BBB rated has a higher creditworthiness than BBB rated corporate bond ([WFFM, 2010](#_ENREF_308)). This argument is strengthened when a comparison is drawn between MB and corporate bonds. In the US, records of defaulted bonds between 1986 to 2014 shows that all MB defaults accounted for 0.24% which is still less than AAA rated corporate bond default rates, which accounted for 0.74% ([Black et al., 2015](#_ENREF_30)).

The below sections will discuss credit rating assessment, validity, and credibility by evaluating the possibility of LA insolvency, and the role of central government.

### 2.5.3.1 Credit rating assessment

[Floater. et al. (2014)](#_ENREF_96) explained that one of the major barriers for LAs accessing capital markets, both generally and specifically bonds, is the lack of municipal creditworthiness. Similarly, some industrial press reported that creditratings might prove to be difficult for those LAs who are financially distressed. This would limit the number of LAs who would find MBs suitable for them ([Llewelyn, 2017](#_ENREF_152), [Gavin-Brown, 2018](#_ENREF_102), [Brady, 2020a](#_ENREF_48)). Unlike PWLB products, this extra layer of scrutiny relates to associated risk represents one of the key reasons behind the lack of MB use in England ([Marrs, 2019m](#_ENREF_181)).

Nonetheless, credit rating is an essential element for any LA who seeks to issue bonds and want access to the capital market ([Smullian, 2019](#_ENREF_275), [Knezevic, 2019](#_ENREF_134)). This argument is further strengthened when looking at the Local Government Act 2003; *“a local authority may not mortgage or charge any of its property as security for money which it has borrowed or which it otherwise owes”* ([Parliament, 2003, P6](#_ENREF_223)). Therefore, neither UKMBA nor any LA is able to use their assets to guarantee their borrowing, making the credit rating essential to reassure buyers on the safety of their investment. Danny Mather, Warrington Council’s Corporate Finance Manager, confirmed that by stating that their bonds cost would have been much higher if they did not have the credit rating in place ([Room151, 2015](#_ENREF_242)). Nevertheless, [Smullian (2019)](#_ENREF_275) warned that a good credit rating is a long and costly journey with no guaranteed outcomes that the price able to be obtained on issuance would be cheaper than PWLB’s costs.

So far, public bodies in England who had their credit rating in place either went out to market and issued bonds, or at least were ready to borrow from the market should they need. Back in 1994, both AAA rated Salford Council and Leicester City Councils, issued £100m and £80m bonds, respectively. In 2005, Birmingham City Council, rated AAA, issued £200m to refinance its National Exhibition Centre ([Rodgers, 1994](#_ENREF_238)). TFL had successfully issued three times since 2012, rated at AA2/AA+/AA- at a range between 89-58 basis points over gilts. Cambridge University and Manchester University, rated AAA and AA1 respectively, issued bonds at 60 basis points over gilts as well ([Aidan et al., 2014](#_ENREF_9)). In 2015 both GLA and Warrington City Councils issued their first bonds. While GLA achieved credit rating of AA and issued £200m to fund the Northern Line extension, Warrington City Council achieved AA2 and issued a £150m bonds deal, mostly aimed at developing its town centre. All those issued bonds either equalled or beaten the PWLB rate at the time ([Sandford, 2016](#_ENREF_253)).

The other group are Authorities who obtained their credit rating but have not yet gone through bonds issuance, such as London Borough of Wandsworth AA+, Guildford Borough Council AA+, Cornwall Council AA+, Lancashire County Council AA1 and Woking Borough Council AA- ([Sandford, 2016](#_ENREF_253)).

The previous spectrum of rating shows that both groups have generally achieved a strong credit rating. Although the above may show the strengths of public sector creditworthiness, the question is the validity of this generalisation. What is not clear is for those who have not obtained credit rating as yet, and whether they have not done so due to their lack of interest in the financial market or lack of creditworthiness.

#### UKMBA and credit rating

The UKMBA’s own credit rating given by Moody’s is AA3 ([Marrs, 2019q](#_ENREF_185)). Such rating aims to make savings and diversify LAs against PWLB borrowing, but most importantly it helps to harness the collective credit strength of LAs seeking to access the capital market. This may well be why the Agency obtained its rating not only once, but twice, using both Moody’s and Standards & Poor agency credit rating services ([Cross, 2016](#_ENREF_67)).

Nonetheless, many LAs voiced their concerns about the liability risk they bear should they be part of pooled issuance, as well as the impact on investors views of the pool should any weaker or riskier LA be part of it. Along with Brent Council annual report ([Marrs, 2019c](#_ENREF_171)), Aberdeen City Council’s Investment Director warned of the threat of including a risky LA in the pool and its impact on the sectors reputation. Therefore, the call has been for UKMBA to apply rigorous credit checks, and exclude those who do not reach the required standard from the pooled issuance stream ([Marrs, 2020g](#_ENREF_196)). Those concerns were pronounced in response to the letter sent by the UKMBA Chairman to its shareholders. One of the key demands LAs identified is a more rigorous credit process for pooled issuances ([Marrs, 2019q](#_ENREF_185)). This would not applicable for a single lane issuance even when being facilitated by the UKMBA. This was clarified in the most recent news about Lancashire Council’s bonds issuance via UKMBA. UKMBA’s Chair confirmed that as Lancashire Council already had its own credit rating in place (AA3), it will not be subject to the UKMBA credit rating process ([Brady, 2020b](#_ENREF_49), [UKMBA, 2020a](#_ENREF_294)).

### 2.5.3.2 Credit validity and credibility.

#### Can LAs go bankrupt?

Many public sector experts asserted on the level of trust in LAs’ creditability in England. It was widely discussed that the UK public sector offers some of the best credit risk available for the investor. Historically, in over 900 years, none of the LAs in the UK had ever defaulted on their debt liabilities. The latest default was the City of London in 1076 ([Wall, 2019b](#_ENREF_306), [Marrs, 2014](#_ENREF_164), [Eichler, 2018](#_ENREF_87)). LAs credit quality is further strengthened by a number of existing safeguards that makes default a very unlikely possibility. In addition, there is the fact that LAs are legally unable to borrow for revenue purposes ([Eichler, 2019](#_ENREF_88)), and all of their debt is secured on their revenues. This includes both Government grants and statutory taxations ([Wall, 2019b](#_ENREF_306)). Furthermore, if LAs’ Section 151 officers in any authority are concerned about the Council’s ability to meet obligations, then they will report their concern, and not take on any further debt ([Marrs, 2014](#_ENREF_164)). A similar argument was put forward by the UKMBA, stating that LAs are subject to statutory and legislative controls, such as the Prudential Code, that prevents them from excessive risk. On top of this, there is always the PWLB in the background for liquidity support as well as the central Government power to intervene at any point to prevent any LA from defaulting on their debt ([UKMBA, 2015](#_ENREF_293)).

[Davey (2011)](#_ENREF_68) argued that in some cases, the general Government fiscal position very much determines the cost of municipal bonds, regardless of the creditworthiness of the issuer. This explains the limited accessibility of local governments to borrowing in highly indebted countries, such as Spain.

The role of the central government is found to be significant in credit rating process and outcomes. One such impact is evidenced in Moody’s credit rating for Aberdeen City Council of AA2. The granted rating came with a negative outlook, mirroring the negative outlook of the UK sovereign rating following the vote to leave the European Union ([Room151, 2017](#_ENREF_243)). Another impact is found when looking at the methodology followed by Moody’s on Aberdeen Council’s credit rating. Two factors relating to central government were considered. The first is the Government’s baseline credit assessment, and secondly, the likelihood of extraordinary support from the Government ([Whyte and Stewart, 2016](#_ENREF_310), [Moodys, N.D](#_ENREF_206)). This was clearly stated in Moody’s Bank Rating Methodology (2015) *“The CR assessment will be positioned relative to the adjusted Baseline Credit Assessment – also a measure of default probability and our opinion of issuers’ standalone intrinsic strength – and incorporate government support where applicable”* ([Moody's, 2015 , P9](#_ENREF_205)).

The possibility and the ability of central government intervention was stated in the Local Government Act 2003 as follows *“The Secretary of State may, if he thinks it appropriate, make payments to the Public Works Loan Commissioners so as to reduce or extinguish such debt (whether then due or not) of a local authority in England to those Commissioners as he thinks fit & The Secretary of State may, if he thinks it appropriate, make payments to a local authority in England for application by the authority in reducing or extinguishing such debt (whether then due or not) of the authority as he thinks fit”* ([Parliament, 2003 , P19](#_ENREF_223)).

On that point, [Knezevic (2019)](#_ENREF_134) analysis concluded that, despite the possibility of governmental intervention, both investors and creditors in general do not believe in the exitance of a central government guarantee. Nonetheless, in England, such intervention is evident in the most recent practice where the state intervened to prevent Northamptonshire County Council fall into insolvency ([Wall, 2019b](#_ENREF_306)). Similarly, Christian Wall, PFM Director told Room 151 that fears of LA’s bankruptcy are *“misplaced”* especially with the Northamptonshire County Council case proving that the central government will not allow a large authority to go bankrupt ([Marrs, 2019c](#_ENREF_171)).

In England, many experts believed that LA creditability is best shown in how they managed their finance post the GFC. This assessment is believed be sufficient for investors to conclude that lending to them proved to be less risky compared to similar rated corporate bonds ([Marrs, 2019j](#_ENREF_178), [Twinch, 2019b](#_ENREF_291)). David Couling, broker at Tullet Prebon, explained that in England, not all lenders are familiar with public sector credit, but predicts more demand once they know and understand the sector *“I think offers will come out over the course of time as potential lenders get comfortable with the sector. They won’t rush into this”* ([Marrs, 2020b](#_ENREF_191)).

Furthermore, the existence of PWLB as the lender of last resort empowers any LA with the possibility of refinancing any maturing debt and repay it back even when financial markets are not accessible ([Marrs, 2014](#_ENREF_164), [Eichler, 2019](#_ENREF_88)). Therefore, it is argued that the possibility of an English LA becoming insolvent and defaulting on its debt is not possible in the same way private entities are able to. According to Local Government in England: Structures report (2018), a local authority cannot decide to cease to exist, and even the merge of two authorities is subject to Parliamentary approval ([Sandford, 2018](#_ENREF_254)).

Similarly, in Sweden 1992, the municipality of Haninge was unable to cover one of its subsidiaries costs and was close to bankruptcy. The situation was resolved by a central government bail-out for both the municipality and its subsidiary by offering them a loan. This is believed to have sent a strong message to investors that municipalities cannot go bankrupt ([Knezevic, 2019](#_ENREF_134)). Like restrictions placed on English local authorities, Swedish LAs cannot cease to exist, and only Sweden’s Parliament can merge two or more together, in which case their assets and liabilities of one becomes the assets and liabilities of the others. Further similarity exists in the fact the Swedish LAs are liable for all their obligations with all their tax power and total assets. The key difference is the autonomous tax power that is enjoyed by Swedish LAs, as opposed to the limited taxing powers enjoyed by English LAs ([Knezevic, 2019](#_ENREF_134), [Parliament, 2003](#_ENREF_223)).

In the US and China, the default risk proves to be different. According to [Marrs (2019e)](#_ENREF_173) and [Blakeley (2017)](#_ENREF_31), many cities have accumulated debt by issuing bonds which have caused them to file bankruptcy. Cities in the United States, such as Detroit (Michigan), San Bernardino (California), Hillview (Kentucky), and Central Falls (Rhode Island) have all become insolvent. Similarly, in China, the prediction is that many cities might become heavily indebted due to the fact that state banks are compelled to buy cities’ bonds, even if there are no sufficient resources to pay the debt back ([Floater. et al., 2017](#_ENREF_95)). Considering that bond investors are not limited to local, but also include international investors, credit rating seems to be essential to attract the latter group who may or may not be familiar with the strengths of the public sector in England.

## 2.5.4 The impact of transparency on bonds issuance in England.

Transparency is considered as one of the main features of any successful bond market. The quality and equal availability of information to all stakeholders is key to the latter actions in the market. The argument is that market information, when reaches the level of being a common knowledge for all stakeholders, then the market is considered to be fully transparent. Most financial markets, aiming to increase participation, thrive on providing stakeholders with adequate levels of transparency, competition, impartiality, and protection. Generally speaking, transparency can be divided into two categories. The first is connected to the publication of generic information about the issuer’s recent performance. The second is related to publication of market related data that might have an impact on any of the stakeholders at the time of such data release ([Biais et al., 2006](#_ENREF_28)).

Unlike corporate bonds, price transparency is deficient in municipal bond markets. This is due the fact that the latter is normally traded by “over the counter” dealers networks and not via a “centralised exchanges”. On top of that, most bonds are never traded again in the secondary markets leaving investors will little capacity to assess their investment price or value. In addition, it is hard for investors to obtain information on the underlying issues, or to obtain statements that are comparable across issuers and show a full historical background of the issue. Furthermore, the absence of such information and the complexities of bond markets makes it harder for small bond issuers and buyers to assess their decisions. This makes their participation in the market uneven when competing with large institutional investors ([Ang and Green, 2011](#_ENREF_15)).

For non-institutional investors, trading in the secondary market for municipal bonds can be expensive, and very problematic; the secondary market is not transparent enough, both in pricing and execution. A successful trading in the secondary market requires deep knowledge, understanding, and experience in how it operates ([Bennyhoff, 2009](#_ENREF_25)).

The following section will evaluate the level of LA transparency already existing in England and looks into the role of UKMBA as a facilitator to enrich information availability and quality.

### Existing levels of transparency

Different studies have highlighted the impact of transparency and information release relating to the bond market. Some focused on pre-trade transparency, and others on post-trade transparency. One study found a positive correlation between post-trade transparency and both liquidity and price efficiency ([Bloomfield and O'Hara, 1999](#_ENREF_33)). Furthermore, the findings of [Flood et al. (2002)](#_ENREF_97) noted a trade-off between liquidity and efficiency in line with the increase pre-trade transparency.

In England, the fact that English LAs handle 22% of UK public sector spending requires the *“highest level of transparency”*, according to CIPFA Chief Executive, Rob Whiteman ([Twinch, 2019a](#_ENREF_290)), who called the MHCLG to have an *“oversight brief”* to ensure the sector has more transparency ([Brady, 2019f](#_ENREF_47)).

The counter argument made by James Palmer, the Conservative Mayor of Cambridgeshire and Peterborough Combined Authority, was that there is already enough financial transparency in the sector, and more would be needed if more powers were devolved down to LA level ([Brady, 2018g](#_ENREF_41)). Similarly, Christian Wall, Director of PFM, told Room 151 that LAs are actually publishing *“a wealth of financial information”* which is far more than any other sector in the UK ([Room151, 2019b](#_ENREF_246)). Also, Jo Pitt, Local Government Policy Manager at CIPFA, noted that there was an increase reporting and transparency practices, and warned that this might burden already overwhelmed staff and ask them to deliver more reports ([Marrs, 2018b](#_ENREF_167)).

According to CIPFA Chief Executive, Rob Whiteman *“transparency is the vehicle by which governments can be held to account”*. This measures how well the Government is opening itself and engaging with public scrutiny. Whiteman noted there was a lack of internal transparency within the public sector. This is evidenced in discussions around the effective communication methods between Councils financial management teams and their leadership teams, who scrutinise the standards of accountability and efficiency. Therefore CIPFA, in its 2019 Financial Management Code, aimed to increase internal transparency within each Council ([Whiteman, 2019](#_ENREF_309)).

In 2014, a report called Steering Urban Growth highlighted the urgent need for more transparency in the public sector. The report noted that the lack of transparency is still a barrier for strengthening LAs’ fiscal position as well as their engagement with the private sector necessary for their urban development needs ([Floater. et al., 2014](#_ENREF_96)). It is argued that most of the sector is transparent and have very strong financial management. Nevertheless, a proportion of LAs need to provide more assurance and transparency in relation to their investments, which will have a significant impact on improving trust in the whole sector ([Brady, 2018d](#_ENREF_38), [Room151, 2019a](#_ENREF_245)).

Probably the hottest topic about controversial decision making is around LAs excessive investment in commercial properties. Tim Seagrave, Financial Lead at Manchester City Council, argued that it is obvious that excessive investment in commercial properties is the wrong decision. Thus, enquiries around LAs’ resilience show a pressing need to take a closer look at LA balance sheets. Some elements are overlooked, not completely transparent and not reported clearly on the balance sheet ([Marrs, 2019t](#_ENREF_188)). Similarly, a report produced in 2019 by the MHCLG found that some Councils need to improve their transparency around investments decisions made ([Marrs, 2019o](#_ENREF_183)).

Meg Hillier, the Public Accounts Committee Chair, spoke about the urgent needs for LAs to be more transparent as a result of in increasingly *“savvy”* British public that do not trust their LAs to spend their money well. Meg argued that, as a result of the decision to dissolve the audit commission, there has been a drop in transparency levels. Therefore, more is needed to improve scrutiny as to how public money is being spent ([Brady, 2018g](#_ENREF_41)). Both Ed Hammond, Director of Centre for Public Scrutiny, and Gareth Caller, Head of the Local Government Finance Unit at MHCLG, expressed the view that it is necessary for LAs not only to publish their figures and data, but to justify that their decisions are based on the best value for money and explain why such decisions have been made ([Marrs, 2019n](#_ENREF_182), [Brady, 2018g](#_ENREF_41)).

One example is the Northampton International Academy, which is a project that overspent by £11.7m. A report presented to Northamptonshire County Council in 2019 highlighted poor budget management and lack of transparency as the main reasons behind the issue. An audit was launched by the Council’s new Chief Executive as a result of a resident complaint about not being able to get answers to their questions, even after submitting a freedom of information request. The audit report said: *“Neither consultation nor approval was sought by the relevant officers. It is difficult to avoid the conclusion that this refusal was indicative of a culture of limited transparency across the council at the time”* ([Smith, 2019b](#_ENREF_273)).

At the same time, there were some calls for top-down transparency as well. Meg Hillier, PAC Chair, argued that the Treasury should release more detailed and transparent data on its funding decisions regarding grants to LAs. This would allow better scrutiny on whether grant money has been allocated based on needs ([Brady, 2019a](#_ENREF_42)). Even MPs showed their frustration that the advice given by civil servants to ministers on LA finance arrangements have not made available for debate. Melanie Dawes, Permanent Secretary at the Communities Department, noted the lack of such transparency and analysis of LA finance in the public domain ([Marrs, 2018c](#_ENREF_168)).

Another issue reported was the number of Councils that fail to meet the deadline required for publishing their audited accounts. An example of that is that in 2019 where 40% of LA audits were not completed by the deadline of the end of July. The problem is that by doing so, they have not broken any laws and there will be no sanctions for missing this deadline. This suggested an issue around financial transparency measures that are in need of an update ([Room151, 2019d](#_ENREF_248)).

It may be well concluded that most LAs in England provide a good level of information, boosting sector transparency. Nonetheless, there are several areas that needs improvement in both the amount of information supplied and the quality of such information. This enhanced transparency will be able to better give a rounded picture of the public sector overall, and specifically LA, to facilitate sound bond market development.

### Methods to enhance the transparency

The UKMBA could potentially play a great role in increasing transparency levels of LA borrowing and create better scrutiny around borrowing via intra-lending, as well lending from the financial markets. The borrowing price the Agency would offer depends on the performance of individual LAs, and the group, thus a greater peer scrutiny would drive the pool ([Aidan et al., 2014](#_ENREF_9)).

It has been reported that Northamptonshire County Council’s financial turmoil has triggered demands for more scrutiny and transparency around LA finances ([Brady, 2018e](#_ENREF_39)). Therefore, and to avoid another failure like Northamptonshire County Council, and to protect the overall public sector reputation, more *“honesty”* is needed both internally, in the local authority, and externally with peers ([Brady, 2018d](#_ENREF_38)). Such critical need for more transparency, and the disappointment in the sector, were shown in the fears presented by London Borough of Brent whereby its representatives expressed their concerns of being in the same pool as Northamptonshire County Council ([Marrs, 2019c](#_ENREF_171)). Similarly, Fiona Dickinson, Investment Director at Aberdeen Standard Investments, told Room 151 that no LA would like to be in the pool with a risky LA, making it imperative that each LA can *“screen out”* those authorities who may not have the needed credit quality. Dickinson continued by commenting *“We have seen an awful lot of noise about commercial real estate investing … clients do not want to see headline risk”*. After the bailing out of Northamptonshire County Council, clients were asking if they were exposed to that debt. There had also been the recent reports about excessive borrowing by LAs to invest in commercial properties. All of that put investors in a position where they needed to provide answers to their credit committee ([Marrs, 2020g](#_ENREF_196)).

Don Peebles, head of CIPFA UK Policy & Technical, told Room 151 that, unlike before, LA finance is making the headlines nowadays ([Brady, 2018e](#_ENREF_39)). Nevertheless, some of the issues are not directly related to the actual level of transparency, but in the credibility attached to those headlines seen in the press. Some industrial press claimed that most analysts lack the needed resources, expertise, and the time to do such in-depth analysis. This increases the risk of superficial and headline grabbing pronouncements ([Room151, 2019b](#_ENREF_246)). An example is found in one of the BBC reports in 2019, which named eleven LAs that were at risk of running out of their reserves. The figures used to produce the report were described by some LAs as misleading as they were based on *“incorrect assumptions and faulty maths”* ([Marrs, 2019k](#_ENREF_179)). Jane Aston, Knowsley’s Cabinet Member for Resources, said that the reports are misleading, and that her Council position was misinterpreted, which is incredibly frustrating for the Council ([Room151, 2019a](#_ENREF_245)). Therefore, calls have been made asking LAs to consider private sector branding and marketing efforts to better help them communicate their strength with their wider investor audience ([Blakeley, 2017](#_ENREF_31)). Here, it seems that the UKMBA is at the best position to speak out to investors and enforce the financial strengths of its members.

The UK Municipal Bonds Agency report in 2014 noted the Agency’s role in increasing LA transparency. The Agency business model requires a rigorous and transparent credit process for LA part of any pool issuance. At the same time, and based on other international bonds’ experience, both peers and the financial market would also put pressure on LAs to increase their transparency levels ([Aidan et al., 2014](#_ENREF_9)). Another attempt boost transparency levels was presented in 2018 by MHCLG, who started to request LAs to prepare an annual investment strategy. This step meant that LAs would be able to explain the coherence between their capital program, investment and borrowing strategy, as well as asset management to give further clarification on decisions made ([Willcox, 2018](#_ENREF_312)).

At the same time, there were calls for more simplified transparency and an increase in the scrutiny measures of the released data ([Willcox, 2018](#_ENREF_312), [Brady, 2019a](#_ENREF_42)). Christian Wall commented *“Data without context is meaningless. Effective interpretation and correct responses to the funding of the index require context and other data”* ([Room151, 2019b](#_ENREF_246))*.* Therefore, a more useful change would be directing the Government and CIPFA to simplify both LA accounts and financial reporting, along with revolutionising financial reporting both within LAs, and what they publish in the public domain ([Room151, 2019b](#_ENREF_246)).

One of the key reports done on transparency was commissioned by City of London and completed 2006, entitled ‘European Government Bond Markets: Transparency, Liquidity, Efficiency’. The report indicated that fairness and information supply are essential to attract enough market participants needed for the market to function properly. At the same time, the report calls for an *“optimal”* level of transparency, and two aspects of transparency were considered. While the first is related to the release of general information concerned with the issuer performance, the second aspect focuses on the immediate release of market information that might affect market participants behaviour. The report concluded that market dealers would rather work in an opaque market. Therefore, a rational level of opacity is essential to induce dealers to supply liquidity and pre-trade information ([Biais et al., 2006](#_ENREF_28)). Similar findings were reported by other studies suggesting that too much of transparency would adversely affect market quality ([Aitken et al., 2009](#_ENREF_10), [Martínez-Resano, 2005](#_ENREF_198))

## 2.5.5 The impact of Liquidity on the bond market development

The availability of a wide varieties and complexities of bonds and bond issuers, and the decentralization of trading, normally leads to a less liquid bond market ([Ang and Green, 2011](#_ENREF_15)). Municipal bonds are not as actively traded as taxable bonds or corporate bonds, thus they are considered as less liquid and to have higher transaction costs ([USAID, 2010b](#_ENREF_299)). This is mainly caused by the fact that municipal bonds are from a large variety of issuers and often include features such as embedded derivatives, which makes them difficult to compare against each other ([Maziad et al., 2013](#_ENREF_200)).

There is a growing body of evidence to suggest that municipal borrowers, and the retail investors who hold their bonds, pay too much to issue new bonds or to buy and sell existing bonds. As a consequence, many bonds simply stop being traded after a few months. Because investors value and will pay more for securities that are more liquid, the lack of liquidity drives up financing costs for municipal borrowers ([Ang and Green, 2011](#_ENREF_15)).

[Maziad et al. (2013)](#_ENREF_200) discussed how bond liquidity could be enhanced, such as concentrating government bond issues in relatively limited key maturities. This would help to lower borrowing costs for issuers relative to a preferred risk level. This might take time for newly a developed bond market, and issuers would need to establish a benchmark strategy that allows standardisation of debt instruments, maturity distribution for benchmark issues, and establish a threshold regarding the optimal issuance size and the frequency of those issues. To enhance the activity level in secondary markets, market makers can help to standardise execution transactions in terms of pricing and trade services provided. Issuers and bond dealers can also assist when forming repurchase agreements, which ultimately will help to stimulate the secondary market. Short selling is another practice that could enhance liquidity, which entails selling bonds with the intention of rebuying the bonds at a later date to return to the lender.

Unlike Sweden and other active bond markets, the lack of issuance in England and the lack of market information makes it harder to determine the market liquidity. Even in active markets, liquidity has different factors that are not easily controlled ([Lybek and Sarr, 2002](#_ENREF_157)). One of the measures to determine market liquidity is the monthly issuance of government bonds as a percentage of overall government debt ([Knezevic, 2020](#_ENREF_135)). The key difficulty in the Sterling market is that the lack of issuance makes it harder to apply similar measures, especially considering the gaps between fragmented issuances can be years, and the fact that very few LA repeated their bond program. Ulrik Ross, Global Head of Public Sector and Sustainable Financing at HSBC, expressed both the potential and the need for the UKMBA to be active in order to bring attractive liquidity levels to the market ([GlobalCapital, 2016](#_ENREF_104)). [Knezevic (2019)](#_ENREF_134), suggested practices to assist an aggregator to increase market liquidity, such as increasing investor awareness by targeting them with public relation efforts, including their bonds in a well-known security index, and employing market makers such as commercial banks, all of which can help aggregators improve their investor base.

# 2.6 Formal and informal rules and Ideas that prevails in English bond market

This section will attempt to discuss the formal and informal rules, ideas, and norms which separately and collectively affect the development and application of the bond market in England. On the issuer side, this section will review key matters such as the level of knowledgeable in-house expertise and capacity, ambitions, and structural difficulties. This will be followed by an evaluation of the effect of impact bonds, mainly social and green bonds, on the actions and interest of both issuers and investors.

## 2.6.1 In-house expertise and risk tolerance

Most Councils in England, and regardless of their size, rely heavily on the PWLB, and factors such as the simplicity and certainty offered by PWLB are certainly the most important drivers for this reliance. In September 2019 alone, Councils added £3.847bn extra borrowing to their total borrowing from the PWLB. Leeds City Council was the biggest borrower from PWLB during this month, taking out a loan of £200m ([Marrs, 2019i](#_ENREF_177)). However, even with PWLB simplicity, it is suggested that there might be a misuse of PWLB products. One of the reported issues was Councils taking a 45-year loan on a much higher fixed rate (almost double) than taking the same loan but over a 25-year term. Christian Wall told LocalGov that, aside from the argument as to whether PWLB is the best option, financial decisions must come from a strong strategy linked to project cashflow requirements. The lack of experience might, therefore, be the reason why some LAs take their borrowing decisions around a feel for interest rates and the cash available and not based on sound financial planning ([Wall, 2019a](#_ENREF_305)).

[Eckersley (2017)](#_ENREF_83) has argued that the notion of capacity has not been researched in depth, which leaves a gap in the understanding of how subnational governments’ governance varies across countries, and within the same country. Eckersley continues that internal capacity is evident in *“weak”* subnational bodies where their elected members *“look to private businesses to provide them with the power to achieve their objectives”*, which in turn, forces LA, in some instances, to compromise ([Eckersley, 2017](#_ENREF_83)). [Mertens et al. (2021)](#_ENREF_204) adds that, when it comes to in-house expertise, this varies drastically across different LAs which can either limit or liberate the financial power for each of those authorities.

[Tickell (1998)](#_ENREF_286) argued that, in the history of LA finance, some brokers and financial institutions sold complicated financial products to naive decision makers. This is referred to the differences in human capacity between LAs and financial institutions resulted in deals with unfavorable pricing, and were deceptive due to the lack of risk understanding from the buyer. Such differences are likely to be found in those smaller LAs, and therefore lack the in-house expertise that can understand complex financial products.

Martin Easton, Head of Financial Strategy at Birmingham City Council speaking to Room 151, questioned LA expertise and competence to engage with the financial markets. Easton asked whether this engagement was part of the original LA’s role, and if the associated risk is fair on taxpayers. He said that a Local Authority’s role was to provide services to the public, and not to be financial institutions. *“It is not our prime expertise as local authorities. Are we really skilled and competent to do that kind of activity? But, more fundamentally, still, is that kind of risk the right thing to be doing with public money? And in my view, it is not”* ([Marrs, 2019t](#_ENREF_188)). As well as the lack of investment expertise in LAs, a wider *“skills-deficit”* was presented as one of the main reasons behind LA’s risky financial decisions ([Willcox, 2018](#_ENREF_312), [Marrs, 2020b](#_ENREF_191)). This often results in undervaluation of loan components and options, and decisions solely based on *“beating”* the PWLB rate ([Brady, 2018b](#_ENREF_36), [Marrs, 2019a](#_ENREF_169)). Even outside of the issuance of bonds, some Councils made commitments to financial products, such as LOBO, that were later seen as toxic, unfair, and complicated. Some of those products’ offerings have risen in a *“predatory manner”* in a response to sudden changes in the PWLB rates ([Brady, 2018b](#_ENREF_36), [Pickard, 2018](#_ENREF_230), [Marrs, 2019a](#_ENREF_169), [Wall, 2019a](#_ENREF_305), [Marrs, 2020b](#_ENREF_191)). Most LA decisions to take out unfair LOBO loans were as result of the lack of the needed in-house expertise, and people who can ask the right questions ([Brady, 2018b](#_ENREF_36)), and those who can understand the answers in terms of the risks associated with those loans ([Wall, 2019a](#_ENREF_305)).

It is often reported that LAs who decided to instigate bond programs were boosted by either existing commercial experience in the Council, or the desire to build such experience. In Aberdeen City Council’s bond program, a combination of the in-house expertise, ambition of the leadership, and close connections to the market players, came together to allow the Council to communicate its vision and financial resilience to the investing audience ([Room151, 2017](#_ENREF_243)). Similarly, one of the main reasons behind Warrington Council’s bond program was their desire to build on their commercial culture and attitude ([Room151, 2015](#_ENREF_242)).

The recent hike in PWLB rates prompted further thoughts about what financial markets could offer LAs’ sector. Before the increase in PWLB rate, it was possible to obtain bond funding at a cost of between 0.2 to 0.5% above the PWLB rate, after the increase, lenders will offer 0.5% - 0.8% below PWLB rate. The argument is that although bonds would require more administrative work, if councils are set to save around £1m per year for a long term maturity, then they should be willing to invest more time and money up front by increasing their in-house expertise required to manage the process ([Green, 2019](#_ENREF_106)).

## 2.6.2 Structural problems

When assessing the UKMBA model, in addition to the structural risks associated with mixing council borrowing across UK’s home nations, other structural issues arose around Brexit and the Scottish Independence referendum, which presented further risks to how markets react to pooled municipal bonds. Such risk was found even in a single lane issuance, as undertaken by Aberdeen City Council. The market makers conveyed doubts about market activities, and whether the required demand would materialise on their bond programs ([Room151, 2019a](#_ENREF_245)). The structural limitations could be extended to entail pooling bonds for Councils within England. Along with Northamptonshire County Council and other councils, who are repeatedly reported to be in financial distress, there are councils who are much stronger in their financial resilience. Examples of such strong resilience are Greenwich Council and Somerset Council. While the former reserves levels are reported to be one of the best in London, Somerset Council managed to turn one of its projects from an overspend of £12m in 2018 into an underspend of £6m in 2019 ([Room151, 2019a](#_ENREF_245)). The difference in financial planning and soundness shows a difficulty that the UKMBA may face when attempting to pool councils’ borrowing.

Further structural complexity within a council can be seen in council’s decision makers. The role of political leadership and councillors, along with councils’ individual leaders, was discussed as being an important factor. Speaking to PF, Guy Clifton, the Head of Local Government Advisory at Grant Thornton, stated that LA financial success needs an *“effective gateway process”* between council financial experts and elected members, to be necessary for decision making. Along with stressing on the importance of the role of elected members to scrutinise decisions, Clifton advised that some risks should be left to the specialists. Ed Hammond, a Director of the Centre for Public Scrutiny, which champions good scrutiny and accountability in local government, agreed with that adding, in order to have an effective communications, finance experts should understand exactly what elected members are in need of knowing ([Willcox, 2018](#_ENREF_312)). Therefore, when it comes to engaging with the financial markets or attempting to place debt via the bond market, financial experts at a council will be faced with the pressing need to communicate their clear and simple vision, in order to bring their politicians on board.

## 2.6.3 Social and green bonds

This section will cover how impact bonds, mainly green and social bonds (GaS), can shape the strategies and interests of both investors and issuers, and discusses the associated reporting issues related to these types of bonds.

### Green and Social bonds’ Investors

There is strong evidence showing declining demand for non GaS investments, as a result of continual pressure on investors. [Marrs (2020e)](#_ENREF_194) argued that several local government pension schemes (LGPS), investors, and individual shareholders called on Barclays Bank to cease its fossil fuel investments. The demands were for Barclays to set and publish targets to phase out its finance to non-green energy companies alongside their annual progress disclosure. Laura Chappell, Chief Executive of Brunel Pension Partnership, discussed the role investors can play to carry out climate change risk assessment across the financial sector. Similarly, Nick Robins, Professor in Sustainable Finance at the London School of Economics and Political Science, speaking at the annual conference of the Local Authority Pension Fund, expressed the urgent need to expedite climate investment related actions ([Hinks, 2019](#_ENREF_117)).

[Blakeley (2017)](#_ENREF_31), in his report ‘Paying for Our Progress’, indicated that sovereign wealth funds represent a large pool of money that could be accessed to lend LAs funds to facilitate their green energy projects. Furthermore, [Hailstone (2011a)](#_ENREF_108) argued that the Government is encouraging private investors to buy social impact bonds in an attempt to stimulate demand. In line with that, Pete Gladwell, Head of Public Sector Partnerships at Legal & General Investment Management, expressed the pensions sector’s determination to support LAs in their role of delivery of social infrastructure and houses needed for their communities ([Marrs, 2019n](#_ENREF_182)). More recently in 2020, three LGPS bodies announced their plan to fund a number of housing and infrastructure projects in an attempt to reinforce their positive contributions to local social and environmental issues ([Marrs, 2020f](#_ENREF_195)). Therefore, there is emerging and growing evidence of the potential demand on green and social investments in general, which can, to an extent, be extended to include the demand on GaS bonds.

[Floater. et al. (2014)](#_ENREF_96), in his report of ‘Financing the Urban Transition’, explains that the green bond market is an emerging market aiming to finance low carbon infrastructure. It can be issued not only by governments, but also banks and corporate entities as well. The estimated size of this market is around $503bn globally ([Climate, 2014](#_ENREF_59), [Floater. et al., 2014](#_ENREF_96)), of which municipal bonds represent a very small proportion; around 2.5% ([Oliver and Boulle, 2013](#_ENREF_217)). The market is fast growing and mainly dominated by issuers from developed countries. For example, Johannesburg City Council issued green bonds worth of $136m, which was oversubscribed by investors. This bond program aimed to fund green projects, such as renewable energy and hybrid transportation ([Floater. et al., 2014](#_ENREF_96), [Climate, 2014](#_ENREF_59)). In the US, a green energy bond issuance raised close to $5.6bn between 2006 and 2011 ([Merk et al., 2012](#_ENREF_203)). France, in 2012 had issued two bond programs worth of €950m ([Morel and Bordier, 2012](#_ENREF_208)), and the City of Gothenburg (Sweden) had an issuance close to $273m to fund public transport and energy projects relating to water and waste management ([Floater. et al., 2014](#_ENREF_96), [Climate, 2014](#_ENREF_59)). All of the aforementioned GaS issues were met by sufficient investor demand and demonstrates a clear appetite for such investments.

### Green and Social bonds’ issuers

[Hameed (2019)](#_ENREF_112) reported that impact bonds are effective tools to address public service challenges by allowing LAs to deliver services but with improved outcomes. Similarly, the [Lab (2016)](#_ENREF_143) and [Davis and Cartwright (2019)](#_ENREF_72) reports concluded that impact bonds have the potential to bring stakeholders together (outcome payers, investors, service providers and intermediaries) to achieve a better collaboration and innovation.

The demand from the public creates an encouraging atmosphere for LAs to consider GaS bonds. A poll conducted by the Association for Public Service Excellence Membership Organisation has found that many citizens think councils are not investing enough socially and environmentally. Some demands are for councils to do more regarding the energy efficiency of homes , better recycling, reduced waste, and enhanced flood defences ([Brady, 2019d](#_ENREF_45)).

In England, GaS bonds are gaining importance. Leeds City Council in 2013 launched its bond program worth of £101m, in its aim to finance social housing projects ([Sharman, 2013](#_ENREF_266)). Similarly, Transport for London issued a green bond program to finance its green infrastructure projects ([Floater. et al., 2017](#_ENREF_95)). Warrington Borough Council announced in 2019 the creation of a social impact investment of around £75m, with a minimum investment of £1m, which would provide investors with ethical returns. Such programs are considered by many councils, some of whom contacted Warrington County Council for more information, but a lack of expertise still presents a large barrier for many ([Marrs, 2019u](#_ENREF_189)).

One very successful program is the solar bond program undertaken by Swindon Borough Council in 2016. The program, designed to partially fund a solar farm in Swindon, faced very high investment demand whereby bonds sold out a month earlier than predicted ([Eichler, 2016a](#_ENREF_84), [Eichler, 2016b](#_ENREF_85)). The program targeted investments from small local investors, and also across the country. The investment minimum stake was £5, offering a 6% return along with the perception of being a low-risk investment. The program allowed increased collaboration between the Council and the public to deliver better outcomes for both, which has worked perfectly thus far ([Eichler, 2016b](#_ENREF_85)).

In the last years, industry experts and players have been taking notice of retail GaS bonds. In 2016, Merrick, Chairman of UKMBA, suggested that the sector turn back to its communities by using retail bonds which have significant social impact ([Cross, 2016](#_ENREF_67)). [Holmes (2019)](#_ENREF_118) report, entitled ‘Community Investment Scheme’, advocated the viability of online fundraising practices for the public sector. Holmes, as part of his advisory report for West Berkshire Council, argued that the use of GaS bonds would enable LAs to tap into funding sources at cheaper costs than PWLB ([Dunton, 2019a](#_ENREF_80)). Similarly, [Davis and Cartwright (2019)](#_ENREF_72) noted the financial and non-financial benefits the public sector can achieve by running community municipal bond programs via crowdfunding. It was suggested that such programs would allow a LA to raise capital efficiently, in a cost effectively manner, along with increasing civic engagement by linking their project delivery to local residents and allowing greater transparency ([Marrs, 2019n](#_ENREF_182)). In 2019, Horizon 2020 (the largest EU funding program for research and innovation), called for LAs to bid for grants to pilot community municipal bonds to fund green and low-carbon projects ([Eichler, 2019](#_ENREF_88)). Room 151 reported that, as a pilot authority, West Berkshire Council, was one of those who applied for the climate-change bond program as part of the its goal to be a carbon-neutral city by 2030 ([Dunton, 2019a](#_ENREF_80)). The argument put by the [World Bank (2016)](#_ENREF_313) report is that municipal bonds would allow LAs to be less reliant on the central government and would empower them to invest more in their local development. Further argument was made by [World Bank (2016)](#_ENREF_313) whereby they claimed that all MBs can be perceived as social impact bonds due to their core aim in benefiting local communities and enhancing social outcomes.

Therefore, in addition to the encouraging investor demand, GaS bonds are more attractive to investors, as the social and environmental responsibilities are at the heart of what LAs deliver. By having the public behind them, LAs have a great opportunity to tap into different sources of lenders efficiently while simultaneously enhancing their social and environmental impact.

### GaS bonds’ reporting

[Hameed (2019)](#_ENREF_112) reported a complexity associated with GaS bonds as being the significant amount of time and capital required to make them a success. Despite the suggestion that transactional costs can be decreased over time, GaS bonds are still complex, making them hard to standardise or replicate and scale. Furthermore, [Hameed (2019)](#_ENREF_112) raises the issue around their lack of transparency that prompts concerns by investors in how on measure their returns. However, the Green Growth Best Practice report in 2014 argued that GaS bond investments are worth the associated difficulties as they will return with benefits on the market. Advocates for GaS bonds claim that they would create a better market by enforcing more transparency and provide valuable information on funded projects. This, in turn, would allow similar green projects to be packaged similarly and turned into GaS bond programs. Along with the market growth, compiled data would create an index for investors to evaluate the financial performance of such bonds compared to non-GaS loans ([Floater. et al., 2017](#_ENREF_95)).

# 2.7 Conclusion,

This chapter provided a historical review of the funding arrangements for local authorities in England and the changes took place as a result of the austerity measures post GFC. Such impact is evident in central government cuts that exceeds LA tax income, and the fast consumption of LA’s capital reserves used to close their funding gap which suggested the potential risk of financial failure in the near future.

A further assessment showed a concerning picture over LA borrowing arrangements being mostly limited to the PWLB, with the lack of interest from banks to continue lending to English LAs. In addition, it provided an evaluation of the bond market development and applications in different countries and different contexts such as USA, Emerging Economies, Sweden, and the housing sector. This served to evaluate the success and failure of various bond applications and helped in choosing the suitable case studies to offer better understanding of the phenomena as explained in Chapter 4.

The chapter went then to discuss the key players and stakeholders who have the influence to determine the path of developing a local bond market. This chapter found PWLB to be in the position of market maker due to it being the largest lender to LAs. Nonetheless, gaps in PWLB products and conditions, suggested that an alternative funding source that speaks specifically to LA funding needs is essential, such as bonds. The UKMBA was discussed, and its role as a facilitator of municipal bonds and the importance in diversifying LA borrowing sources and addressing their needs. This paved the way for the necessary evaluation of bond advantages and disadvantages, as well as the key barriers that are likely to limit bond applications in England, in line with level 3, the *Barriers*. The key barriers suggested by the literature that face LAs, when attempting to access the bond market, are:

* Efficiency
* Uncertainty
* Creditworthiness
* Transparency, and
* Liquidity

The last section of this chapter dealt with the formal and informal rules and ideas, such as knowledge, ambition, and structural difficulties and how they affect different stakeholder behaviours and attitudes towards the bond market. This was followed by evaluating the effect of impact bonds, mainly social and green bonds, on the actions and interests of both issuers and investors.

By reviewing the relevant literature on local authority finance and the development of the municipal bond market, the research poses significant questions.

The first question is related to the uncertainty associated with the success/failure of the different municipal bond market development internationally and in different governmental contexts. It is found that there is a lack of profound evidence on why some applications of municipal bonds suffered lack of demand, pricing issues, investors’ concerns, structural problems etc and which one of them was the most significant in determining the outcomes of the bond market. This lead to the first question for this research being:

* ***Question 1 -*** Why were some LAs, in certain countries and/or governmental contexts, successful in accessing the bond market, while others struggled to get the desirable outcomes?

The second question is related to the evidence provided by the literature review around the five main barriers predominant in the market and essential for any municipal bond market success. How significant are they? Are they correlated? What is their impact individually and collectively on a sound MB market development? And whether there are lessons to be learnt on how to overcome them or limit their impact on the market and the market players? This is represented in the 2nd question being:

* ***Question 2 -*** What are the key barriers facing local authorities when trying to access the bonds market, and how do they overcome these barriers?

The following chapter will discuss the theoretical position of this thesis, the rationale behind choosing Historical Institutionalism approach, and the conceptual framework utilised for this study.

# Chapter 3: Theoretical framework:

# 3.1. Introduction:

This chapter will provide an important theoretical review aiming to show the usefulness of applying the Historical Institutionalism theory, and the benefit of positioning said theory at the heart of the empirical fieldwork analysis. Therefore, this chapter will assess the theoretical foundation and the methodological approaches to be utilised for the development of the bond market in England and evaluate whether they are applicable to this research. The structure of this chapter will start with a comparison between the general theories applicable to the research: Rational Choice Institutionalism (RCI), Sociological Institutionalism (SI), and Historical Institutionalism (HI). The chapter then addresses financialisation and its relevance to the analysis.

As mentioned in Chapter 2, this chapter addresses the selection of the most suitable theory to be utilised for this research being Historical Institutionalism. The literature review in the previous chapter suggested the need for a theory that addresses not only the current environment in which MBs are issued and traded but also the development in LA financial arrangements overtime that led to their current financial policy and future decisions which HI served very well for. The choice is found to be suitable as well to the study nature, aims and objectives. The link is established by connecting the functions of HI to the nature of the research questions. The last section of this chapter explores the conceptual framework applied in this study by using the framework developed by [Healey (1992)](#_ENREF_116). Healey proposed a four-level analytical model which is used throughout this research to guide the empirical fieldwork and analysis of the findings. This chapter will then be followed by chapter 4 that covers the methodological design of this research and the data collected to achieve the research aim.

# 3.2 Review of some important social and political theories

Institutional economics pose critical questions such as those who aim to answer why do institutions exist, why do they develop in specific ways, and how efficient they are? These questions have been approached from different perspectives of social and economic theories ([Groenewegen et al., 1995](#_ENREF_107)). These theories can be classified into different dichotomies such as individualist *versus* holist; rational choice *versus* behaviourist, etc ([Rutherford, 1994](#_ENREF_251)).

Starting from a social controversial issue such as the interrelationship between the individual and society, this creates the base for the argument between holism and individualism. While it is possible to argue that society is created out of the actions of individuals, it is also possible to argue that individuals, to some extent, create their social situation. More deeply, while individualism emphasizes how individuals’ actions give rise to institutions and institutional change, holism seeks unwrapping on to how social forces (institutions, social conventions, etc) affect individual behaviour ([Rutherford, 1994](#_ENREF_251)).

After the Second World War (WWII), social science in US and EU witnessed a behavioralism revolution, which pushed old institutionalism (a dominant pre-WWI theory) into the background. Behavioralism focused on assumed universal regularities of behaviour ([Immergut, 2010](#_ENREF_119)), and caused a shift in attention away from the state and the formal organisations of governments towards a more society focus. This was associated with an emphasis on the socially embedded nature of pressure group politics, individual political behaviour, and informal distributions of power ([Bell, 2002](#_ENREF_24)). In economics, the neo-classical model with its standardisation of market behaviour grew to undisputed dominance. In the political domain, pluralists concentrated more on the voters and their visible behaviour ([Immergut, 2010](#_ENREF_119)).

The best way to depict the way that behaviourists contribute to the social science is to see them as chemists. They believed that breaking down the greater world surrounding us into components is the best way to understand each of those components separately. *“One day, they seemed to believe, we might have a Periodic Table of Politics”* ([Steinmo et al., 2008, P6](#_ENREF_280)).

However, behavioralism faced lots of critics from scholars ([March and Olsen, 1983](#_ENREF_162)). Firstly, it was “reductionist”, as the explanation of political phenomena were simplified as the sum of individual behaviour; which explains why behaviourists were less motivated to *“ascribe the outcomes of politics to organisational structures and rules of appropriate behaviour”.* Second, it was conducted in a wat that shows that actions are *“the product of calculated self-interest”* rather than a reaction of actors to their *“obligations and duties”* ([March&Olsen,.1993, as cited in Bell, 2002: P4](#_ENREF_24)).

By the end of the 1960s, and because of the limitations and critics of the behaviouralist models, there was an institutionalism revival labelled as “neo institutionalism” (NI) ([Immergut, 2010](#_ENREF_119)). NI was born when many political scientists became more interested in real world outcomes and events and started to ask questions such as why do real world outcomes vary in the ways that they do? ([Steinmo et al., 2008](#_ENREF_280)). NI came in a try to *“examine how the external environment socially constructs organizations, providing them with templates for their formal structures and policies, and thereby increasing organizations’ legitimacy in the wider world” (*[*Powell and Bromley, 2013, P2*](#_ENREF_234)*).* The main difference NI made in comparison with behavioralism, was replacing (or at least modifying) the focus on atomic actors by shifting the focus onto institutionally “situated” actors ([Bell, 2002](#_ENREF_24)).

There are different models of institutionalism, and all are trying to improve political systems. They compete mainly with the other two political- perspectives, Rational Actor, and Cultural Community. While the Rational actor perception views the political life organised by exchange among calculating and self-interested actors, the *“cultural community”* perspective views political life to be established by the most mutual values and views in a community that is sharing common culture, knowledge and vision ([March and Olsen, 2005](#_ENREF_163)).

NI traces its roots to Old Institutionalism yet diverges from the later traditions substantially. Both the old and the new Institutionalism share skepticism toward a rational-actor model of organization ([March and Olsen, 2005](#_ENREF_163), [DiMaggio and Powell, 1991](#_ENREF_76)). Each views institutionalization as a state-dependent process that make organisations less instrumentally rational by limiting the options they can pursue. Both emphasize the relationship between institutions and their surrounding environments, and similarly emphasises on how the cultural environment influences institutions. The NI has responded to empirical anomalies with *“What we observe in the world is inconsistent with the ways in which contemporary theories ask us to talk” (*[*Hall, 1994, P58*](#_ENREF_110)*).* Also, [DiMaggio and Powell (1991, P3)](#_ENREF_76)highlighted problems such that *“most of the organizational and political studies routinely point to findings that are hard to square with either rational-actor or functionalist accounts”*. So, a core idea that has been argued is embeddedness of institutions in their social and political environment in a way that their actions and format is a result of them reflecting or reacting to the ideas and rules prevalent in their environment ([Powell, 2007](#_ENREF_233)).

Furthermore, there were some significant reasons for the renewal of interest in political, economic, and social science institutions, such as the fact that *‘social, political and economic institutions have become larger, considerably more complex and resourceful, and prima facie more important to collective life’ (*[*March, 2008, P204*](#_ENREF_161)*)*. In political science, it was the renewal of interest in the *‘State’* (Statism theory) ([Bell, 2002](#_ENREF_24)).In economics, it was the rising interests in clarifying the origin of economic institutions ([Immergut, 2010](#_ENREF_119)).Furthermore, the social science witnessed similar institutional change associated with the emergence of new elements in economics, sociology, and political science ([Powell and Bromley, 2013](#_ENREF_234), [DiMaggio and Powell, 1991](#_ENREF_76)). All of that caused the creation of a number of institutional analysis: mainly rational choice institutionalism, sociological institutionalism and historical institutionalism ([Steinmo et al., 2008](#_ENREF_280)). Institutionalism has been applied in a various analysis concerned with the political and public policy applications. It is considered as a ‘middle-range’ theory as organisations are seen as entities that sits between smaller components (actors) and bigger political assemblies ([Pontusson, 1995](#_ENREF_232)). However, different institutional approaches have had different applications in politics and public policy. The following section will discuss those applications and the key characteristics associated with each.

Old and Neo-Institutionalism (NI) approaches, like any other theory, have some critics and scepticism. Common criticism for old institutionalism is that it is more descriptive, rather than providing explanation and building theory ([Shepsle, 1989](#_ENREF_268)). On the other hand, NI had been questioned as to whether institutions interpretations had any new revelations; how sustainable their claims are, and to which extend their clarifications are confirmed ; and how different are institutional explanations are from those of politics ([Jordan, 1990](#_ENREF_127), [March and Olsen, 2005](#_ENREF_163)). Nevertheless, no social, political, or economic theory can be strictly on one side or the other. Many theorists have a modest aspect when analysing. For instance, certain criticisms of formalist notions are shared by old and new institutionalists, and some "behaviourists" do not entirely exclude rational choice and economizing behaviour ([Rutherford, 1994](#_ENREF_251)).

## 3.2.1 Rational Choice Institutionalism

Most institutionalism theorists depict institutions as rules that structure behaviour. Nonetheless, they vary in their interpretation of individual’s nature whose behaviour is being structured. However, they differ in their understanding of the nature of the beings whose action or behaviour is being structured ([Steinmo et al., 2008](#_ENREF_280)). Rational choice institutionalism (RCHI) argues that human being are self-interested, rational individuals ([Steinmo et al., 2008](#_ENREF_280), [Jevnaker, 2015](#_ENREF_123)), and emphasize that institutions are viewed not only as a cause of behaviour, but also as an effect of behaviour ([Bell, 2002](#_ENREF_24)). RCHI believes that institutions frame an individual’s strategic behaviour; people follow rules because they are strategic actors and always seeking to maximize their gains. Rational choice theorists argue that humans co-operate because they get more with co-operation than without it ([Steinmo et al., 2008](#_ENREF_280)). RCHI scholars also argue that, seeking to achieve their goals, individual actors are actively engaging in altering and forming institutional environment. This presents the original creation of such institutions as a result of actors calculated rations goals ([Bell, 2002](#_ENREF_24)).

Furthermore, [Jevnaker (2015, P5)](#_ENREF_123) argues that “*RCHI sees the organizations that have institutionally given formal influence within a policy-making process as the relevant actors and analyses their interests as causal factors for the outcome of that process. Actors are self-interested, rational and evaluate institutional design instrumentally: gains from the current state of affairs are compared to those expected from a potential alternative. Outcomes then follow from the sum of deliberate choices made by relevant actors seeking to realize their preferences within a short time-span”.*

RCHI, influenced by the original rational choice theory, argues that individuals and state actors *‘seeking utility maximizing’* are central actors in the political process, and that institutions are the results of interdependence, interaction, and action of these actors ([Jönsson and Tallberg, 2001](#_ENREF_126)). In economics, RCHI depict institutions as coordination mechanisms that solve collective choices and collective action problems by generating new forms of commitment and rule-following ([Powell and Bromley, 2013](#_ENREF_234)). In other words, they try to investigate the suboptimal outcomes of rational actions when it depends upon the decisions of more than one actor; they study what is called ‘strategic action’ ([Immergut, 2010](#_ENREF_119)).

There are some common criticisms to the RCHI approach. Firstly, it ignores the social context as it views the institutions as merely the sum of individual levels properties ([DiMaggio and Powell, 1991](#_ENREF_76)). Second, its overemphasis on institutions and structures and downplay choice and agency. Third, most commonly, RCHI is well criticised for its use of deductive methodology and tendency towards narrow and mechanical specification of actors’ motives, preferences, and institutional contexts. Therefore, a sceptics view of RCHI theory is formulated as it often leans towards making general assumptions about the actors, and limits the analysis of their aims in being related or influenced by the external ([Bell, 2002](#_ENREF_24)).

RCHI has been influenced by developments in the so-called new institutional economics (NIE) in particular, which considers ‘transaction’ as the primary unit of analysis ([Jönsson and Tallberg, 2001](#_ENREF_126)). It emphasizes that individuals and institutions behave opportunistically with a bounded rationality, so the participants of an exchange always wish to economize on transaction costs. Some NIE scholars view opportunism as a key source of transaction costs, while others refer to it as the cognitive costs of organizing and monitoring transactions. It has been used previously to understand the interaction between the contractual incompleteness and the transaction attributes such as specificity, uncertainty, and complexity, which give rise to institutions that serve to provide dependable and efficient frameworks for economic exchange ([Joskow, 2003](#_ENREF_128), [DiMaggio and Powell, 1991](#_ENREF_76)).

RCHI initially came from a study of American Congressional Behaviour which played a significant role in lowering the transaction costs when making deals. To solve the legislators collective action problems, Congress allowed the implementation of stable legislation through allowing gains from exchange between legislators ([Sudhipongpracha and Wongpredee, 2015](#_ENREF_281)). Later on, RCHI had many different applications in political studies such as analysing Congress and the courts relationship ([Ferejohn and Fiorina, 1975](#_ENREF_93)); understanding the institutional reforms in the EU ([Tsebelis, 1994](#_ENREF_289)); in addition to studies related to the development of political institutions.The RCHI has contributed importantly towards institutional origins and continuous exist, depending on its functions and beneficial outcomes ([Hall and Taylor, 1996](#_ENREF_111)).

## 3.2.2 Sociological Institutionalism

Sociological Institutionalism (SI) started when a distinct group of sociologists built upon behavioural psychology and organization theory to produce a view of individual cognition and collective decision-making within organizations ([Immergut, 2010](#_ENREF_119)).

The way that SI looks at individuals differ drastically from RCHI. Rather than viewing individuals as self-interested or rational actors, SI views individuals as social beings and ‘satisfiers’[[1]](#footnote-2) who act habitually ([Steinmo et al., 2008](#_ENREF_280)).Furthermore, instead of individuals questioning themselves *“what do I get out of X?”* as in RCHI, the SI believes that people ask, *“what should I do and what is appropriate?”* ([Koelble, 1995](#_ENREF_136), [Bell, 2002](#_ENREF_24)). This means that individuals are not seen as rule followers to maximize their gains. Instead, the rules followed by institutions and organisations correspond to the prevailing social norms part of the daily life ([Steinmo et al., 2008](#_ENREF_280)).

Another side of the SI is the emphasis on the influence of the broader social structures, with more focus on the cultural view of institutions and their roles in providing models for actions ([Powell and Bromley, 2013](#_ENREF_234)).The SI scholars view indicates that through institutional life there is an establishment of normative orientation, conventions, and taken-for-granted practices, which in turn shape and influence behaviour in unseen ways ([Bell, 2002](#_ENREF_24)).

The SI theory argues that rather than being a result of extreme ‘rationality’, the contemporary institutional forms and procedures are not adopted as they were most efficient way to complete tasks. Instead, the transmission of cultural norms to be implemented into organizations, from the SI perspective, is what formulated the institutional forms and practices. That, in turn, provides a good explanation for the unpleasant bureaucratic practices that could spread across nations ([Hall and Taylor, 1996](#_ENREF_111)).

SI provides an explanation of how institutions affect individual behaviour by arguing that when an individual gains a position in a certain institution, he/she starts to adapt to the norms associated with this position ([Berger and Luckmann, 1967](#_ENREF_26)). SI has recognised contributions to the term ‘institutions’ as it sees institutions not only as rules and norms, but also as cognitive scripts and moral templates. It also insists on the interference between institutions and cultures and challenges the separation between both. Furthermore, SI contradicts the RCHI approach in that institutional practice changes by the means of efficiency. Instead, SI scholars argue that the new practices are adopted because they enhance the social legitimacy of the organization, which might have adverse effects on achieving the organizations goals ([Hall and Taylor, 1996](#_ENREF_111)).

The neo-institutionalism, in its sociological branch, has been applied in different political research studies. For example, SI has been utilized to understand the contemporary immigration policy in Europe and America. Another application was to explain how East Asia production techniques have spread throughout the world ([Hall and Taylor, 1996](#_ENREF_111)).

## 3.2.3 Historical Institutionalism

The Historical Institutionalism (HI) scholars are primarily interested in ‘*explanation – not prediction’* ([Steinmo et al., 2008](#_ENREF_280)). This is considered as a cornerstone of comparative political research. [Powell and Bromley (2013, P2)](#_ENREF_234) argue that the HI approach *“underscores how institutions emerge from and are embedded in temporal processes through path dependence and divergence at critical historical junctures”*.

HI scholars do not believe that humans are either simple rule followers or simply strategic actors and utility maximizers. Instead, they see political outcomes as a product of both rule following and interest maximizing. The way a person behaves, in the lens of HI, depends on the individual, context, and rules. HI scholars want to ascertain the reasons behind a certain choice, as well as the causes of the outcomes ([Steinmo et al., 2008](#_ENREF_280)).Individuals and institutions are viewed as ‘embedded’ in so many social, economic, and political relationships beyond their control and cognition, which in turn, makes it more difficult to expect utility-maximising and rational behaviour in a strictly economic sense. Furthermore, the rationality in HI is dependent upon its environment, and institutions are seen as *‘shapers of’* rather than a result of the rational calculations of individuals ([Bell, 2002](#_ENREF_24)).

The best way to understand HI scholars is to illustrate them as environmental biologists. In their attempts to understand a specific organism, they must explicitly examine that organism or behaviour in the ecology or context in which it lives ([Steinmo et al., 2008](#_ENREF_280)). HI focuses less on the choice; instead it cares more about the long-term historical development of institutional structure, actors as well as their interests, and institutional changes ([Aspinwall and Schneider, 2000](#_ENREF_16)). They depict a stable situation for the institutions and believe that institutional changes happen in a ‘path-dependent’ way, in which pre-existing institutions affect the direction of new institutions and the form of subsequent changes, and so elements of the old and new path may coexist and formulate a third-new path. Such analysis needs going back to the set of events that led to the change. This includes finding out the key and different stages of the institution path-dependent development and the historical development of such institution ([Jevnaker, 2015](#_ENREF_123)).

[Steinmo et al. (2008)](#_ENREF_280) argue the best way to understand HI is not to look at it as a theory or a method, but as an approach for studying politics. Instead of determining institutional outcomes, HI assumes a range of potential directions for institutions that emerge when previous policy choices are taken. Affected by structural functionalist’s theory ([Hall and Taylor, 1996](#_ENREF_111)), HI has been used in a large scale in comparative politics and public policy studies, whereby phenomena is understood as dynamic interaction among institutions that vary over time ([Sudhipongpracha and Wongpredee, 2015](#_ENREF_281)).

Although HI agrees with RCHI that actors behave in a strategic manner ([Hall and Taylor, 1996](#_ENREF_111)), HI do not use RCHI’s deductive methods. It is argued that HI, by using inductive methods ([Hay and Wincott, 1998](#_ENREF_114)), could provide better definition of the ‘content’ of such strategic behaviour and a wider understanding of which institutions matter and why they matter ([Hall and Taylor, 1996](#_ENREF_111), [Bell, 2002](#_ENREF_24)). Another difference between HI and RCHI is the way they explain the institutional change. While RCHI understands institutional change as a product of actors’ interests, HI depicts it as a product of previous arrangements that evolve over time ([Jevnaker, 2015](#_ENREF_123)).

The HI approach has been applied in different aspects, such as economic development ([Rueschemeyer et al., 1992](#_ENREF_250)), to understand institutional change at the EU level ([Jevnaker, 2015](#_ENREF_123)), democratic transition ([Slater, 2003](#_ENREF_271)), and public services ([Sudhipongpracha and Wongpredee, 2015](#_ENREF_281)). Another important example is when HI has been applied to understand the reasons behind why some nations choose to have a national health care system in place while on other nations construct decentralised and fragmented insurance programs. HI, therefore, asserts that, in order to understand these variations, there is a need to understand, in each country, who isinvolved with these policies and the ‘*rules of the game’*. Hence, the argument that the variation of the rules is what shaped the differences in policy outcomes ([Steinmo et al., 2008](#_ENREF_280)).

# 3.3 Lessons from financialisation literature

There is a growing interest in financialisation in a wide range of disciplines. This thesis is not a financialisation study, but financialisation provides an important part of the meta-context and does feed into the way the study was approached. The relevance of financialisation is found in the levels of analysis utilised in the chosen framework and its applications. Referencing back to chapter one, this thesis is a micro study of institutional behaviour, stakeholders’ interactions, and social relations within the local authorities’ sector in England. The study aims to seek further understanding as to whether and how MBs could be used more widely in different governmental contexts in England. Therefore, this study is not a contribution to the financialisation literature, but it is contextualised by the financialisation phenomena. The argument is that the need for this thesis has arisen because of the phenomena of the financialisation but, this is not a financialisation study *per se*.

The concept of financialisation has received a growing attention in the last three decades ([Sawyer, 2013](#_ENREF_259), [Epstein, 2015](#_ENREF_92)). One of the early work done on financialisation phenomena, albeit not named as such, was by [Sweezy (1995)](#_ENREF_282" \o "Sweezy, 1995 #405) and [Aalbers (2017)](#_ENREF_7) who argued that, since the 70s and 80s, corporates and their shareholders were generating profit and keen to expand their gains by throwing their money into the financial markets in different types of financial instruments. This resulted in the old production system of economy, which used to be served by the financial sector, giving *“way to a new structure in which a greatly expanded financial sector had achieved a high degree of independence and sat on top of the underlying production system”* ([Sweezy, 1995: No page](#_ENREF_282)).

Nonetheless, the concept witnessed a huge growth post the Global Financial Crisis (GFC) and has become popular amongst different social science literature ([Aalbers, 2017](#_ENREF_7), [Mertens et al., 2021](#_ENREF_204)). One of the broad definitions for financialisation refers to the *“increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies”* ([Epstein, 2005, P3 in Davis 2017, P1](#_ENREF_91)). Similarly, [Aalbers (2017)](#_ENREF_7) defined financialization as “*the increasing dominance of financial actors, markets, practices, measurements and narratives, at various scales, resulting in a structural transformation of economies, firms (including financial institutions), states and households*” ([Aalbers, 2017: P3](#_ENREF_7)).

[Aalbers (2017)](#_ENREF_7" \o "Aalbers, 2017 #406) stated that when non-financial corporations (NFC) are the subject of study, the term financialisation refers to their increased engagement with practices that have been long known to be the territory of the financial sector. With profit becoming ever more pivotal, NFC management are more likely to undertake practices that aim to increase profit. This resulted in some NFCs becoming a mix between a non-financial and financial entities. Nonetheless, [Mertens et al. (2021)](#_ENREF_204) argues that most scholars who contributed to the concept of financialisation have predominantly focused on the macro-economics of corporations and households, which left a gap in the understanding of the financialisation of states and subnational tiers.

When it comes to precise definitions for financialisation, they vary depending on the field of analysis ([Davis, 2017](#_ENREF_71)). [Aalbers (2017)](#_ENREF_7) argues that the nature of financialisation is not a one-size-fits-all concept, resulting in it unfolding differently across subjects of analysis *“it is fundamentally fragmented, path-dependent and variegated”* ([Aalbers, 2017: P3](#_ENREF_7)). Likewise, [Christophers (2015)](#_ENREF_56), stated that financialization “*has fundamentally fragmented. To the degree that it is excessively vague and stretched, it is an increasingly nebulous and even, arguably, unhelpful signifier”*, and suggested that it might be clearer to *“dispense”* with the term altogether ([Christophers, 2015: P5](#_ENREF_56)). [French et al. (2011)](#_ENREF_99) and [Aalbers (2017)](#_ENREF_7) stated that financialisation is seen as a *“chaotic concept”*. The varying definitions of financialization are proof of its problematic nature, and it became too stretched to cover *“related, but fundamentally different projects”* ([Christophers, 2015: P4](#_ENREF_56)). Nonetheless, [Jacobs and Manzi (2020)](#_ENREF_120) agree with [Aalbers (2015)](#_ENREF_4) that there might be less importance to demanding a fixed definition for financialisation as *“concepts in social science are always value-laden, contested, open to multiple interpretations, and on occasions confusing. Furthermore, financialisation, inadvertently perhaps, provides opportunities for researchers to facilitate dialogue across different disciplines”* ([Jacobs and Manzi, 2020: P7](#_ENREF_120)).

According to ([Aalbers, 2019](#_ENREF_1)), financialisation can be interpreted differently depending on the subject. Financialisation of the economy refers to the increased dominance of the financial sector in economic terms. Financialisation of nonfinancial corporations refers to the change in those corporations whereby they follow financial narratives, activities, and assessments in a way that mirrors that of the financial sector. Financialisation of the state and public or semi-public sector is where government, subnational authorities, housing associations, and other service providers are driven by the financial narrative, activities, and assessment methods.

Another considerable part of financialisation literature is concerned with fixed investment. Such literature addresses the changes in the balance sheet of nonfinancial firms, especially the growth of their financial assets ([Davis, 2017](#_ENREF_71)), as well as the increase of interest and dividend income ([Krippner, 2005](#_ENREF_142)). An example of that would be the [Lazonick (2011)](#_ENREF_145) study that showed the change from production output to earnings per share to be the dominant measure of firms’ performance assessment.

Broadly speaking, local authorities’ access to financial market products (the concern of this study) is widely recognised as a form of financialisation ([Sbragia, 1986](#_ENREF_260), [Mertens et al., 2021](#_ENREF_204), [Løding, 2020](#_ENREF_153), [Preunkert, 2017](#_ENREF_235)). For example [Sbragia (1986: P3)](#_ENREF_260) argues that *“the state-market relationship in the UK often resulted in central government's attempts to regulate authorities' borrowing through various types of orders and voluntary agreements. In retaliation, the authorities have devised new and sophisticated borrowing strategies designed to maximize their objectives and to circumvent the restrictions put on them by central government”*. In that context, [Preunkert (2017)](#_ENREF_235) highlighted bonds as financialisation-driven tools applied at state and subnational levels. Another form of subnational financialisation is found in so called “innovative funding” tools, as in the lender option borrower option (LOBO) loans. According to [Mertens et al. (2021)](#_ENREF_204), in the last two decades, almost half of English LAs had borrowed using LOBO products, betting on the rising interest rates. When interest rates did not rise, LAs faced all sorts of public pressure, inquiries, and allegations of mismanaging public funds, especially due to the existence of the PWLB as a safer option. The depth of financialisation at subnational level in England is captured in the fact that it was international banks who started lending to LAs in England on LOBO terms, and not local banks.

Similarly, the housing sector witnessed an increase in the utilization of financialisation as a term post GFC whereby more researchers started assessing the changes in the housing system, its structure, and practices. Such changes were shown in the increased power of the financial actors and markets associated with an increase of profit-making outcomes ([Jacobs and Manzi, 2020](#_ENREF_120), [Aalbers, 2017](#_ENREF_7)). But even when it comes to housing, financialisation literature defers depending on analysis methods and study in place. Therefore, the impact of financialisation has been assessed in the housing sector by looking at the overvalue pricing policies and mortgage securitisation ([Aalbers, 2012](#_ENREF_3), [Aalbers, 2008](#_ENREF_2)), credit rating of buyers and buyers bearing market risks ([Aalbers, 2008](#_ENREF_2)), housing associations credit rating and the role of credit rating agencies ([Froud et al., 2006](#_ENREF_100), [Jacobs and Manzi, 2020](#_ENREF_120)).

[Jacobs and Manzi (2020)](#_ENREF_120" \o "Jacobs, 2020 #412) argue that the changes to the UK as a welfare state, and its housing markets, manifested itself in reduction of subsidies received by housing associations (HAs) from the central government. This exposed HAs to financial market risks as they have been forced therefore to rely on the financial products provided by the market, such as bonds. Such exposure meant that the housing sector bears financial markets risks and vice versa ([Jacobs and Manzi, 2020](#_ENREF_120), [Aalbers, 2008](#_ENREF_2), [Aalbers, 2017](#_ENREF_7), [Wainwright and Manville, 2017](#_ENREF_304)). Bonds borrowing for HAs posed an issue of capacity and efficiency of borrowing whereby smaller HAs were disadvantaged. Thus, many of them had to merge with other HAs to form larger organisations to create benchmark size bonds and issue them efficiently ([Jacobs and Manzi, 2020](#_ENREF_120)). In the middle of all of these changes to the sector, [Manzi and Morrison (2018)](#_ENREF_160) argued that *“the not-for-profit housing sector has also struggled to balance the demands of commercialism with a need to retain a core social purpose”* ([Manzi and Morrison, 2018: P2](#_ENREF_160)). Similarly, [Wainwright and Manville (2017)](#_ENREF_304) stated that despite the positive impact of financialisation in enabling HAs to access bonds conveniently, HAs drifted from their social responsibility framework into more commercial and profitable orientation.

To summarize, financialisation literature is very wide-ranging and is utilised in different subjects and using different methods. This resulted in financialisation being approached and defined differently depending on the field of study and the analysis carried out. A large part of financialisation literature focuses on public sector governance, including local authorities and housing associations. It assesses how financialisation impacted and reshaped local authorities and housing organisation work and how they conduct their activities. Those are more meta-aspects that are playing out in the public sector and housing associations specifically, and this research is interested in those areas specifically. Although, this thesis has arisen from the phenomena of financialisation, it is not designed to contribute to the financialisation literature or debate. Instead, this thesis seeks to understand and evaluate various MB models in different contexts, and how and when they work, by looking at aspects of institutional behaviour; the key stakeholders’ interactions and the social norms that governs those interactions within LAs’ sector in England. Financialisation, therefore, is relevant to this thesis as the interest in the phenomenon has significantly increased in the last three decades, making it part of the economic and political context that frames this thesis.

The next section is going to discuss the theoretical position of this thesis, the chosen conceptual framework and how to operationalise the latter which draws lightly on the lessons from financialization literature while remaining distinct from it. Specifically, financialisation is considered due to its impact on the emergence of new financial instruments such as bonds. Although such consideration is not influencing the micro-behavioural aspects of this study but instead in the meta-context, therefore, it comes at the higher levels of the framework applied.

# 3.4 Theoretical position of the research questions

The literature review in the previous chapter suggests that in the EU, the type of governance and level of the fiscal autonomy of subnational authorities are factors that affect the ability of LAs to access debt funds, mainly bonds ([Boulanger and Vallier, 2012](#_ENREF_34)). Even with the adverse outcomes of the GFC, some financially federated and decentralised governments, where subnational authorities have sufficient fiscal autonomy, witnessed a clear growth in municipal bonds issuance. However, less decentralized and less autonomous subnational governments are still struggling to access the municipal bond market as an alternative source of funds ([Davey, 2011](#_ENREF_68)).

It is important to address the common uncertainty around the applications of MB market as an alternative source of funds for LAs by seeking further understanding whether and how MBs could be used more widely in different governmental contexts in England

To do so, an in-depth evaluation of the developed MB markets in different countries and industries is essential to highlight the reasons behind any successes or failures. As the literature suggests, even successful applications of municipal bonds are still faced with barriers such as cost, uncertainty, and transparency, rating, and liquidity related issues. These barriers prevent stakeholders from enjoying the maximum benefits of municipal bond market. Furthermore, the research attempts to answer questions related to the municipal bunds’ applications; where and why they work, identifying the key barriers faced by LAs and the ways to overcome them by asking the following:

* Why some LAs, in certain countries and/or governmental contexts, were successful in accessing the bond market, while others struggled to get the desirable outcomes?
* What are the key barriers facing local authorities when trying to access the bonds market and how do they overcome the barriers?

To answer these questions, it is important to approach the answers from different perspectives. While the first question suggests the needs to make a comparison of the mode of governance and its implications on the municipal bond market in different countries, the second question needs a framework to show how to identify and overcome these barriers. The following section will explore the analytical framework in which those questions will be approached by reviewing theoretical application in line with those questions.

## 3.4.1 Research Questions and Historical Institutionalism

The review of various dominant political and social theories suggest that the above questions are better approached from Historical Institutionalism perspective. The next section will elaborate on the justification for using the HI theory to better obtain the research answers.

* ***Question 1 -*** Why some LAs, in certain countries and/or governmental contexts, were successful in accessing the bond market, while others struggled to get the desirable outcomes?

The nature of the question suggests the use of the Historical Institutionalism theory for several reasons:

1. There is a need to explain the reasons why some authorities were able to access the municipal bonds while other authorities could not.

In relation to that, HI follows ‘indicative methods’ ([Hay and Wincott, 1998](#_ENREF_114)) which are more suitable when ‘explanation not prediction’ is needed ([Immergut, 2010](#_ENREF_119)). Additionally, HI seeks to ascertain the reasons behind a certain choice as well as the outcomes occurring due to this choice ([Steinmo et al., 2008](#_ENREF_280), [March and Olsen, 2005](#_ENREF_163)).

1. The need to make a comparison between different municipal bond applications in different countries in addition to the following facts.

When looking at RCHI’s work, it is mostly considered as normative with little comparative analysis. This is due to the fact that RCHI does not encourage the development of intermediate-level concepts that facilitate comparative research ([Healey, 1992](#_ENREF_116)). HI approach, in turn, is considered as a cornerstone in comparative politics research ([Healey, 1992](#_ENREF_116), [Powell and Bromley, 2013](#_ENREF_234)). Furthermore, the differences in hypothesis formation between RCHI and HI suggests that the latter functions better when applied for cross-national comparative. This is because HI’s work begins with empirical puzzles that emerge from observed events or comparisons, such as why do some countries tax and spend more than others? ([Steinmo, 2004](#_ENREF_279)). On the other hand, RCHI’s work starts with puzzles from an observed behaviour that deviate from general theory prediction, such as why would citizens ever volunteer for war? ([Levi, 1997](#_ENREF_147), [Thelen, 1999](#_ENREF_285)).

Essentially, HI allows the evaluation of municipalities as institutions in which they are not simply following the rules in favour of ‘utility maximizing’. Instead, municipalities are somehow restricted by social, economic, and political relationships when making their decisions, and are always looking for justifications for their actions, rather than the benefits from them ([Bell, 2002](#_ENREF_24)). This is, to a certain extent, the case in subnational authorities when planning to access the bond market, as they have to deal with certain social constraints such as voting and stakeholders, economic constraints such as cost and revenue availability, and political constraints such as laws and power control.

Most importantly, the way that HI depicts individuals/institutions behaviour as always asking “what should I do and what is appropriate?”. When attempting to make a comparison, and to understand the reasons that lead to the difference in municipal bond experiences, the focus on the variation in attitudes cannot explain how and why countries developed such wide variances ([Steinmo et al., 2008](#_ENREF_280)). However, applying HI allows the analysis of the rules that govern the actions undertaken by municipalities, which in turn can provide a clearer indication of why each municipal experience developed in certain way.

* ***Question 2 -*** What are the key barriers facing local authorities when trying to access the bonds market, and how do they overcome these barriers?

The nature of the question suggests that there is a need to apply an approach that could aid in the drawing of a clear framework to explain the methods used to help municipalities and other stakeholders to overcome current market barriers. Historical institutionalism, again, is the most suited approach to answer this question, as explained below.

It is clear that the number of actors involved in municipal bonds is relatively big, and that the municipal bond market has different preferences and goals for different stakeholders. When LAs are considering municipal bonds, the process is affected by internal and external players, each having their own goals. Internally, decision making is highly affected by the different local players'/departments' differing interests, such as those in the finance department compared with the service delivery department or legal department. There are also political layers, as well as the citizens and individual voting. Furthermore, there are a number of external players and actors who are affected by and effect the bond issuance and market such as rating agencies, financial institutions, lenders, banks, investors, etc. The best way to demonstrate the role of these actors is to look at them through the HI lens.[March and Olsen (1983)](#_ENREF_162) explain that HI actors, faced by uncertainty when making their decisions, guess their future preferences and outcomes. HI expresses that those decisions are based on assessments of the current situations and their consequences, not on conclusive calculations of the situation**.** As [Kerremans (2001)](#_ENREF_131) describes *“When historical institutionalism is at play, one can expect more from institutions”*. He suggests that institutions are helpful in this case, as they provide information about capabilities.

[Hall and Taylor (1996,as cited in Kerremans, 2001, P6)](#_ENREF_111)argues that institutions *“provide information about capabilities. They narrow the scope of possible actions because they create procedures that provide for a specific sequence of actions and for specific rights, duties, and constraints for each of the participants.* Similarly, [Scharpf (1997,as cited in Kerremans, 2001)](#_ENREF_261) explains that institutions protect rights and carry out obligations, as they serve to provide the required enforcement mechanism. Therefore, they will serve to narrow the options in a way that reduces unfeasible actions and enhance efficiency compared to the case of absence of institutions. Hence, they affect the usefulnessof the resources controlled or held by the actors.

This clarifies the potential role that institutions/institutional arrangement could play to provide the information and procedures needed from different actors involved within municipal bond issuance and market. This suggests the potential of institutions’ applications, such as UKMBA, to reduce uncertainty and costs associated with municipal bonds.

Generally speaking, institutions have a wider role in the historical institutionalism perspective in comparison to the RCHI and SI. Firstly, in RCHI, institutions are important as features of a strategic context; imposing constraints on self-interested behaviour. However in HI, institutions have greater role in shaping politics and political history ([Healey, 1992](#_ENREF_116)). This helps in evaluating the role of LAs as influential entities who are capable of changing the dominant political path to suit their needs and duties.

Secondly, HI provides equal benefits to the RIHC calculus approach and SI cultural approach, as HI considers both calculus and cultural options ([Hall and Taylor, 1996](#_ENREF_111)).

Thirdly, HI agrees with RCHI that actors act strategically, but it differs in the way HI analyses an actor’s preferences. Preference formulation is treated as *exogenous* in RCHI and *endogenous* in HI. This allows HI scholars to ask questions such as what the actors are trying to maximize? and why they emphasize certain goals over others ([Healey, 1992](#_ENREF_116), [Ostrom, 1995](#_ENREF_219)). In that sense, HI allows the assessment of LAs as bodies that are motivated mostly internally to make a change based on their internal requirements, rather than being driven by external factors. Therefore, the assessment of each LA decision of entering the bond market should be looked at from each LAs’ current resources position.

Fourthly in viewing LAs’ bonds through the lens of HI, institutions can change the actor’s preferences rather having a limited role to change the strategic environment in which actors behave, as in RCHI ([Kerremans, 2001](#_ENREF_131), [Longstreth et al., 1992](#_ENREF_154)). Institutions can affect the actors relative power positions and their own assessment of their interests and goals and mediate their relationship between corporation and conflict, and thus have an effect on outcomes ([Healey, 1992](#_ENREF_116), [Kerremans, 2001](#_ENREF_131)).

With all of that in mind, and with this variety in players, preferences, goals, and ideas, involved in the municipal bond market, it is important to understand the role institutions can play and what they can add to the whole process. When HI is applied to understand the bond market, we can expect more from institutions in order to derive an impact on actors’ environment, goals, interests, and ideas to enhance the outcomes, and overcome the barriers faced in the market. That expresses the need for the comprehensive approach of HI that allows deeper understanding of the greater role institutions could play.

Generally, HI represents an attempt to clarify how institutions settings can mediate political struggle. HI literature is diverse but most HI scholars prioritize path-dependency, in that other theoretical perspectives obscure the same ([Healey, 1992](#_ENREF_116)). Stability and persistence are essential characteristics of institutions from a HI perspective, otherwise institutions will be seen as secondary phenomenon. When persistence exists, path dependency exists, as choices of the past will affect the present outcomes, and today will impact the future. This, in turn, clarifies how the importance of path dependency lies in the nature of its consequences ([Kerremans, 2001](#_ENREF_131), [Davies, 2004](#_ENREF_69)). Such features will enable the research to look at and evaluate the key elements in LAs history that played/plays a role in the development of the bond market in England. By doing so, it is possible to determine what factors influenced LAs inclination, or lack thereof, to access the bond market. Such factors will provide a provision for the reasons behind each LA choice regarding the bond market.

Furthermore, HI accepts that individuals do calculate their interests, however, outcomes are caused by the interaction between different groups, interests, ideas, and institutional structures ([Koelble, 1995](#_ENREF_136)). Individuals do not seek optimal payoff, but satisfying outcomes ([Kerremans, 2001](#_ENREF_131)). They create institutions to achieve certain outcomes closer to their preference. But institutions can generate both intended and unintended consequences. As [Kerremans (2001,P9)](#_ENREF_131) describes *“The unintended consequences can be found in the norms of appropriateness that interacting within institutions brings with it, and eventually in the preference changes that this entails”*.

HI is one of the best approaches to analyse institutional development and policymaking, as it is concerned with the impact of political struggles on institutional outcomes and the way in which these outcomes, in turn, shape further political struggles over policy and rules. Further, HI emphasizes the importance of the interaction between intended and unintended consequences of political exchange, and the impact of these interactions on individuals’ goals ([Koelble, 1995](#_ENREF_136)). Therefore, when viewed through the lens of HI, we can expect more from institutions, as we can expect them not only to affect the power relations between actors but also the norm of the appropriateness of their actions and interactions ([March and Olsen, 2005](#_ENREF_163), [Kerremans, 2001](#_ENREF_131)).

## 3.4.2 Conceptual framework

Although HI is the chosen approach to the theoretical positioning of the research, choosing the key stakeholders, their interactions, relationships, and interests is of significance and linked to research objectives as well as the questions being posed by this research.

When talking about issuing MBs, there are some common problems that LA, as well as other stakeholders, face; cost, uncertainty, rating, transparency, and liquidity are problems not only affecting the LA that issue bonds but, to an extent, they affect and are affected by other stakeholder groups such as banks, PWLB, financial institutions, individual investors, citizens, etc.

As explained, applying the HI approach allows the design of a framework that suggests how stakeholders can overcome the barriers and problems facing them in the municipal bond market. This could be done by examining the potential benefits of applying institutional arrangements in a way that manages and organizes the bond market process. This research will try to identify the institutional arrangements that can help to overcome these barriers to achieve the best course of action and reduce occurrence of suboptimal outcomes. Furthermore, this research will try to design a framework that will help to organize competitiveness and co-corporation between municipalities in a way that all can benefit from, such as “pooled issuance” as per UKMBA model.

Most of the HI scholars define institutions as “*the formal and informal procedures, routines, norms and conventions embedded in the organizational structure of the polity or political economy*” ([Hall and Taylor, 1996 , P938, as cited in Sudhipongpracha and Wongpredee, 2015](#_ENREF_111)). The mix of routines, norms and conventions describe institutional change over time in response to historical experience ([March and Olsen, 2005](#_ENREF_163)). To analyse the municipal bond experiences and to understand the development process and the changes that took place in these experiences, it is important to analyse the rules that govern the municipal bonds issuance, as well as bond markets. This can be done by exploring in depth the institutional structure, mainly the formal and informal procedures, routines, and norms. However, it is important to note that each group of municipal bond market actors has its own goals, preferences, and ideas. The proposed model to analyse the municipal bond process should take into account this variance and try to address the connections between these different groups. [Healey (1992)](#_ENREF_116) proposed a four-level analytical model to allow research to combine the understanding of influences within the urban political economy with an appreciation of the social relations involved. The model uniqueness is that it concentrates on the classifications of each level of analysis, rather than on the typologies of actors, events, and interests although the latter will be partially considered for descriptive purposes. The four-level analytical model will be applied in this research as follow in figure 10. However, its worth noting that the model used is almost 30 years old this required adaptation of this model to fit with the current local authorities climate. As proposed by the literature review in Chapter 2, more in-dept exploration of the key stakeholders is required in the context of England local authorities. Furthermore, the literature review highlights the importance of thematic bonds such as green and social bonds and their potential impact on assisting local authorities in overcoming certain market barriers. Those adaptations are reflected in the section below by giving more emphasis on those contemporary aspects.

Figure 10 Analytical Framework

Diagram

Description automatically generated

Source: (Healey, 1992, P6)

1. **The first level *“Environment”*** includes a description of the events which constitute the process, and the agencies that undertake them. This includes mapping different kinds of actors and factors related to LAs, PWLB, credit rating agencies, investors, UKMBA, banks and other key players such as the central government, that potentially would have a role in the development of the municipal bond market.
2. **The second level *“Actors”*** includes the analysis of those agencies involved in the municipal bond market development, their roles, and the power relations that evolves between those agencies.

Both the first and second levels aim to identify the most significant events in the process of developing the municipal bond market, and which events are most difficult to accomplish. Further, these levels should ascertain who are the agencies, actors, and which relationships were most significant in determining progress and outcomes. Both levels consider the broader drivers in the market, such as the politics, economics and the financialisation to address changes in the orientation towards emerging financial instruments and related market mechanisms. Such factors are pertinent to the structural context in both the environment and actors’ levels.

1. **The third level *“Barriers”*** includes an assessment of the actors’ strategies and interests associated to the most significant sets of relationships within the process of developing a bonds market. This will lead to an analysis of the municipal bond market advantages and disadvantages and prevailed barriers to the market. This should give a clear idea of how these barriers influence the actors’ and stakeholders’ strategies and interests and assist in suggesting best methods to overcome said barriers.
2. **The fourth level *“Formal and Informal Rules”*** includes the theorization of how social relations such as resources, rules and ideas, affect the municipal bond market and make up the strategies and interests of different levels of actors. Furthermore, this level will address the role of thematic bonds (green and social bonds) in the bond market and how they affect different stakeholders’ actions. This, in turn, can be used as a framework to observe and describe how actors reproduce, reinforce, and transform social relations.

The above levels and the adaptations of the model are reflected in figure 11 below

Figure 11 Proposed Analytical framework

Freedom

Suitability

Project- Delivery

Reputation

Scrutiny

Output

Level 1: The Environment (Events)

Austerity, Central government, financialisation, reserves, borrowing arrangements, financial position, UKMBA.

Level 3: The Barriers

Certainty, Transparency, Costs, Credit rating, Liquidity

Project

Ambition

Debt size

Expertise

Level 4: Formal and Informal Rules and Ideas

Input

Level 2: The Actors

Actors on the issuer side

Actors on the buyer side

Market makers

Roles and behaviours

Relationships and strategies

Resources, rules and ideas

# 3.5 Conclusion

This chapter provided an in-depth discussion of the theoretical position of this study by reviewing three of the most relevant theories: Rational Choice Institutionalism, Sociological Institutionalism, and Historical Institutionalism. This allowed the careful selection of Historical Institutionalism as the most suitable theory to help guide the theoretical and empirical processes of research. The Historical Institutionalism theory selection was linked to the research nature, literature review, and the key questions it poses. This drove the selection of the conceptual framework which was addressed at the end of this chapter. The chosen framework is found to be useful for this study purpose as it guides the data collection as explained in Chapter 4, and the analysis of this data as outlined in Chapters 5, 6, and 7.

The next chapter, Chapter 4, concerns the research methodology. It outlines the key issues relating to the methodological position of this study, the case study design, research quality and other issues.

# Chapter 4: Research Methodology

# 4.1 Introduction

This chapter presents the methodological approach taken by this thesis. The primary research time was between 2017 and 2020. The chosen theory of this thesis is Historical Institutionalism, structured the methodological thinking of this thesis and guided data collection and analysis. The first section of this chapter clarifies the rationale behind the use of multiple qualitative case studies design carried by this research. The case study design included three case studies being, English Local Authorities, English Housing Sector, and the Swedish bond market all of which are outlined in this chapter. This is followed by data collections techniques, sampling method and the semi-structured interviews used for the data collection. The chapter then goes on to discuss how the data will be analysed, and the use of computer software for the storage of the analysed data. Finally, this chapter discusses the research quality issues related to this study including research validity and reliability parameters.

# 4.2 Case study design:

Every research study has a design that acts to strengthen its validity and guides the collection of data relevant to the study ([Yin, 2011](#_ENREF_319)). The choice between different research methods can be determined by the type of research questions. Case studies are compatible when research questions are either descriptive, eg “what”, or explanatory, eg “how and why” ([Yin, 2012](#_ENREF_320), [Yin, 2004](#_ENREF_318), [Baxter and Jack, 2008](#_ENREF_22)). [Yin (1994, P1)](#_ENREF_316) argues that *“case studies are the preferred strategy when ‘how’ or ‘why’ questions are being posed, when the investigator has little control over events, and when the focus is on a contemporary phenomenon within some real-life context”*. [Ragin (2014)](#_ENREF_236) argues that the case study approach is suitable when clearly identified cases, with boundaries, can provide an in-depth understanding of those cases, or to compare different cases. Furthermore, case studies are particularly useful when the relationship between the phenomena and its causes are not well understood. Case studies allows us to bring evidence and theories together to unwrap and understand that evidence.

All case study research start from the same compelling feature: *“the desire to derive a(n) (up-)close or otherwise in-depth understanding of a single or a small number of “cases,” set in their real-world contexts”* ([Yin, 2012 , P2](#_ENREF_320)). [McClintock et al. (1979)](#_ENREF_201) argued that the main goal of a case study is to identify the key factors of an event, allow the analysis of the organisational process and reveal factors that improves the process of understanding a phenomenon.

When designing case study research, there are some choices to be made regarding research questions and purpose. Firstly, there are three categories of case study namely; exploratory, descriptive and explanatory case studies ([Yin, 1984](#_ENREF_315), [Zainal, 2007](#_ENREF_323)). Secondly, the research should have either a single case study or multiple cases. Thirdly, is to choose either to keep the case as holistic or to have embedded subcases within the overall holistic case ([Yin, 2012](#_ENREF_320)). In table 2, the different parts of [Yin (2003, P13)](#_ENREF_317) definitions are separated and linked to the research design objectives.

Table 2 the application of Yin’s case study definition.

|  |  |
| --- | --- |
| **Yin’s technical definitional terms for case study research** | **Context of this research design** |
| Investigation of a contemporary phenomenon, within its real-life context | The literature review of this study has positioned the research in the contemporary context of the bond market development in England. |
| Boundaries between phenomenon and context not clearly evident. | The Historical Institutionalism theory approach suggests that the social phenomena in this study, individuals and institutions are embedded in so many social, economic, and political relationships beyond their control and cognition, which in turn, makes it more complicated to expect utility-maximising and rational behaviour in a strictly economic sense. |
| Research object involves more variables of interest than data points | The study of the development of the bond market, associated barriers, and the prevailing norms and rules come from a wide range of perspectives within the same group of stakeholders, and this is further amplified when considering the wide range of stakeholders involved in the bond market. |
| Relies on multiple sources of data, which are convergent in analysis | Triangulation between different sources of evidence will be used in each of the case studies chosen, and across case studies, to strengthen the research and its findings by applying a single conceptual framework, as developed by [Healey (1992)](#_ENREF_116). |
| Benefits from the prior development of theoretical propositions to guide data collection and analysis | The literature review guided the development and utilisation of the conceptual framework applied in this research, which respectively led the research methodology development. |

Source: an updated table of the version used by [Kennell (2017)](#_ENREF_130)

The previous review of case study research strongly suggests that the case study method is a suitable choice for this project. Furthermore, such option is strengthened by the application of the conceptual framework and the indications of the literature review. The next section will explore the case study design and the choices of the case studies used in this project.

The choice between a single or multiple case studies has been considered in this project. The use of a single case study is preferred when the case study covers an extreme, unique, or revelatory event or subject ([Yin, 2012](#_ENREF_320), [Schell, 1992](#_ENREF_262)). However, if one is seeking increased robustness of the project findings, a multiple case studies should be applied, in line with [Yin (2003)](#_ENREF_317). His suggestion of using 2 - 3 case study design is suitable using the replication logic, rather than sampling logic prevailed in quantitative studies. Multiple case studies are used to either predict similar results or opposing results that aligns with both the literature, and the conceptual framework applied. In this project, similar results logic is being used in the design of the chosen case studies, whereby they have been chosen for various similarities, such as bond market characteristics, stakeholders involved, barriers, and the nature of the issuer (being in the public sector domain). The available literature, or lack of, does not provide evidence that results will differ across cases when looking at bond market development. The literature suggests similarities in the key barriers faced in bond markets in developed countries, and similarities in the prerequisites needed for the development of a sound bond market. Nonetheless, the research design leaves possibilities open for different results and findings, due to the differences in legal, financial and cultural aspects, as well as the context of each case study.

Case study research, like any other research methods, has advantages and disadvantages associated with its applications.

***The advantages*** of using a case study in this research are:

1. It is a robust research method when a holistic, in-depth investigation is required. When studying the MB market in England, due to the multitude of factors involved, the number of stakeholders and the special characteristics of English LAs, an in-depth investigation into all of these elements is needed.
2. It allows analyses of both quantitative and qualitative data. In this research, although the research aim, objectives and questions are seeking qualitative data and results, it will benefit from the embeddedness of quantitative data as the subject is financially related.
3. Case study use helps to understand the complexities of a real life situation, which may not be possible when using experimental or survey research ([Zainal, 2007](#_ENREF_323)). The research looks into the key barriers faced by local authorities when accessing the bond market. Therefore, the research needs to reveal the complexities associated with such interaction between the LAs in England, and the other stakeholders in the bond market.
4. Yin (2009) explains that triangulation of findings, which is a major strength of research, can be achieved in case study methods by allowing the flow of multiple sources of evidence. Also, [Rose et al. (2015 )](#_ENREF_249) argues that case studies helps research to be conducted in detail and in context.

***The disadvantages*** of case study and how to overcome it:

1. When a single-case study design is applied, it raises questions related to the ability to generalise findings to a broader level ([Yin, 2012](#_ENREF_320), [Yin, 1984](#_ENREF_315)). Yin argues that the generalisation of a single case study is possible in a situation of an analytic, not statistical generalisation ([Yin, 2012](#_ENREF_320)). However, in this project, a multiple case study design has been followed in line with the conceptual framework applied and the literature review revelations.
2. Another criticism of the case study approach is that it is too long and difficult to conduct. This could cause the researcher to end up with a massive amount of documentation and data ([Yin, 2012](#_ENREF_320)). This can be avoided by following systematic data collection and analysis procedures ([Yin, 2012](#_ENREF_320), [Zainal, 2007](#_ENREF_323)).
3. Also, case studies design raises a technical issue related to “selection bias”. It may happen when the choices of cases skew the findings of the research, mainly when the selection excludes certain cases that contradicts the chosen theory ([Rose et al., 2015](#_ENREF_249) ). However, in this project, the selection of case studies was strongly based on the evidence provided by the literature and the similarities in the context to the development of the bond market in England.

According to [De Vaus (2001)](#_ENREF_74), a multiple case study design is normally rather powerful and persuasive, as it provides more insight compared to a single case study. When considering research questions, the theoretical and analytical framework and the literature, two bond markets case studies were identified to enable the research to draw parallels with the municipal bond market in England. Both case studies were explored in Chapter 2, providing a background about their nature, characteristics, and development.

This research aims to understand the key barriers in the bond market and how to overcome them. As municipal bonds have not been used extensively in England or in the UK, there was not enough points of research to conduct a comparative case study across the UK. The choice of case studies considers the challenges associated with policy transfer research related to the reliability of such transfer when differences are evident between the chosen cases.

The first option was to do an international comparative case study between MB experience in another country compared to England. The potential of such policy transfer and lessons learnt will be limited by the difference in the social, economic, legal, and governmental environment.

The second option was to do a comparative case study between the housing sector bonds in England and the municipal bond market in England. Although such comparative research would offer a good insight on how the bond market functions within England, it will not be ideal by itself as it compares two different sets of entities that differ in their tasks, scale, and structure.

Therefore, the choice landed on integrating both options together by looking at MB in England with a lens on an international case study (Swedish LA bond market) and another lens on national case study (the housing bond market in England). This helped in cross examining any international evidence by triangulating it with the findings from the housing sector and vice versa. Also it served well for the purpose of strengthening the research design, the reliability of the data, the validity of research findings and its subsequent policy transfer lessons.

The first case is the international development of a bond market, i.e., the Swedish municipal bond market. It offers the potential of unwrapping specific features, barriers and policies applied to overcome certain barriers faced by Swedish municipalities and offers a view of the current stakeholders within the market, and the relationships between them.

The second bond market is the English Housing Sector bond market. This provided an insight on how different stakeholders in the market may react to the development of the MB market in England. Also, it allowed an assessment of current market practices, how they have developed, and provides an idea on the potential role to be played by international and national actors in the development of the MB market in England.

Furthermore, both cases have provided a close insight into the role of a bond aggregator, where and when they can be used, and their role in facilitating borrowing by overcoming some market barriers. In Sweden, there is Kommuninvest that was set up in 1986, and in the English housing market there is THFC, established in 1987. This helped in understanding the possible role the UK Municipal Bond Agency can play to enable Local authorities’ access to the bond market in England and the prospective role it can play in the future as a market maker.

[Yin (2003)](#_ENREF_317) asserted the importance of identifying the units of analysis of the project when designing the case study. Those units of analysis, once identified, focus the data collection and assist structuring the case study by using various perspectives within the case. The applied conceptual framework in this project is a version of the framework developed by [Healey (1992)](#_ENREF_116) and derived from the Historical Institutionalism theory to guide the study in understanding the development of the municipal bond market in England, and the means to overcome market barriers (see Chapter 3). The framework suggests a number of elements to be studied being:

1. *“The environment”* - the most important events and the agencies concerned with the development of the bond market,
2. *“The actors” –* the role, power, and interests of those agencies, and
3. *“The barriers” -* including an analysis of the key actors’ behaviours and the prevailed bond market barriers.
4. *“The formal and informal rules”* the role of formal and informal ideas, rules, and norms that plays out in the bond market.

Therefore, those elements identified by the conceptual framework are used as the units of analysis for this project.

The use of units of analysis in the design can be described as an embedded design according to [Yin (2003)](#_ENREF_317). This design allows the implementation of triangulation between different sources to understand the same event. Triangulations are useful when attempting to answer a number of questions or, due the utilization of different methods and sources, to corroborate each other ([Silverman and Marvasti, 2008](#_ENREF_270)). [De Vaus (2001)](#_ENREF_74) argues that a well-designed case study will consider examining all essential elements without overlooking any of them. Therefore, when all those elements are taken together, a much more informative picture of the case will be formulated in which is given to all information gained from different levels. This, in turn, will allow a much deeper and more complex understanding of the whole matter.

On the importance of triangulation, [Yin (2004)](#_ENREF_318) notes that the main idea for data collection in a case study design is to “triangulate” or create congregant evidence in order to strengthen findings, ideally by relying on two or more different sources that point to the same set of events or facts. Such corroboration *“serves as another way of strengthening the validity of a study”*([Yin, 2011 :P81](#_ENREF_319)). Similarly, [Knafl and Breitmayer (1989)](#_ENREF_133) argue that triangulating data sources strengthens the principles in case study research by allowing the phenomena to be understood from different perspectives, leading to more confirmed findings. One way of achieving this, according to ([Krefting, 1991](#_ENREF_141)), is by researchers seeking a long-lasting or strong exposure to the subject phenomenon of the study and its context. The connection between the participants, therefore, can be created and different viewpoints can be collected and identified to reduce the possibility of collecting desirable responses in the interviews conducted.

[Fielding et al. (1986)](#_ENREF_94) states that application of triangulation in qualitative research should focus on the necessity of using a single theoretical perspective throughout the project. Also, study methods and data used for triangulation should be carefully chosen to give a clear insight on structural matters and allow accurate capturing of participants perspectives. Those rules were followed throughout the design of the case studies in this project, by approaching each of the units of analysis from the perspective of Historical Institutionalism theory and by evaluating the context of each case study to understand the associated structural issues. The project used in-depth interviews that obtained a thorough understanding of the participants viewpoints.

[Mason (2002:P 36)](#_ENREF_199) also argues that *“You will need to begin by asking whether data generated via different sources or methods take a similar or complementary form in a technical or organizational sense, so that they can be straightforwardly aggregated, or grouped together, or made comparable in some way”.* Mason’s advice is that to do so, the different forms of data obtained should have used the same or complimentary units of analysis. Such guidance was used in this study; the data collected came out of the same units of analysis utilised in the same conceptual framework.

The study design in this project will use a bottom up/inductive approach as it allows movement from specific observations to broader generalizations and theories. When undertaking inductive studies, qualitative methods are more suitable in order to allow the collection of data from different perspectives that could assist the explanation of a phenomenon ([Saunders et al., 2009](#_ENREF_255)). Qualitative methods also allow more flexibility and subjectivity for the researcher than a quantitative approach would, and will allow understanding of the phenomenon within its context ([Rohitarachoon, 2012](#_ENREF_241)).

The research methodological approach is determined by its theoretical position and the questions asked by the research. When it comes to this project, there are two reasons for choosing qualitative methods.

1. Understanding the development of bond markets and their implications is a complex process that entails gathering data from a wide range of stakeholders in the chosen markets and cross examining the evidence in a comprehensive way to allow understanding of the key barriers in such markets and how they have been overcome. This means that such study needs to take into consideration different perspectives, such as economic, legal, political, financial, structural, social, market regulations, as well as different stakeholders concerned with the development of a municipal bond market.
2. The questions posed by this research attempt to understand the context in which bond markets operate, explore the key barriers in each market and understand the ways to overcome such barriers. Such questions require not only a mere understanding and interpretation of bond market development but also examining the reasons and leading influences of such development.

Therefore, this research, by utilising an institutional approach, focuses on understanding how key actors views and approaches are being shaped to drive their behaviours in the bond market. [Coast (1999)](#_ENREF_60) argues that qualitative methods allow a deeper exploration of the certain subject or phenomenon and enhance the robustness of the findings in a way that they are produced from a meaningful context.

When considering the main research elements, such as: research nature, b) theoretical position in the use of Historical Institutionalism theory and the conceptual framework utilised, c) research questions and literature suggesting that qualitative design is the most suitable approach as it allows an in-depth understanding and obtaining of relevant evidence on the development of the bond market.

Such approach facilitates the understanding of different stakeholders’ views and positions in a way that makes quantitative data meaningful and helps to understand the reasons behind it.

“*Qualitative research begins with assumptions, a worldview, the possible* ***use of a theoretical lens****, and the study of research problems inquiring into the meaning individuals or groups ascribe to a social or human problem. To study this problem, qualitative researchers use* ***an emerging qualitative approach*** *to inquiry, the collection of data in a* ***natural setting*** *sensitive to the* ***people and places*** *under study, and* ***data analysis that is inductive and establishes patterns or themes****. The final written report or presentation includes the* ***voices of participants****, the reflexivity of the researcher, and a complex description and interpretation of the problem, and it* ***extends the literature or signals a call for action****.*” ([Creswell, 2007, P37, as cited in Kennell, 2017](#_ENREF_66)).

The areas highlighted in the quotation above relate directly to the conceptual framework of this research and the literature in this field, as shown in the table 3, below:

Table 3 Qualitative elements of research design

|  |  |
| --- | --- |
| **Definitional term in qualitative research** | **Element of conceptual framework** |
| Use of a theoretical lens | This research design is guided by the conceptual framework in Chapter 3 developed by [Healey (1992)](#_ENREF_116) and the Historical Institutionalism theory. |
| Emerging qualitative approach | The research design was informed by the in-depth review of the relevant literature related to the development of bond markets. |
| Natural setting of research | The data collected for this research purpose came from various participants from the three bond markets in Sweden, England, and the English housing sector. |
| Study of people and places | The study design and data collection focuses on the three case studies, stakeholders across them, and their distinct views. |
| Inductive data analysis | The data analysis of this research is built around the thematic analysis of conducted interviews and available documentation using appropriate coding methods. |
| Use of participants voices | When choosing participants and conducting interviews, this research design gave great consideration by making sure that all stakeholders are represented, and therefore their different perspectives are captured |
| Extends the literature, or signals a call for action | This research contributes to the literature on the development of bond markets in the developed nations. It also provides a wealth of findings that are related to future policy development. |

Source: ([Kennell, 2017](#_ENREF_130))

# 4.3 Data collection methods

The data for the chosen case study research design can come from various sources of evidence. Generally, there are six common sources of evidence for case study;

1. Observation,
2. Interviews,
3. Archival records,
4. Documents,
5. Participant observation, and
6. Physical artifacts.

A good case study benefits from having multiple source of evidence ([Yin, 2012](#_ENREF_320), [Baxter and Jack, 2008](#_ENREF_22)). The use of these sources could be at its best when applying

1. a formal instrument such as interviews, surveys etc, and
2. a rigorously defined data collection procedure ([Yin, 2011](#_ENREF_319)).

This study uses a combination of interviews, archival records, and documents as sources of the case study data.

The sampling plan has considered the variety of stakeholders involved in the chosen bond markets and sought data saturation and triangulation. This, in turn, helped to generate a reasonable generalisability out of this research which can be used to suggest policies for future applications.

The data collection process included the selection of samples (units) and the choice of data sources. The use of units in this research helped in evaluating different bond market developments using a variety of lenses which, according to [Baxter and Jack (2008)](#_ENREF_22), allows for multiple facets to be revealed and understood.

The data collection comprises of interviews with different stakeholders; local authorities, banks, credit rating agencies, bond aggregators, housing associations, PWLB, and MHCLG. In addition to this, documents and reports from Kommuninvest and certain municipalities are used for analysis.

When speaking about the data collection units there are different types of sampling methods that could be followed in qualitative research. A sampling plan can be a choice of four types;

1. Snowball sampling conditioned by being purposive snowballing,
2. Convenience samples, which are more likely to produce an unwanted degree of bias,
3. Random sampling, which serves better for generalising the finding numerically, or
4. Purposive sampling which is more applicable to this research as it may produce evidence that offers contrary viewpoints, especially given the need for testing rival explanations ([Yin, 2011](#_ENREF_319)).

Purposive sampling was deemed to be the most suitable method for this research. According to ([Creswell, 2007](#_ENREF_66)), when qualitative research is conducted, the sampling method is mostly purposive. Such method of sampling enables in-depth investigation of the cases chosen. Similarly, [Yin (2011)](#_ENREF_319) argues that purposive sampling serves better the purpose of qualitative studies when cases are used *“the goal or purpose for selecting the specific study units is to have those that will yield the most relevant and plentiful data, given your topic of study”* ([Yin, 2011; P 88](#_ENREF_319)).

Furthermore, [Tansey (2007)](#_ENREF_284) argues when purposive sampling is applied, elite interviewing is relevant for process tracing in a case study research. Elite interviewing in the political science sphere allows the required level of evaluation at high end government and civil service positions. And therefore, the argument is that, elite actors will provide a very good insight on essential information related to the political processes of interest.

[Tansey (2007: P3)](#_ENREF_284) outlines the key benefits of utilising the elite interview method *“1. Corroborate what has been established from other sources, 2. Establish what a set of people think, 3. Make inferences about a larger population's characteristics/ decisions, 4. Reconstruct an event or set of events”.* Table 4 below outlines the suitability of elite interviewing using the lens of [Tansey (2007)](#_ENREF_284), and shows four benefits.

Table 4 The rationale behind elite interviewing in this research.

|  |  |  |
| --- | --- | --- |
| **Tansey elements** | **Research design** | **Suitability** |
| Corroborate what has been established from other sources, | Elite interviewing helped to cross examine the evidence collected from interviews from different stakeholder groups with the available literature and documents. for the purpose of enhancing the findings robustness. This, in turn, helped to either confirm or reject the early evidence found in the literature. | This study was conducted in a way that allows gathering evidence from both the Swedish bond market and the housing bond market in England and correlate the evidence with what the municipal bond market in England offers. |
| Establish what a set of people think, | The research design was tailored around the use of units of study to establish in depth understanding of each group of stakeholders’ actions, attitude, values, and beliefs around the subject matter. | Elite interviews along with purposive sampling, allowed a better understanding of different actors’ positions towards the development of a bond market in England. Also, it allowed differentiation between each group position and how each perceived bond market barriers, depending on whether they are issuers, investors, or intermediaries. |
| Make inferences about a larger population's characteristics/ decisions, | As the study could not possibly interview all involved actors in the chosen case studies, elite interviewing was essential to not only to gather evidence but also facilitate drawing conclusions and findings out of such data. | This method was particularly useful to gain an insight on the beliefs and activities of certain set of groups or entities (such as MHCLG, PWLB, and UKMBA) when municipal bonds are the subject. |
| Reconstruct an event or set of events | This study aimed mainly to understand the key barriers in the development of bond markets and the methods by which they can be overcome. Hence, it was essential that the sampling method allows better understanding of the key circumstance, decisions, events, and actions that lie behind the existence of such barriers in the first place. | Elite interviewing served the purpose of unwrapping hidden elements of political and economic actions that were unclear when looking at the available primary and secondary sources. Elite interviewing allowed a more direct and focused questioning to bolster the findings with an in depth collection of evidence. |

Considering the meta context of financialisation and the specific context of [Healey (1992)](#_ENREF_116) framework, this thesis has overtly designed the purposive sample to include specific elite interviewees from each of the stakeholder groups. This has helped unwrap the relationships between different stakeholders within the bond market,

The theoretical framework provides an insight to the important stakeholders. The broader literature suggested which groups would provide fundamental perspectives; therefore, these 24 elite interviewees were best positioned to provide the needed answers.

Interviews were conducted with the following groups and individuals.

Group one - Local authorities

1. Strategic Director and Councilor
2. GLA Senior Policy officer
3. Chief of Finance in Swedish LA
4. Senior member of Core Cities Group

These interviews provided different views on how the MB market works from LA perspectives, and the role of intermediaries and other financial actors. In addition to that, the senior member of Core Cities Group provided valuable insights on how bond markets can work in favour of LAs, and how can market barriers be overcome from Core Cities Group’s perspective.

Group two

1. GLA strategic advisor
2. Urban economics advisor
3. Academic researcher

This group provided a practical perspective of their vision for how MBs are better utilized, where and how they work best for the LAs in England.

Group three

1. Senior Financial Control Officer, Capital Finance representative from MHCLG
2. PWLB advisor

These interviews helped to gain an in depth understanding of how MHCLG perceives LA finance and what its position is regarding the development of the MB market in England, and the existence of the PWLB as a well-established and safe lender.

Group four

1. Two Senior members of the Chartered Institute of Housing
2. Three financial treasurers
3. Academic practitioner.

The Chartered Institute of Housing members explained the major changes that have happened to the housing sector, the role and behaviour of different bond market makers, and the impact bonds had on housing association practices. This view was backed with the other four interviewees They provided an in depth perspective on how bonds worked and continue to work for some HAs, what sorts of barriers faced HAs and how they overcame these barriers, what changes needed to take place in the sector, the impact of social norms and culture and how they played out in the bond market, and the role played by different intermediaries, credit rating agencies, and aggregators.

Group five

1. Senior Investment Consultant
2. Director of Investment and Commercial Banking in one of the leading banks
3. Senior member of Public Debt from one of the leading credit rating agencies (CRA)

These interviews provided a very important view on the role of market makers and credit rating agencies. The intermediaries explained how banks work to facilitate bond market activities and transactions, the changes in their role from lenders to intermediaries, and what they are offering to assist borrowers. The CRA representative provided their insight on how credit assessment is carried out, the purpose of such assessment, how can credit rating be enhanced, and the role debt-aggregators can play in assisting borrowers who lack the credit rating required by the bond market.

Group six – representing bond aggregators who work to pool borrower’s needs together

1. Senior UKMBA and Public Finance Management officials
2. Kommuninvest senior financial manager
3. Two senior interviewees from THFC
4. Housing Bonds Aggregator treasury member

The senior UKMBA officials gave their vision on how UKMBA can facilitate LA borrowing needs, what can be done to build on MB advantages, how to minimize their disadvantages, and what services they can offer to assist LAs to overcome barriers posed by the market and by the nature of MBs in England. To complement their view with practice, three other senior interviewees were included in this group. Kommuninvest, THFC, housing aggregator interviewees helped to gain a better understanding on which practices work better in favour for borrowers when an aggregator is in place, what and when it works to aggregate debt, which borrowers are better suited to use pooled debt, and what UKMBA can do to draw on the international lessons from both Kommuninvest and the national experience from the UK housing sector.

In addition to their relevance to the thesis, interviewees representing PWLB, UKMBA, intermediaries, and CRAs grew to be even more important as they became prevalent in the context of financialisation and its impact on new financial instruments, market mechanisms and practices. Therefore, financialisation played a role in asserting the importance of involving such actors in the study.

The table below explains the 24 interviewees position, the sector they are active in, and their reference related to the analysis in chapters 5, 6 and 7.

|  |  |  |  |
| --- | --- | --- | --- |
| **Number** | **Position** | **Sector** | **Reference** |
| 1 | Councillor | Local Authority | LA, 1 |
| 2 | Strategic Director | Local Authority | LA, 2 |
| 3 | Senior policy Officer | GLA | GLAH |
| 4 | Senior member of Core cities group | Core Cities | Core Cities Group |
| 5 | Chief of finance | Sweden | Sweden LA |
| 6 | Urban economics advisor | Advisor | Urban economics advisor |
| 7 | Strategic Adviser to Local Government Association | Academic | GLA Strategic Adviser |
| 8 | Academic | Academic | Academic, 1 |
| 9 | Senior Financial Control and Capital Finance representative | MHCLG | MHCLG |
| 10 | PWLB financial advisor | PWLB | PWLB |
| 11 | Senior member of the Chartered Institute of Housing | Chartered Institute of Housing | CIH 1 |
| 12 | Senior member of the Chartered Institute of Housing | Chartered Institute of Housing | CIH2 |
| 13 | Senior financial representative | Housing association | HA 1 |
| 14 | Finance and Treasury director of one of the housing associations | HA | HA 3 |
| 15 | Associate professor in Housing and Urban Research | HA | HA 4 |
| 16 | Financial department of one of the housing associations | HA | HA5 |
| 17 | Senior investment consultant | Investor advisor | Intermediary, 1 |
| 18 | Director of investments at a commercial bank | Commercial Banking | Intermediary, 2 |
| 19 | Senior member of public debt | CRA | CRA |
| 20 | Senior UKMBA official | UKMBA | UKMBA |
| 21 | Public Finance management | UKMBA | PFM |
| 22 | Senior member of Kommuninvest | Kommuninvest | Kommuninvest |
| 23 | Senior member of The Housing Finance Corporation Limited | THFC | THFC |
| 24 | HA Aggregator | Intermediary | HA2 |

In most qualitative studies the number of interviewees practices, policies, or actions included in a study can fall in the range of 25–50 ([Yin, 2011](#_ENREF_319)). The interviewing process was carried out until saturation was achieved. In total 24 interviews were conducted; the number deemed to be enough as it was noticed that at certain level, the same information was repeated with no or little addition from the conducting of more interviews.

Effective research methods are simply defined as *“the tools by which information is gathered.* *Without the appropriate design and use of research methods, we are unlikely to gather quality information and as such create a shaky foundation to any review, evaluation or future strategy”* [MacDonald and Headlam (2009 P2)](#_ENREF_158). Interviews are considered one of the most important tools in collecting case study information ([Bergheim and Ings, 2014](#_ENREF_27)). Case study interviews could be classified into two categories: structured, and qualitative interviews. The latter has two subcategories: unstructured, and semi-structured interviews. Different interview categories are set in the next table (Table 5) with explanation to advantages, disadvantages, and suitable application for each.

Table 5 Comparison between different interviews classification, and their advantages and disadvantages.

|  |  |  |  |
| --- | --- | --- | --- |
| **Type** | **Advantages** | **Disadvantages** | **Suitable for** |
| Structured Interviews | * Standardized questions. ([Bergheim and Ings, 2014](#_ENREF_27)) | * Follow researcher word usage and phrases * Limit responses to a pre-defined set([Yin, 2011](#_ENREF_319)) | * Quantitative research or survey ([Yin, 2011](#_ENREF_319), [Wallqvist and Axelsson, 2013](#_ENREF_307), [Bergheim and Ings, 2014](#_ENREF_27)) |
| Qualitative Interviews (Non & semi- structured) | * Researcher flexibility. * Conversational mode * Use of open ended questions * Allow participants to use their own words to express their opinion([Yin, 2011](#_ENREF_319)) | * Might accompany some bias ([Wallqvist and Axelsson, 2013](#_ENREF_307)) * Ethical issues such as ignoring some selected set of data ([Yin, 2011](#_ENREF_319)) * Needs more efforts to organize and analyse data ([Yin, 2011](#_ENREF_319)) * Needs permission to record([Bergheim and Ings, 2014](#_ENREF_27), [Yin, 2011](#_ENREF_319)) | * Qualitative research ([Bergheim and Ings, 2014](#_ENREF_27)) * Exploring subjects without specific list of questions |
| Non-structured | * Resemble the conversation   - Achieve informality([Yin, 2011](#_ENREF_319)) |
| Semi-structured | * In depth discussion([Saunders et al., 2009](#_ENREF_255)) * Allow researcher to change the wording of questions * Flexible and gives more autonomy to researcher * Allow extra questions when needed([Bergheim and Ings, 2014](#_ENREF_27), [Yin, 2011](#_ENREF_319)) |

When considering the research questions and objectives, unstructured interviews may not achieve enough focus to meet the specific research objective ([Bergheim and Ings, 2014](#_ENREF_27)). In order to achieve better understanding of the development of the chosen bond markets and to highlight the different positions held by different stakeholder groups, it was best to apply a qualitative semi-structured interview. This helped to bring out participants relevant knowledge and experience. By applying planned qualitative methods, accompanied with purposive sampling, this allowed the study to obtain rival explanations and helped to achieve an unbiased picture of the different bond markets in a way that all participants views were presented ([Wallqvist and Axelsson, 2013](#_ENREF_307)). Practically, semi-structured interviews enabled the interviewees to provide additional information and flexibility in their answers, and to account for their own experiences and specific expertise. The questions sought to examine the history and initial formation of the bond market and the rapid growth after the GFC. In addition, the questions examined how innovations occurred, and how new HAs and investors began to enter the market, and the conditions that required this development. Furthermore, the questions also allowed the examination of strategies, practices and difficulties that emerge in reconciling different aims and politics of different stakeholders ([Wainwright and Manville, 2017](#_ENREF_304)).

Telephone interviews were pursued when in person interviews were not possible to be conducted. Telephone interviews offers better access, speed, and lower costs. One of its disadvantages is the fact that it could be associated with less reliability when participants are less willing or refuse to engage. However, following [Saunders et al. (2012)](#_ENREF_256) recommendations to minimise such impact, before the actual phone interview, a preoperational phone call or email was conducted to explain the research, and request arranging a future interview at a convenient time and date for the participant.

By studying the Swedish municipal bond market, it was expected that there will be some language limitation and difficulties. Such language difficulties could have been avoided by the use of a translator, however, this was not required. Nevertheless, even though a translator was not needed, some measures were implemented to avoid difficulties related to the fact that English is the second language for both the interviewer and interviewees. Such limitation related to either concentration on the response or misinterpreting an answer when notetaking. The latter was avoided by requesting permission for audio recording and transcription of the interview, which enhanced concentration on interviewee responses and offered an un-biased transcription of response ([Yin, 2011](#_ENREF_319), [Bergheim and Ings, 2014](#_ENREF_27)). Similarly, ([Seale and Silverman, 1997 : P2](#_ENREF_264)) stated that *“audio recordings are an increasingly important part of qualitative health research. Transcripts of such recordings, based on standardized conventions, provide an excellent record of naturally occurring interactions. Compared to field notes of observational data, recordings and transcripts can offer a highly reliable record to which researchers can return as they develop new hypotheses”.*

Secondary data was collected from raw data, published summarizes ([Wallqvist and Axelsson, 2013](#_ENREF_307)), annual reports, and archival data ([Yin, 2012](#_ENREF_320)). Such information sources were found in municipality archives, MHCLG, UKMBA, Kommuninvest’s and other electronic records and libraries.

# 4.4 Research quality

The research design quality should be developed to serve the purpose of enhancing and strengthening the conditions related to the overall design quality. ([Litman, 2019 :P2](#_ENREF_151)) stated that *“Good research reflects a sincere desire to determine what is true, as opposed to bad research that starts with a conclusion and only presents supporting evidence”*. More specifically, [Yin (2003)](#_ENREF_317) discussed the aspects of research quality in case study research design as validity and reliability.

**Validity** reflects whether or not the study has accurately collected data which reflects the real world, or the case that was studied. To achieve a reasonable level of reliability and validity the research will seek multiple sources of evidence ([Schell, 1992](#_ENREF_262)) and follow rigorous methodology and pre-designed features, as explained before. Internal validity is one of the aspects discussed by [Yin (2003)](#_ENREF_317), emphasising its necessity when the case study employed is explanatory and aims to create links within each case study.

This project has been designed around a conceptual framework developed by [Healey (1992)](#_ENREF_116) and Historical Institutionalism theory whereby both propose a number of structural relationships between the frameworks four elements. [Yin (2003)](#_ENREF_317) pinpoints the need for cross case synthesis to increase internal validity of the research when an explanatory case is sought. Yin argues that such synthesis is suitable for a multiple case study design, whereby each case is explored individually. This would allow generating a set of outcomes out of each case separately to increase the validity of a cross case study analysis. [Yin (2011)](#_ENREF_319) argues that cross case synthesis reduces the possibility of ignoring a selected set of data, whereby a researcher might find some excuse to justify their exclusion. This will help to decrease the potential of researcher elimination of the data that divert across cases; therefore, the analysis will not be selective to just the confirmatory data across the cases. Guidance was applied when analysis was carried for each case study data generated for this research purpose.

**External validity** was discussed as well by [Yin (2003)](#_ENREF_317) as a necessity for the generalization of the research findings. Yin argues that when a multiple case study design is followed, the same protocol should be followed in all case studies explored. This research has followed the same protocol in all three cases chosen, and the data collection method and questions asked were very similar as they all followed the structure of the conceptual framework employed.

**Reliability** means that the results are repeatable and consistent ([Bergheim and Ings, 2014](#_ENREF_27)), and it evaluates the consistency of the research design ([Yin, 2003](#_ENREF_317)). Yin’s recommendations to increase reliability is that the research should have a set of objectives, data collection methods, and analytical methods employed. All of that was clearly outlined and explained in this chapter.

**Credibility** was achieved by providing the respondents with the relevant information prior to the interview in addition to a consent form as recommended by ([Bergheim and Ings, 2014](#_ENREF_27)), both provided by email. Additionally, all interviewees will be permitted to leave the interview or conversation at any time if the questions or conversation caused them any difficulties or worries ([Rohitarachoon, 2012](#_ENREF_241)).

In regard to the **ethical** considerations, this research is not seeking the personal position of the participants, and there will be an avoidance to any potential harm or reputation damage to the interviewee. Along with sending all needed information, consent forms, and request the interviewee permission for recording the interview, the research will be conducted in a way that avoids any kind of privacy invasion or deception of participants ([Bergheim and Ings, 2014](#_ENREF_27)).

**Analysing** qualitative research can take different forms. Although it does not follow any certain routine, which are procedures that may exist in other research methods, it is also not totally undisciplined ([Yin, 2011](#_ENREF_319)). This research applied a computer aided qualitative data analysis software (CAQDAS) to aid analysis. In this research NVivo software was used as it provided an unlimited data bins, organised the data, and recorded all data source and timing details ([Baxter and Jack, 2008](#_ENREF_22)).

[Yin (2011)](#_ENREF_319) recommends that in qualitative research, regardless of the particular qualitative orientation being adopted, should follow a general five phase cycle.

Those five steps were pursued as shown:

1. Each of the interviews/information was compiled and organised within the same order
2. The compiled data was broken down into different classifications
3. The previous parts were reassembled into similar groups ready to be analysed
4. The groups were used to create the new narrative with accompanying tables and graphics when needed
5. Final conclusions were extracted from the entire study for any future applications ([Yin, 2011](#_ENREF_319)).

[Yin (2012)](#_ENREF_320), aiming to increase credibility in case studies design, suggests that researchers may need to undertake both data collection and data analysis together. This research, where it was possible, followed that suggestion to achieve single analysis following each data collection associated with caution to avoid any *“premature closure”* by not jumping to conclusions too early and without analysing and evaluating all of collected data ([Yin, 2004](#_ENREF_318)).

# 4.5 Summary

Following Chapter 3, which covers the theoretical position of this research, Chapter 4 outlined the methodological design of this research. It laid out the methodology applied and the application of a qualitative approach along with a multiple case study design, being the Swedish municipal bond market, England housing bond market, and English municipal bond market. This was followed by data collection methods, sampling plan, the use of semi-structured interviews and the elite interviews with different stakeholders took place during the data collection. Finally, this chapter outlined the research quality features related to internal reliability, external reliability, credibility, and other ethical matters concerned with the research design quality. The next three chapters of this thesis (Chapters 5, 6 and 7) discuss the results of the case study analysis, broken down and aligned with the four levels of the applied conceptual framework developed by [Healey (1992)](#_ENREF_116).

# Chapter 5: The Environment

In line with the Healey (1992) framework, this chapter includes analysis of the first level of the framework, *“the Environment”.* This chapter addresses the main activities, measures, and relationships most significant in determining progress and outcomes of the bond market. Furthermore, this chapter will seek to identify the most significant events in the municipal bond process and which events are most difficult to accomplish. This chapter provides foundation for the second level *“the Actors”* whereby by it provides an in-depth mapping for different kinds of actors and agencies, including to LAs, PWLB, credit rating agencies, investors, UKMBA, banks and other key players, such as the central government, that potentially would have a role in the development of the municipal bond market.

## 5. Local Authorities Financial Position

Austerity was identified by several interviewees as one of the key changes that occurred in local authority funding arrangements, which impacted their need to borrow. The GFC resulted in the reduction of central government grants to Local Authorities, as a part of wider austerity programs applied by the UK Government. The result was reductions in public funding which cuts the lifeline to fund essential local services, such as social care. But in a country with a serious crisis in housing, local Authorities do not have adequate resources to overcome or to contribute to the solution to housing and social care crises *(Urban economics advisor, Academic 1, LA2, Core cities, UKMBA, PFM)*.

On average, each local authority in London lost about 63% of its central funding for services after the GFC. This meant that they have less revenue available to fund the interest payment and the capital costs of any asset they buy. Many LA are partially offsetting that by pursuing some investment such as housing or commercial property *(PFM)*. Such 63% reduction since 2010, required London LAs to make savings of up to £2bn between 2018 and 2020 to balance their books ([Twinch, 2019b](#_ENREF_291), [BBC, 2019](#_ENREF_23)).

The austerity impact is not limited to services, but also revenue and capital funding for all forms of investment right across the board *(Core Cities Group)*. LAs absorbed most of the central government cuts since 2010 and had limits on their ability to compensate that through increase in council tax, which is capped at 3% *(UKMBA)*. With the urgent need for larger amounts of money for mega-projects, investment in renewable energy and housing, and even with increasing taxes, it is not sufficient to finance the level of investment is required today. Therefore, the need to borrow becomes essential for LAs to deliver *(GLA Strategic Advisor)* and might be the only way forward *(HA1).*

English LAs, when compared to Swedish LAs for example, lack full taxing power enjoyed by the latter. This taxing power is described as *“essential”* even though politicians at the local level might never support or want to raise taxes’ rates, but it has proved its impact when such power is urgently needed *(SWEDEN LA)*.

Austerity, in addition to its impact on service delivery and investment at local level, has a clear impact on human resources and expertise available in local authorities. A reduction in the total number of staff available affected their ability undertake certain tasks as they had very limited capacity and in house skills. To compromise, each LA reacted differently, which very much affected their performance. While Greater Manchester has grouped local authorities into bigger entities to allow shared expertise, other LAs witnessed an increased reliance on external consultants and managers, that itself came at a high cost and did not serve saving money purposes *(Urban economics advisor)*.

## 5.1 Current LAs borrowing methods, problems, and limitations

### Borrowing from Banks

One of the key issues raised by a number of interviewees is the limitation of borrowing sources LAs have at the moment. This is further strengthened by the absence of the previous LOBO structure that banks provided to local authorities to fund their projects. After the GFC, those banks were under pressure to reduce their balance sheet lending to LAs, and therefore, were no longer in a position to provide such long-term funding for councils. Fundamentally, LA borrowing options are either PWLB or the European Investment Bank *(UKMBA, Intermediary 1, LA 2, Urban Economic Advisor, Core Cities).*

Similar circumstances were experienced by housing associations *(HA)*. While the government pressured HA to build more dwellings, grant rates have been severely reduced over time. This led to an increased demand on borrowing by the sector; *“The bank lending group within this sector is not that big. You have your traditional UK banks, your HSBCs, Barclays, Lloyds, RBS, Santander, people like Nationwide Building Society, but beyond that it’s not that big and thus that naturally leads to more emphasis on the bond market” (HA1)*. Similar to the case with LAs, post-GFC all banks were under great pressure to reduce their exposure to long term lending to HAs *(HA1, HA3, CIH2)*. Under the pressure of GFC, banks exploited sector needs by imposing practices that are not fit for purpose. Some HAs sought further efficiencies by merging together but they needed the consent from their individual lenders pre-merge. Such consent came at a cost as banks often repriced their lending resulting in even more expensive borrowing *(HA1)*.

Any new bank lending option did not fit with the sector needs for long term fixed costs borrowing. Instead, banks offered much shorter loans, subject to costs review every five years, which increased the uncertainty faced by HAs *(HA3)*. This imposed two risks on the sector, being the refinance risk and interest rate risks. Considering the business model of LAs and HAs whereby both deliver long term projects, it a high risk to be exposed to, not knowing whether banks are willing to engage in the refinancing and unsure about the interest cost in five years’ time *(THFC)*.

### Historical reliance on the central government

Taking into account the limitations of appealing products or preferable lenders, and the existence of PWLB, LA seem to share the view that central government handles debt finance to distribute it later to local authorities via PWLB rather than debt finance being seen as something LAs responsible for *“There is kind of detachment between the way local authorities think about raising debt. They don’t see it as something they have to do to take any kind of responsibility of accountability for whether raising this money or not is there right thing to do” (Intermediaries, 1).* The view was shared by a UKMBA interviewee arguing that PWLB, by being an easy and cheap source of funding for LAs, resulted in LAs not being urged to maintain regular access to the capital market, and thus were disadvantaged by doing that opportunistically *(UKMBA 1)*.

However, it does not seem to be the case for all LAs. A representative of one LA in England expressed the frustration of these limitations and explained how municipal bonds are viewed as an empowering option“*There are few other options there but really it is central government or nothing.**We would be very keen on doing a municipal bond. I think it is so much a need to way of showing to our residence where our financing is coming from rather than just have to rely on central government all the time” (LA, 2).* Similarly, Gwyn Llewelyn, a Director in the Infrastructure Advisory Group at KPMG, suggested that LAs are keen on the idea of raising funds directly from the market and not overly relying on the central government. With the devolution agenda, such options allow LAs to be more self-sufficient to fund the projects they feel are needed to boost their local economies and communities ([Llewelyn, 2017](#_ENREF_152)).

### LA Reserves

LA borrowing is linked and affected by their available reserves. When they borrow, they must set off a provision in their budget which requires them to make an allowance for the capital expenditure in the revenue budget, as well as their interest rate. As they borrow more, their interest rates increase respectively, compressing their capacity to increase their capital expenditure as well as increase borrowing. The main reason behind this is the central government desire to push LA to their limit and force them to use their internal reserves. This led to crises in councils like Northamptonshire County Council, who used all their reserves and at the same time did not cut costs quickly enough. Therefore, a combination of reduced capacity to borrow and the pressure not to borrow more, produced a noticeable increase in councils coming back into the market to borrow more from PWLB *(UKMBA).* Please see Local authorities reserves page 23.

### Borrowing freedom

The MHCLG interviewee argued that PWLB is available as an optional source of finance, and provided no specific view from MHCLG on which lender or type of finance local authorities should seek. Instead, LAs have the full power to borrow from any source, as a result of an entirely devolved local system. The fundamentals of the borrowing system and legislation, since 2004, allow LAs to borrow from any lender in Sterling currency without the need for any government consent, subject to assuring themselves that the borrowing is affordable and represents the best value for money. Local authorities’ duties in borrowing affordability were explained in the following statement:

“*In assessing affordability borrowing they are required to have regard to the prudential code issued by CIPFA. And what had regards basically mean is you are expected to comply, if you chose to depart from the code, you have be prepared to publicly explain why you are doing something different and obviously any decision that you have made were you have departed from any statuary code*. *They also have the duty of best value but that is basically similar to value for money. So just normal business decisions that they need to take but borrow from lenders who are who gives them a good value in terms of the loan finance”* *(MHCLG).*

A senior representative from the Core Cities Group backed this opinion by explaining that, with the Prudential Code, local authorities can borrow an infinitive amount of money. Despite such freedom, the main problem is in their ability to repay that debt being limited, as they do not have access to the needed revenue streams. Therefore, bonds are just another type of borrowing with additional freedom, but the main problem still exists “*the conversation needs to be talking about other income streams and the freedom to access other income streams whether that through the tax system or elsewhere in order to pay back that borrowing” (Core Cities)*. This was supported by a THFC representative who stated that *“Local authorities have borne the brunt of a lot of cuts since 2009/2010 and they just do not have the resources to do anything. They have been cut to the bone. So simply by giving them the ability to borrow capital doesn’t form a new industry” (THFC).* Even when arguing that LAs are enjoying a good access to revenue streams or cash, the problem lies in the freedom associated with this money. Most of it, if not all, is already allocated or ring-fenced to certain activities *(UKMBA 1)*.

An Urban Economic Advisor expanded on the view by stating that LAs are unable to even retain their projects business rates, instead they must provide these rates back to central government who distribute such funds nationally. The dilemma of access to income streams LA face when borrowing to fund certain projects was discussed using two examples undertaken by the Borough of Barnet and Croydon. Both The Red Cross, a regeneration project at the Borough of Barnet, and Brick by Brick, a regeneration project run in Croydon, required legal changes so they were able to retain their business rates or taxes to repay back their debt to the Treasury.

## 5.2 Municipal bonds VS Public Work Loan Board

The potential of bond success or failure was strongly linked to the historical and current relationship between the central government and LAs. There was a consensus on the idea that this relationship nature, and therefore any changes in it, would very much shape the applicability and outcomes of municipal bonds *(MHCLG, UKMBA, PFM, Core cities, PWLB, LA2, GLA strategic advisor, MHCLG, and CRA)*.

The dynamics of this relationship presents unclarity regarding MBs impact on issuers future funding, that originally comes from central government. Essentially, some LA may be wondering whether they will be victims of their own innovations and whether their funding from central government will be affected once they start raising debt by themselves *(Intermediaries 1, Urban economic advisor)*. A CRA interviewee suggested that the lack of bonds might be a *“reflection of history”* as English LAs do not enjoy the financial freedom available in the US, and the fact that UKMBA did not get the support received by its sisters in Scandinavia from their central governments “*They are just different dynamics obviously the 3 trillion market in the US but then you have got a much more decentralised funding system. And in the Nordic, there is probably a very strong support for the specialised lenders with the central government but there is not that for the UKMBA”* (CRA)*.*

Similarly, up until the late 80s, HAs were debt free, as there were not allowed to borrow. The UK Government decided to give them the power to borrow and encouraged them to seek funding from the capital market. At the start, almost 90% of HA funding came in the form of grants, and only 10% were debt. As grants shrunk, HAs found bonds were the best way of filling their funding gap (THFC).

A PWLB representative explained that the central government perception on bonds has not dramatically changed since the 1974, when the Treasury wanted to encourage local authorities to use the bonds market. The framework of which local authorities can borrow using bonds was outlined in a Statutory Instrument called “Local Authority Stocks and Bonds” ([UKSI, 1974](#_ENREF_296)). However, later on, the central government felt that instead of competing with LA on issuing bonds, central government would issue bonds and lend them to the local authorities via the Public Work Loan Board (PWLB).

“*When it got to about 1977, the Treasury changed its view and thought it did not want local authorities to go into the bond market because they would be… well, not exactly competing, but they would be going alongside the government, and they felt it was better if the government did the borrowing and then the government would then lend to local authorities. But that is not done directly. It’s done by the intermediary called the Public Works Loan Board” (PWLB)*.

*“The reason that we don’t have muni bonds here is because PWLB and there has been an historic concern about the professionalism of local authorities to invest, both in terms of their investment decisions and in terms of bribery and nasty things that happen around Government” (THFC)*.

As a result of those changes in the relationship between central and local government bodies, as represented by the existence of PWLB alongside its terms and arrangement, the current legislation, such as the Prudential Code and borrowing framework, are all purposed to undermine potential benefits from bonds issuance. This presents bonds as a risk baring, inflexible and expensive option compared to PWLB *(PWLB*).

### 5.2.1 PWLB is superior to Bonds

The consensus that took place across many interviewee was around the superiority of PWLB, due to it being backed by the central government, to any alternative source of funding including bonds. Features of PWLB such as easy access, cheaper funding, and products suitability will be discussed in this section.

There was a general consensus expressed by the interviewees on the aspect of *“easy-access”* to funds that the PWLB provides *(GLA strategic advisor, urban economic advisor, CIH 1, Intermediary 1, PWLB, UKMBA 1, and PFM)*. PWLB loans require nothing, or very minimal disclosure, representations and warranties compared to bonds *(PFM)*. This feature might have contributed to a change in the PWLB position from being a lender of last resort, to a lender of first resort *(UKMBA 1)*.

#### Cheaper funding

The idea of PWLB offering cheaper funding than the raising of bonds, was brought up by different interviewees *(MHCLG, PWLB, GLA strategic advisor, PFM, GLAH, CIH1)*.

“*So, one of the things that created the move to municipal bond agency is widening of the spread of PWLB lending over the borrowing cost. But even with that widening it’s not clear that an agency can beat PWLB obviously still dominant until either, if spreads come down, the agency can issue close to government, or something else happens that allow the agency to take over” (GLA Strategic Adviser)*.

From a LA point of view, PWLB is superior as it is backed by the central government, cheaper, and credit risk baring as opposed to it being borne by Local Authorities *(GLA strategic advisor, PWLB, MHCLG)*. No other country enjoys the existence of a structure such as PLWB, which is very unique to the UK and that is why municipal bond agencies in other countries would do better than the UKMBA *(GLA Strategic Adviser, PFM).*

This view was supported by an interviewee from MHCLG who stated that PWLB is a market-maker because it is cheaper, easier to access, and provides unlimited funds with regard to how much a LA can borrow.

*“With PWLB being a sort of a competitive rate and having very quick access terms. Whilst government official position is that it is not a lender of last resort, I almost see it as if it was the market maker. So if you are a local authority and you can borrow at 80 basis points above gilts and effectively you can get the cash at 2 days’ notice, then any other form of debt financing has to be at a similar rate and can’t be overly onerous to access in order to be competitive because otherwise why would you bear lots of compliance costs and borrow at a higher rate when you can get effectively an unlimited amount of money it is not unlimited but effectively it is for local authority purpose. If they can afford it, they can borrow” (MHCLG).*

Similarly, it was stated that *“As long as you stay within prudential limits, you can keep borrowing off PWLB” (GLAH).*

A senior representative from PFM forecasted bonds to be better over time. The anticipation is that the first couple of bonds would not produce significant savings, but over time and as the market gets used to the concept, the risk will ease, and thus it is expected that the pricing would improve, and issuance would pick up. This might rely on UKMBA pooling a number of benchmark size issues first *(PFM)*. A UKMBA interviewee went further to argue that when assessing the latest bonds issuances in the UK, all have either beaten or equalled the *“80 basis points over the gilts”* that PWLB provides *(UKMBA)*. Both Warrington and Aberdeen City Councils issued small inflation linked bonds, and despite inflation being *“fairly high”* they still managed to achieve savings from it *(UKMBA, PFM)*.

#### The lack of demand for PWLB alternatives

A representative from MHCLG explained that with the existence of the PWLB, there might be no gap in the market to be filled by MBs *“if there is perfectly acceptable product in the market through PWLB with very low for local authorities’ barriers to inter and cost issuing debt. Why would you want to take the risk?” (MHCLG)*. Similarly, a representative from PWLB explained that PWLB offers a variety of loans that leaves little or no gap in the market *“lots of different loans for different periods”,* and takes the risk away from LAs *(PWLB).* Please see the discussion about the lack of demand for PWLB alternatives, page 39.

There was a general consensus, however, that MBs can be successful if mainly focused on filling market gaps left by PWLB. A MHCLG representative explained that despite having no pre-disposition against any new source of debt finance, those options should be delivering, for the most part, a product that PWLB does not offer at the time *(MHCLG)*. Furthermore, it was stated that, although the competitive rates PWLB offers might be advantageous, PWLB ease of access is the main reason why bonds are only viable to fill any gaps left *(Intermediary 1, PWLB)*.

MBs are said to have great potential, as they fit with LA long term planning more neatly than PWLB funding does. As LAs continuously seek certainty on the long term, they need to borrow on a fixed rate for several years, which is not something that PWLB currently offers. Rationally, such gap in PWLB products and thus the current market, could be filled by bonds. With the current low interest rates, and with the forecast of it increasing in the coming years, more LAs would take the advantage that bonds offer; of borrowing at locked interest rates for as long as 45 years, an option that PWLB does not offer *(PFM, HA5)*. This feature is what made bonds advantageous for the housing sector, as it allowed HAs to eliminate different risks, such as refinancing risks associated with short borrowing and interest risks associated with variable rates or LOBO rates *(THFC)*.

The idea that PWLB offers a variety of loans leaving no gap in the market for alternatives was challenged by UKMBA and PFM representatives. They argued that PWLB lending options are limited to two structures.

1. Either LAs borrow money, and pay it back in 20 years and pay the interest along the way, or
2. They borrow the money and pay it back annually from the debt date onwards

The two options expose borrowers to two types of risks. The first risk is that in both options, repayment starts immediately and thus do not give LAs the option to hold repayments (capital or interest) until they start to generate income from the funded project. The other risk is when LAs try to adjust their debt later, they will face a high penalty for prepayments. Both problems can be avoided by using other types of debt structure, such as bonds *(UKMBA, PFM)*

*“So, if you’re for example building houses, if you want to build houses, if you want to build 1,000 houses and you need, whatever it is half a billion put out 4-5 hundred million pounds to do that, then actually you want to borrow the money now but hold off on annual repayments until the houses are built and you’ve started monetising them. So, you want it structured type of debt product which theoretically you may be able to get in the bond market, or you may be able to get something done, whereas a more bespoke lending structure. But with the PWLB you cannot do that and it’s going to be very expensive whereas funding is the object from the cost of carrying to the inherent inefficiencies of going about it in that way. The whole thing with the PWLB, you get those numbers wrong, and you borrowed too much and want to repay it early? The PWLB puts in a very high discount rate on prepayment. So, you could end up paying back an awful lot more than you would have otherwise. So, it’s not the most efficient type of structure available but it is relatively cheap and relatively easy to access” (UKMBA).*

Bonds offering the possibility of delayed repayment and the ability to adjust the repayment period would allow matching between repayment and income streams that would make long term projects *possible (UKMBA 1, PFM, HA3, GLAH, HA5, CIH2, THFC)*. Along with this, PWLB puts a very high penalty on prepayment or early repayment that does not work in favour of LA long term planning and their need for a continuous funding adjustment *(PFM)*.

The inflexibility of PWLB products (no delay of initial payment and early repayment penalties) were both reported extensively by the public sector press. Christian Wall, the Director of Local Government at PFM, explained that there are financial products in the market that offers beneficial interest rates without the need for immediate repayment. Despite the initial interest rate being higher than the current rate, those products are exactly what regeneration and housing projects need. Bonds, specifically, are thought to be advantageous in comparison to PWLB products, as they allow better matching between the repayment profile and the capital projects income profile by offering delayed repayment until the project is generating income ([Wall, 2019a](#_ENREF_305)).

#### LAs freedom to seek PWLB alternatives

Legislation wise, many stakeholders clearly stated that there are no constraints that prevents local authorities from issuing bonds *(PWLB, LA 2, MHCLG, CRA)*. It is *“a totally devolved matter”* said a MHCLG representative, which is evidenced by current and previous issuances, such as GLA and TFL. Although central government is offering PWLB services, they do not think of the type of debt local authorities choose to undertake, as long as they represent good value for money. “*We don’t feel that we have any obligation to or any reason to either create a market with a particular type of debt or to restrict the market in a particular type of debt. We, the government, provide the facility, which is the PWLB, and if the local authority to use this facility they can and if they want to go elsewhere, they can and providing they can comply with the framework” (MHCLG).*

The freedom of choice was also confirmed by the Strategic Director of one of the local authorities *“All we have to do is to make sure that in our own individual treasury management strategy, which in our full council, was approved. There are some local authorities who only will want to go to PWLB” (LA,2).* [Sandford (2016)](#_ENREF_253) explained that LAs have always had the power to issue bonds. Some LAs used bonds in early and mid-20th Century, but the introduction of PWLB during the 70s and 80s led to them being almost abandoned by LAs.

### 5.2.2 Bonds empowerment

A former PWLB representative stated that Local Authorities are still perceived to be very *“constrained”*, leaving very little scope for borrowing by bonds to be considered. Although many LAs would wish to issue bonds, and even though it would be very easy to arrange them, bonds are not widely used as they currently do not present good value for money. This view was counterargued that although bonds are not perceived as a solution to all LA problems, being just another way of arranging debt, but they are needed to allow LAs more freedom, as well as to allow collaborations between different local authorities *(Core Cities)*. Similarly, it is stated that *“they are a part of the solution, but I don’t think that there a complete game changer” (GLAH).*

This view was supported by a GLA Strategic Advisor, stating that considering bonds costs and the presence of PWLB, it can be argued that there are too many single lane bonds issuances in England. Nevertheless, those issuances are not necessarily driven by cost efficiency, as what brings borrowers to PWLB, but rather by the empowerment they give to a local authority to choose and act. This, to a certain level, demonstrates how LAs do not like “*being beholden unto the Treasury*” *(GLA Strategic Adviser).* Similarly, a local authority’s Resources Strategic Director welcomed the empowerment the UKMBA can give to LA’s and stated that *“Actually, having the UKMBA, you get that decision. Then it is back with you again you can make that choice rather than having to have the terms of what you can borrow for dictated by central government” (LA, 2).*

The empowerment given by the utilisation of bonds may become more valuable, especially when considering that banks are uninterested in big transactions, and the uncertainty associated with Brexit regarding the funding available from the European Investment Bank *(PWLB, UKMBA 1)*. Thus, LAs might be left with a single source of funding; PWLB. *“This not a very happy place to be a local authority”* especially if PWLB stopped lending, increased its lending costs, which has *“historically both happened”,* or even any funding being subject to MHCLG credit permission *(UKMBA)*. Similarly, its stated that *“It’s good that local authorities have an alternative so that like us housing associations do”* *(CIH 1)*.

On this point, a representative from a LA reflected on an article in the Sunday Times that referred to PWLB as *“an arcane sort of sub-department of the Treasury”*. This shows the risk of hidden assumptions that local authorities are able to finance their capital needs, and that the central government will not be very comfortable with more financial freedom reflected in their attempt to limit local borrowing purposes. *“But I think sort of unwittingly shows how reliant and precarious that reliance is on us being able to finance capital expenditure. And I am sure that the government think really twitchy about local authority borrowing to then go out and by commercial investment around the country. And one of the things they nearly pushed through last year was to say well actually you cannot borrow to invest in certain things” (LA, 2).*

In terms of government policy, the biggest impediment is the government’s attitude shown by PWLB actions. On the one hand, it elects market solutions, and on the other hand, the biggest lender to the sector is under direct Treasury control, and thus serves as a policy control tool *(PFM)*. The view was supported by the arguments that PWLB, from a central government point of view, works well to mitigate the risk associated with more financial freedom at the local level, mainly as local debt will be reflected on the central government debt and accounts. Therefore, PWLB allows central government more monitoring of local debt, and works as a tool to provide clear information, and control, of how much is being borrowed and what they are using the finance for. Regardless, PWLB works well in that it allows LAs to have quick and cheap access to a lending source, and provides central government with clear information regarding the date and amount of those loans *(PWLB)*. Similarly, a local authority Resources Strategic Director stated that MHCLG *“won’t like”* the idea of UKMBA because it removes their ability to control what local authorities borrow for. PWLB, therefore, is a method that central government, MHCLG, and the Treasury use to enforce certain policies. As an example of that, he mentioned that his LA has no general fund borrowing needs, but they have around £150m worth of “housing revenue accounts” borrowing. However, borrowing is not available for the HA from central government. “*So, I can’t go out and borrow for more housing which is the district and the country need but I can go out and borrow and buy a warehousing. And I think that is as a result of very odd central government relationship with local government. I should be able to go out and do both” (LA, 2).* Please see PWLB vs bonds’ empowerment page 42.

### 5.2.3 PWLB misuse

Many interviewees suggested that PWLB is not the right model every time, especially for financially distressed authorities as *“it doesn’t do really very strict monitoring”.* The lack of monitoring is advantageous from a LA point of view as they can borrow without rigorous checks on how financially sound, they are. However, this resulted in some LA incurring significant problems *(GLA Strategic Adviser)*.

Existing example of the misuse of PWLB easy funding can be found in Woking Council. Currently, the Council has approximately £1.4bn debt based on less than £100m in revenue *“which is ridiculous, the market would never lend it that money” (PFM)*.

With those consideration in mind, a combination of PWLB funding and bond funding may prove an efficient mechanism, where Central government can focus only on funding projects that the market will not be able to cover. *“Central government should be able to divert resources away from those things that could be very efficiently handled by the market. Basically, the government should be adjusting for market failure. So, the market works very well over here. You can build houses in Croydon because the market works very well, and the municipal bonds will do it. Somewhere else in rural areas in Cornwell bonds does not work so you divert your resources to them" (Urban Economics Advisor)*.

## 5.3 The use of Bonds in England and its difficulties

All interviewees shared the same view that bonds are very much under used in England. An Intermediary and an Urban Economics Advisor both said that they have never seen or worked on a project funded by local authorities’ bonds. Most projects rely on borrowing from central government, retain the money and pay it back later *(Intermediary 2, Urban Economic Advisor)*.

Different views were presented on the reasons behind the lack of bonds use at the local level. It was asserted that very few LAs obtained a credit rating, and individually most LAs lack the benchmark transaction size, which stands at £250m, and also that fact that they could not work together, so far, to achieve pooled issuance. In addition to that, there are psychological and practical barriers associated with bonds in being far more difficult to issue than one phone call to the PWLB *(UKMBA 1, PFM, and KOMMUNINVEST 1)*.

### 5.3.1 Bonds complications

MBs require a lot of disclosure, representations, and warranties that LAs do not have to give to the PWLB. Therefore, MBs might not be an option to all Las, especially with the increased scrutiny that might not be beneficial for all local authorities, particularly for those who know that they will not achieve a good rating.

Credit rating might prove to be more problematic for LAs. A local authority’s Resources Strategic Director went to explain that CRAs will never give local authorities rating that is equal to, or better than, a central government rating, suggesting that the sector as a whole need to change to allow better credit ratings for local authorities. Councils such as Spelthorne Borough Council or Woking Borough Council, for example, might not easily gain access to the bonds market as the capital market may well be unwilling to lend them. This makes the existence of PWLB essential especially for such authorities *(PFM)*.

The lack of freedom enjoyed by English LAs is evident in the existing taxing arrangements, cuts in funds, and access to income streams, representing a strong set of challenges to LA borrowing arrangements, whether it is via bonds or PWLB. MBs, however, will be even more disadvantaged as they bear more operational costs and require a level of in-house expertise capable of dealing with bonds complexities which is not generally available at small LAs *(Urban Economic Advisor, Core Cities Group, CIH 1)*.

*“Obviously, capital investment is down so bonds become more interesting in that respect. But the capacity of local authorities to have people who understand the bond market who can generate from those sources has reduced as well. Because obviously it is up to make staff reductions” (Core Cities Group)*.

There are further limitations to the application of MBs in England, as their use is limited to capital investments only, while in other countries it has various uses such as for revenue, cultural and social investment *(PFM, Core Cities Group)*.

Despite all the previous reasons, and mainly because of the continuous decline in capital investment available to LAs, bonds are gaining more importance at the local level (LA 2, Core Cities Group). A Strategic Director at a local authority explained that from 2020 onward there is no core central government funding available for his Authority. As it stands, it is better to give local authorities the freedom to borrow using bonds *(LA, 2)*. The previous difficulties have shown why, in the short run, only some of the largest City Councils in England would use MBs *(Intermediary 1, MHCLG)*.

### 5.3.2 Where and when bonds can work

A consensus took place amongst interviewees that the success of previous and future MB issuances is always subject to the project in place, the nature of the debt product being something that PWLB does not currently offer, and the size of the issuer *(MHCLG, Urban Economic Advisor, Core Cities Group).* Those are the main aspects of the discussions in this section.

#### Project

An Urban Economic Advisor explained that for bonds to work efficiently, they must be project and revenue related:

*“The market would look after the housing in London and the public sector has to do the sewage in Cornwell. You get a reallocation. A lot of this is going to be related to what you are going to spend the money on. If you are putting the money into something that generates financial returns very quickly then you can use bonds” (Urban Economics Advisor)*.

This view was further supported by arguing that the Aberdeen City Council issuance was for asset construction, and Warrington Borough Council borrowed money to lend it back to the housing associations “*So, it is a specific program with a separate risk profile which obviously made it worthwhile” (MHCLG).*

David Blake, Strategic Director at Treasury Adviser Arlingclose explained to Room 151 that lenders are always interested in knowing what the money is going to be used for. If the funded project is a commercial property, then it is likely to struggle to find a lender ([Marrs, 2019m](#_ENREF_181)). Similarly, [Bailey et al. (2012)](#_ENREF_19) suggested that a link between project type and financial method is necessary. Projects with long term, low performance, and low technology risks, such as hospitals, might be better funded via bonds.

#### Issuer size

The issuer debt size, and the size of the issuer itself, were other points considered when issuing bonds. A GLA Strategic Adviser explained the implications for any local authority to go with the single lane issuance; considering the costly obligations of hiring an advisor, intermediaries, and investment bank, in addition to marketing efforts; all of which are too costly for a small LA. Even when a larger issuance is taking place, bonds are still expensive and complicated enough to prevent single authority from going it alone.

Internationally, there is a wide spectrum of borrowing arrangements that offer different levels of monitoring and costs. Compared to US bonds, which is very expensive but enjoys a high level of monitoring, England is on the opposite end with cheap PWLB lending, but very little monitoring. Thus, the availability of an aggregator, such as UKMBA, can achieve a good balance which might be a not ideal, but favourable trade-off between cost and monitoring for LA borrowing. The move towards this type of model is growing throughout the world *(GLA strategic advisor)*.

Similarly, a representative from Core Cities Group stated that single lane bonds may be only an option for big local authorities and cities such as London and southeast cities. This is not the case for most of the Core Cities, as they might represent a less attractive option for investors on profit margins, payback, and return on investment. Therefore, they need to work collectively in the bond market, and UKMBA is best positioned to achieve that *(Core Cities Group)*. This may mean that some local authorities, even when UKMBA is active, would still choose a single lane issuance as they have appropriate in-house resources, while for other LAs a pooled issuance is the only way to make it happen *(Intermediary 1, Urban Economic Advisor, LA 2, MHCLG, Sweden LA, THFC, Kommuninvest, CIH 1)*.

An interviewee from a major Swedish LA explained that they are not part of Kommuninvest, and they issue bonds regularly on a single lane basis. Despite all costs associated with single lane issuance, such as human resources, banking costs, intermediary fees, and compliance costs, this LA still did better in terms of pricing by doing it independently, when taking Kommuninvest membership fees and charges into account. However, the case is different for smaller LAs where an aggregator is vital and cost efficient *(Sweden LA)*. Similarly, a THFC representative explained that for smaller HAs, THFC is the most efficient mean of issuing bonds. Nevertheless, large HAs capable of issuing bonds individually would find it quicker and more efficient to use the single lane route, unless they wanted to issue less than a benchmark size, in which case the THFC would prove useful.

#### Diversification

Bond use as a tool to diversify borrowing portfolio was one point suggested by different interviewees as to how bonds can work. A representative from one of the English LAs stated that when achieving the benchmark size and the right capital program, LAs, individually or collectively via UKMBA, would benefit from diversifying their portfolio and associated freedom from having a non-central government funding source; *“really a much neater solution than always going to central government” (LA, 2)*. This view was supported by a representative of one of the credit rating agencies, who explained that the existence of an aggregator such as UKMBA bears a positive evaluation from a credit rating agency point of view, as a way of achieving diversified funding for LAs:

*“UKMBA, we generally say that it is credit positive to have diversified funding steams so that might be capital markets, but it might be a specialised lender as well or the bank as well or increase in social investment” (CRA).*

Similar statement; *“I think they work very well, particularly for a housing association with a diversified loan portfolio, they’re absolutely brilliant” (HA3).*

A PFM representative also spoke of the positive role UKMBA can play in diversifying LA funding streams, along with enhancing their access to more investors by tapping the potential of swapped issuances in Dollars or Euro *(PFM)*. This comes in line with some industrial views. According to [Cross (2016)](#_ENREF_67), the hope is that UKMBA can represent an alternative source of debt to the PWLB, which helps councils to diversify their debt portfolio. Similarly, Richard Lloyd-Bithell a Treasury Management and Pensions Adviser at CIPFA, told Public Finance that councils should not overlook the importance of diversifying their borrowing sources, and MBs represent one of those sources. At the same time, he stressed that MBs will not replace PWLB, and might not be even an option for smaller LAs on a single lane issuance route ([Brady, 2020a](#_ENREF_48)).

## 5.4 Summary

This chapter provides a description of the main activities, measures and relationships within the local authority sector and the impact on the development of the bond market in England (Level 1, The Environment). This includes the formal provisions that restrict LA access to the bond market, and the development of such market. The bond market in England was strongly affected by central government interventions presented by austerity measures, the devolved tax powers as well as the existence of the PWLB. The unique existence of PWLB as a market maker, makes the development of a bond market much more complicated. Bonds use, therefore, will be always compared to PWLB financing in terms of easy access, costs, and existing products. This might well mean that development of a bond market, despite its role in diversifying borrowing sources and empowering LAs, should focus on filling the gaps in PWLB’s current products.

The next chapter is “The Actors”, which answers to the second level of the Healey (1992) framework. It explores the key actors and main stakeholder groups involved with the development of a municipal bond market in England.

# Chapter 6: The actors

Following the previous chapter “The Environment”, this chapter deals with the second level of Healey’s (1992) conceptual framework. This chapter covers analysis of the key actors and stakeholders involved in MBs and their roles both during and post issuance. This chapter will cover the identifications of those actors’ roles, and the power relations between these roles.

The main actors and stakeholders who had strong influence on the bonds market can be classified into two groups; issuers and investors.

The issuer group has two layers, internal and external. Internally, local authorities, the key players identified as Head of Regeneration, Planning, and senior officers in each LA; these positions are always motivated to find alternative source of projects funding *“These are the people that I have been involved with and these are the people who I have seen trying to find innovative ways of funding things”* *(Urban Economics Advisor)*.

Externally, the key players are developers, investors, sector banks, large local authorities, and large housing associations *(HA1, Core Cities Group)*. The central government, represented by the PWLB, is seen as one of the obvious market makers, along with the potential role UKMBA can play as an aggregator *(GLA Strategic Adviser, MHCLG, HA1, THFC)*.

In the investor group, pension funds were seen as the players with the most significant role in the bond market, as bonds fit with their long asset and liability arrangements *(Intermediary 1, Intermediary 2, Core Cities Group, Sweden LA, HA finance, HA 1, HA 2, HA 3, PFM, Kommuninvest, UKMBA)*. In addition, all interviewees discussed the key role of credit rating agencies as an external player in the MB market.

# 6.1. Issuers

There was a general consensus that banks and the central government have the biggest impact and play key roles in the bond market *(LA 2, Kommuninvest, intermediary 1, CRA, Intermediary 2, UKMBA, PFM, Sweden LA, Urban economic advisor, PWLB, HA1)*.

## Banks

A PWLB interviewee stated that: *“I can assure you that the money market is knocking on local authorities’ doors all the time trying to entice them to go into the bond market because the intermediary is going to get a big thing out of doing that and I know that that goes on a lot. But when they have done their evaluation, the Director of Finance has actually found it’s not worth pursuing (PWLB).*

This view that was partially supported by a Kommuninvest interviewee, stating that banks are *“pushing”* LAs to issue bonds. Instead of the previous approach where banks were lending LAs directly, they have gradually reduced their balance sheet exposure to municipalities and are now trying to stimulate funding arrangements by accessing capital markets using bonds. However, this role was perceived positively, as it allows LAs to overcome international barriers and be active in the market assisted by those banks *(Kommuninvest)*.

An intermediary discussed the role of banks by stating:

*“Bank involved; I think someone potentially underwriting it. So, a number of banks or financial institutions so they will say, so you’ll have someone like Nat West Markets for example, part of RBS who would help arrange the bond and help arrange for it to be placed in the market. But they may also say if necessary, if they cannot sell all the bond, they will buy it. So, the company gets guaranteed the money, but there will be a cost to them for a bank to guarantee that it is all bought up. I imagine there’s probably some brokers in there” (Intermediaries, 2).*

Similar perspectives were presented from issuers viewpoints. They key role of banks in the market is clear, as they handle all the administrative load, tailor the final terms, develop contacts, and provide access to investors. They play a decisive role as brokers, which allows better access to information about investors, costs, rates and even data about similar transactions. Hence, they offer another market view from how issuers see it *(HA1, HA3, Sweden LA)*. Despite their expensive charges which is normally two basis points, brokers allow single issuers to achieve savings compared to bank loans and even aggregator charges, such as Kommuninvest. Their role in practice was described below:

*“we’ve had our programme for so long, so if I want to issue a bond, I would probably see have any of the banks contacted me recently with an interest or otherwise. I just try to be fair so everyone gets a chance, and they contact us and say I have an interest for a six year bond, maybe 200m – 300m, where do you see the level then hopefully, usually, they give me a level that they are with the investors at the… they were perhaps 20 basis points. And then usually we just make a deal so the bank handles everything for us and if it’s a larger sum, say I want to do 500m or I want to do 700m, then maybe I’ll ask two banks to join together and work together to find investors to fill up the book.* *But it is not a complicated process. Once it is in place, and you have a good relationship with the banks you are dealing with, I find it quite easy. They are the broker, so we always deal with one of the banks as a broker when we do our issuance. We never have direct contact with the investors” (Sweden LA)*

Similarly, the role of UK major banks is well recognised as being the biggest lenders to HAs. Therefore, for bonds to work, the relationship between issuers and banks has to be two-way, long term and meaningful “*If your bank supports you, you feed them and that’s how the game works…. It is not about stitching one another up or pulling the wool over a bank’s eyes or vice versa. You want long-term relationships. So, those banks have key roles to play” (HA1).*

## Central government

The relationship between central and local government has a big impact on the bonds market, mainly affecting credit rating and investors’ behaviour *(CRA, MHCLG, LA 2, Intermediary 1, Sweden LA)*. Unlike the US, where money-line guarantors play vital role in the bond market, in England the relationship between the central government and LAs, represented by PWLB, means that most of the borrowing is in the hands of central government. This led to shrinkage in the role played by money-line guarantors and banks in financing English LAs *(Intermediaries, 1)*.

In addition to the local governments and central government, there is a role for the Local Government Association (LGA). The latter role becomes more important when considering the lack of required benchmark size that answers to existing investors groups demand *(CRA)*. This point was reinforced by a Strategic Director of one of LA, explaining the importance of LGA specifically for small local authorities who lack the required debt size for single lane issuance. Those small LAs would look at the LGA as the main promoter of UKMBA to aid in the issuance of MBs *(LA, 2)*.

The role of the central government and its relations with the local authorities also has an impact on issuer credit rating score. This impact was outlined by a CRA representative who argued that *“It is not that you are filling the score card and then you get the rating. It is the jumping off point. But this is the guidance for how we think about it. And so, when we think about really the institutional framework is how we think about that relationship between the local and central government”.* This is highlighted in the CRA methodology whereby this relationship, current legislation, and the financial flexibility enjoyed by LA very much determines the overall credit rating for LAs

*“In the UK there is no guarantee for support but at the moment we are assuming high support. So, we think if a local authority is in a financial distress and there was an issue on the debt. We think because of the reputational risk there will be a relatively reasonable sense that they would step-in and we look at that across different entities. So, housing associations, universities, TFL we would all be making this assessment and it might be different by sector” (CRA).*

This view was echoed by other interviewees who stated that such support will be available providing that the current framework remains as it is, and that UK credit rating is not downgraded. Despite that there are no guarantees for such support, many think of the reputational risk in practice, the presumption in the market is that UK Government will step in in extreme situations *(MHCLG, GLAH, Intermediary 1)*.

That being said, this is not unique to the UK or English LAs, as a representative from a Swedish LA explained that the very same assumption exists in the Swedish market and plays a significant role when credit rating being scored. But what is different is that Swedish LAs enjoy a full taxing power that already plays a great role in their credit rating. In addition to that, there is an *“equalising state system”,* whereby wealthy municipalities pay the less wealthy municipalities a sum of money every year to offset some of their debt or expenditure *(Sweden LA)*. Similarly, in England an example of such assistance is found in the example of Hinkley Point Power Station in Somerset. When the power station shut down for a number of weeks and stopped paying business rates to the Council, there was a significant impact on the LAs finance. However, due to an existing structure in place, the central government compensates LAs for any drop in business rates *(UKMBA 1).*

# 6.2 On the investors side

A Director of Commercial Banking stated that if the investment terms fit with investors strategy and plan, then it is a matter of risk and return preference from an investor point of view. Other key factors are the income levels, length of income and flexibility associated with each investment. When it comes to bonds, two intermediaries explained that investors, when looking for high risk return investment, municipal bonds are not going to be very appealing. However, they would be suitable for an investor who demands a low risk return investment.This assessment extends to cover the differences in the evaluations, or risk return equation, associated with each type of investment. Therefore, while corporate bond investors are foreseeing possibilities of success or failure of one company and its market, MB investors are taking a view on the economy of the entire area and the country *(Intermediaries, 1).*

## 6.2.1 Evaluating investors interest in bonds.

CRA, and investors such as pension funds, are seen as key players, with pension funds representing the majority of investors in the bond market *(HA1, HA2, PFM, UKMBA)*. As long as the debt “*fits in in terms of what their [investors] strategy is”,* then the fundamental decision driver is the “*risk versus reward”* equation *(Intermediaries, 2)*. However, investors might show *“a relative flexibility”* in relation to the investment terms due to their very original nature being long term holders of the debt. They are essentially engaged in a continuous process of matching assets and liabilities. If it turns out that the assets are longer than expected, then they can adjust accordingly *(Intermediary, 1)*.

In Sweden, in most cases, LAs would have very little direct contact with the investor base. All work is done by banks and brokers who engage in matching supply and demand in the bond market *(Sweden LA)*. A more pragmatic view was provided by a CRA representative, who explained that most large investors will be investing in a whole range of things. They are looking not only for government bonds, but instead are looking to see how, through a portfolio, they can obtain 30 years long dated debt that has a certain kind of credit profile *(CRA)*. Therefore, corporate bonds and government bonds are usually dealt with separately by investors, whereby the decision is not a matter of choosing whether to invest in either corporate bonds or municipal/government bonds *(Intermediary 1, CRA)*.

*“I don’t think there is a question if should I buy the bond X issued by this company or bond Y issued by this municipality. I think the market is actually operating relatively separately. So, there will be people looking at corporate sector and people looking at the market for municipal. Just like this sovereign issuance as well is pretty much that kind of market. So, I am not sure there is a direct compression between corporate and municipal bonds. Well, they may be ultimately the same people, but I suspect the way that they will think about it internally is very different. So, there might be bonds department or corporate department” (Intermediaries, 1)*

In England, things are different as the sub-sovereign debt market is marginal for investors compared to other types of investments, such as housing and corporate bonds *(CRA)*.

Although municipal bonds are not very popular in England, it is expected that there will be a market appetite for them as an investment for certain investors. This is mainly because MBs will be seen as low risk investments, associated with the assumption that they will be backed by the central government *“We don’t see much MBs as an investment. I suppose people do like the government backed credit ultimately. I think it is largely it about risk appetite and whether or not a valuer particularly connected issuer” (Intermediaries, 1)*

Therefore, MBs are capable of widening the investor base by attracting investors from various sectors *(Intermediary 2, Sweden LA, UKMBA 1, Kommuninvest 1)*. Bonds are appealing to different investors for different reasons. Municipal bonds are seen as safe, tradable, and long term low income generating products. Thus, the general perception of bonds is that they are stable and offer investors a low risk low return equation *(Intermediary 1, Intermediary 2)*.

Although MBs don’t exist in England in a volume considered popular amongst investors, and despite speculations that investors might be interested in such type of debt, the difficulty lies in the assumption that MBs are unable to offer additional features, as offered by gilts *(Intermediaries, 1)*. This point was supported by a representative from MHCLG, who was skeptical of the actual demand of MB, as opposed to central government bonds. *“Why would you borrow if you are commercial investor? Would you buy a local authority debt unless it was a premium over a sovereign debt because sovereign debt obviously is going to be less risky?” (MHCLG)*.

Nevertheless, housing sector bonds are met with a high demand from investors. Such demand has allowed HAs to issue debt that matches exactly their gradual increase in income streams, with investors being happy to take lower returns as long as it is a safe investment, and also knowing that the income will increase in the future *(HA5, HA3)*. This match between issuer and investor requirements means that the chances of unsuccessful bond issuances are remote, as evidenced by the fact that all HA bonds issues are oversubscribed *(HA3)*.

On a recent bond issuance by Aberdeen City Council, an intermediary commented that it was oversubscribed. The intermediary argued that an oversubscribed program cannot be deemed to be good enough to conclude that the demand is high for MBs. Instead, it might mean that the pricing was just right to make sure there were enough subscriptions, but not so much to conclude that Aberdeen City Council could have had better pricing *(Intermediaries, 1).*

Furthermore, latest pension reforms suggest a compulsory minimum held in gilts might adversely affect pension funds appetite for MBs, as taking on more sub-sovereign debt, or near sub-sovereign fixed income, will not diversify their portfolio. If they have the full freedom to pick and choose, then they might have a more diverse portfolios with fewer gilts. This is why the UKMBA is trying to market itself as a *“gilt pick-up trader”* so pension funds can use its bonds. As the investor base is quite small in the UK, having *“five or six big players”*, they will ask for more returns, knowing that all issues are similar in their maturity and security *(HA1, HA2, PFM)*. What does not help is that all authorities are pleading for money, and warning that they will be *“next after Northamptonshire”,* which makes harder to convince investors that this is all *“hogwash” (PFM)*. Thus, issuers have the responsibility to communicate more with both national and international investors to educate them on who they are, how they operate, and how regulated the sector is, aiming to diversify their investor base to beyond the UK’s local investors *(HA1)*. Please see Evaluating Investors Demand page 55.

## 6.2.3 What Stimulates Investor Demand

An intermediary highlighted the importance of giving investors *“further clarity or legal instrument”* that clarifies to them the guarantor of municipal bonds. Therefore, investors would require LAs to be *“absolutely clear”* about who the payment covenantor is. If it is a central government supported payment covenant, then something statutorily clear is needed to reassure investors *(Intermediaries, 1)*. Similarly, a HA representative stated that obtaining bonds guaranteed by the government would attract more investors, resulting in lower borrowing costs *(HA 4).*

On the other hand, a Strategic Advisor to GLA totally opposed any suggestion that municipal bonds need to be central government guaranteed. The main reason is that government guaranteed bonds would be just the same as PWLB, but less efficient. The previous experience of government guaranteed bonds issued by Eurotunnel and others, resulted in them being more expensive, as they had higher yield than the equivalent government bonds even without all the paperwork. This showed a *“bizarre”* practice and revealed that the yields on the central government bonds are lower than those of a central government guaranteed bond of another issuer. That is the reason why PWLB products are so efficient, as it gets funded at the gilts’ rate.

Speculations on the lack of MB investors could potentially be affected by volatility of the financial market, and what market makers can do to increase demand municipal bond *(Intermediary 2, CRA)*. The market is *“quite fickle”*, with no good explanation for ups and downs in demand. It could be argued that there is a lot happening in the background, and that market makers are buying up certain investments, such as shares or bonds, resulting in creating demand for one type of investment or another. So, *“it’s possible to create demand artificially in the market” (Intermediaries, 2).* In addition, there is the potential role of an aggregator, like UKMBA, who may allow access to a much wider investor pool in different currencies by offering swaps *(PFM)*.

Nevertheless, whatever happens, the main drive for demand seems to be the credit rating in place *(PFM, Sweden LA)*. The GFC impact is still felt, with very high investor demand for AAA and AA+ rated bonds. This, to a certain level, guaranteed more certainty in having demand for bonds issued by those municipalities that enjoy high rating, even in the event of downturns in the Swedish, EU, or global economy *(Sweden LA)*. Likewise, in England, and in addition to the credit rating for marketability purposes, for UKMBA members, credit rating is a must, not only to investors but also as a matter of *“public interest”*. The reason is that no local authority wishes to break from the Agency, and the benefits of being indirectly subject to market scrutiny. Thus, UKMBA would then remove a lot of what would effectively be *“the mono-line risk of a single credit and sector exposure”* by at least making the sector stand behind it *(PFM)*.

The ultimate purpose of pooled finance is to be able to create a kind of *“ownership structure or governance structure”* that enables an aggregator to issue bonds on behalf of its owners. This in turn improves investor confidence due to the high level of credit worthiness achieved by the aggregator *(Kommuninvest 1)*. This view was supported by a UKMBA representative, stating that UKMBA is capable of boosting investor confidence in MBs and public bodies, as it shows the sector working together to deliver benefits for its community and rising above political differences *(UKMBA).*

In Sweden, experienced stakeholders and active market allowed issuers to tailor their issuance to certain investor demand. Despite having a well developed market that provides high certainty, Swedish LAs found their MB *“sweet spots”* at around a 5 year term, or even an 18 months maturity, that would make it much easier to find an investor. Issuing the same bonds over 8 years for example was found to be much harder due to lack of investors’ interest. Despite having some authorities that issued 30 years bonds (City of Gothenburg Council), generally most Swedish LAs work on a 10 year plan. This provides both issuers and investors with more stability should there be any economic or political upheaval, especially post-GFC. Therefore, it allowed authorities, along with large investors such as pension funds, to access smaller investors interested in buying in small figures (eg £20m). Although credit rating is still very important for big investors, the bond theme might prove to be more important to other types of investors. An example is the *“green-trend”* in bonds whereby issuers are enjoying a high demand from various investors *(Sweden LA).* This comes in line with the argument made by [Maziad et al. (2013)](#_ENREF_200) who suggested that issuing bonds in a limited key maturities would help to attract more investors and lower borrowing costs for issuers relative to a preferred risk level.

Currently in the English bond market, credit rating is still the most important aspect when investors are making decisions. The credit rating importance comes from the fact that most investors have no idea on how to look at a local authority. This would be always a key barrier that holds investors back from taking on municipal bonds. Apart from some bigger well-known County and City Councils, such as Westminster, for a foreign investor, some less well known areas would have less beneficial terms due to their lack of popularity. *“I can easily imagine South Kesteven getting a few basis points less just because no-one knows who it is” (PFM)*. Similarly, in the housing sector, investors geographical awareness plays its role in the bond demand pricing. As most investors are well aware of London and its property market, it would witness more demand and achieve better pricing compared to less well known places such as Rotherham or Scunthorpe *(HA2, THFC).*

# 6.3 UK Municipal Bonds Agency function

There was a general consensus that many countries are moving toward the aggregator model similar to Kommuninvest and UKMBA. This model seems to be preferable as it gives the combination of *“relatively cheap”* funding (*GLA strategic advisor*) along with better market discipline *(MHCLG, Intermediary 1, Intermediary 2, LA 2)*. This does not give the best of either, but a little bit of *“both wells”* which is a clear advantage to what PWLB currently offers *(GLA strategic advisor)*.

A common perspective about UKMBA is that it would most certainly achieve savings associated with the economies of scale. The key role of the Agency is to clarify and *“make it more certain what happens if there is a default by the local authority”*. This might ultimately achieve better funding stability once the sector, including investors, is more familiar with UKMBA’s concept *(PFM)*.

A representative from Kommuninvest explained that efficiency is a very important aspect of their job, however, stability is valued even more by both Kommuninvest and its shareholders. During and after the GFC, many large authorities in Sweden, who used the single lane issuance, had their borrowing arrangements cancelled, and therefore suffered an increased risk of exposure. A much lighter risk was felt by Kommuninvest members, as they did not suffer a severe funding interruption, and continued to secure their borrowing requirements. Furthermore, Kommuninvest provides its members with support services, such as access to its networks including proprietary debt management and liquidity management systems *(Kommuninvest 1).*

UKMBA presents itself as a public body established to provide an alternative funding vehicle for UK local authorities. Currently, it has 56 LA shareholders, and the LGA. It aims to provide the public sector with access to market-based borrowing rates significantly below the existing PWLB rates. In addition to this, there are additional benefits to be enjoyed by its shareholders and members. The main benefits are,

1. Achieve protection from PWLB changes,
2. Increase financial transparency,
3. Avoid excessive borrowing and its associated risks, and
4. Provide products tailored to suit LA needs

The following addresses those benefits, discusses the UKMBA’s delayed start, and its way forward.

## 6.3.1 Transparency Towards LAs

Bond markets are stimulated by banks who, post GFC, are under pressure to reduce their long term exposure, and they would benefit from facilitating LAs access to the capital markets *(Kommuninvest)*. A PWLB representative explained that banks, due to their interest, might feel that the existence of the UKMBA would be advantageous to the market, and therefore they will offer some incentives and free services. Hence, there was an agreement among respondents that UKMBA should be honest is in its diagnoses of LA bond feasibility, and how and when bonds work, rather than encouraging LAs to use bonds only *(Core Cities Group, Urban Economic Advisor, Intermediary 2)*.

A THFC representative explained that they have three treasurers out of 20 staff, and they constantly work with issuers to *“take the jargon”* and simplify the process, aiming to deliver low costs. THFC has built a good reputation of reducing risks and increasing certainty, while its main role is to deliver the best outcomes, though not trying to profit from the sector as a not-for-profit entity *(THFC)*.

Further transparency is needed from UKMBA in explaining to the LAs the impact of credit rating on their public image and political support, as most would like to understand the credit rating before they get rated. Consequences could be a negative press coverage as a result of a low credit rating score *(Urban Economics Advisor)*. This reputational risk is even more significant when viewed through the lens of PWLB as LAs have to justify the political risk of obtaining a credit rating, which is expensive and difficult; almost every time, the expense and risk outweighs the benefits of having a credit rating *(UKMBA)*. Similarly, THFC, by having the expertise, technology, and the understanding of how rating works, carry out all the credit work that is needed. Practically, THFC borrowers do not have to publicly disclose their rating unless they wanted to go with a single lane issuance *(THFC)*. Therefore, UKMBA has a role in presenting LAs in a positive light, so they look investable, and support them to obtain political confidence within the authority to back an issue of bonds *(Core Cities Group)*.

[Marrs (2014)](#_ENREF_164) discussed the role of UKMBA further by arguing that it can play an important role in increasing transparency and providing more information about the sector. This can be achieved by UKMBA becoming a knowledge transfer hub and a centre of excellence. As it sits between the financial markets and LAs, UKMBA can assess LA needs, learn from other aggregators, increase LA standards and collate data as to where LAs are obtaining their capital investment.

## 6.3.2 Diversification

The practical difficulty for LAs in trying to diversify their debt portfolio using bonds, lies in their long allegiance with, and reliance on, the PWLB as an easy and cheap funding source. This has significantly affected LA human resources capacity and confidence. The existence of PWLB resulted in most of LAs having very good project management skills. Nevertheless, they lack the required skills to run debt independently and communicate efficiently with the financial markets *(MHCLG)*.

Aggregators such as UKMBA can significantly contribute to the efforts of reducing borrowing risks by achieving a better diversified portfolio and increasing the competition in the market *(UKMBA, PFM, Kommuninvest 1, Sweden LA)*. As LAs in England are limited in their borrowing sources to almost only the PWLB, UKMBA will allow better diversification to their portfolio, and would automatically result in a political achievement (*UKMBA, MHCLG)* by *“allowing the public sector standing on it is own feet” (PFM)* and would *“Wind-up”* central government and show them that LAs can do things by themselves *(LA 2)*. Furthermore, aggregators such as UKMBA or Kommuninvest are owned and controlled by LAs and thus would always work in their favour to allow even further diversifications, by accessing international investors and tapping into the global capital market. This should allow diversification, while driving borrowing costs down and achieving further efficiencies *(UKMBA, PFM, Kommuninvest).*

Seeking to diversify their debt portfolio, the LA choice between UKMBA and single lane issuance might not necessarily be driven by costs only. A generally agreed point is that LAs who enjoy a good level of in-house skills, confidence, and the desire not to join other authorities, might drive them to single lane issuance anyway. A senior member of the Core Cities Group explained that the question is about the added value the UKMBA is bringing in for those LAs who want to diversify their portfolio, but cannot go with the single lane route. Therefore, as the UKMBA’s core purpose is to place bonds efficiently, its key role is with those LAs who do not have that capacity and confidence to do it themselves *(Core Cities Group)*. Similar evidence is found in the housing sector, as large HAs who have the debt size and the in-house expertise would always issue individually as it is faster and, most importantly, cheaper than an using an aggregator. But those who lack the size and skills are the most in need of THFC services *(HA1, THFC)*.

Nevertheless, most English LAs lack the required level of diversification, and it is unclear why large authorities who have large infrastructure projects and the capacity have never issued bonds before *(PFM)*. The justification is found in one of the Swedish LA representatives who explained why MB issuance is hard even for larger LAs. For MB issuance to work, it needs a very close and positive relationship with the banks who are dealing with the bonds, as they offer sufficient and up to date information about the market that makes it *“quite easy” (Sweden LA)*. Therefore, that fact that large English LAs have not considered bonds as an option may show the lack of capital market connections, experience, and information.

## 6.3.3 Products that suit Local Authority needs.

The UKMBA, like its sisters in Scandinavia, such as Kommuninvest, has a major role in providing pooled financial products that overcome the gaps between English LAs. These gaps have created differences in their funding needs, geographic scale, and credit rating making bonds more suitable compared to other lenders *(UKMBA, PFM, Kommuninvest, GLA Strategic Advisor, MHCLG, Urban Economic Advisor, Intermediary 1, Core Cities Group, LA 2, Intermediary 2)*.

LAs in England are not all in the same size, and thus have different ambitions. The borrowing options between single lane issuance and UKMBA, or even the consideration of bonds, will be very much driven by those differences. *(Urban economic advisor, PFM, Intermediary 1, Core Cities Group, LA 2, Intermediary 2).* England has over 350 councils that are spread over a wide spectrum of investment needs and ambitions. While rural authorities may not be very keen on investing in something even as simple as a new road, at the other end of the spectrum there are Metropolitan Boroughs and counties that are keen to invest in improving their areas for a variety of reasons *(UKMBA)*. Therefore, UKMBA would constantly need to work towards putting forward pooled issuance programs and terms that fit all individual local authorities, as in tailored funding programs. This will prove difficult due to the different debt size and timing issues:

*“Well, it is complicated because the agency will not want to just issue some bits and pieces that are tailored to individual authorities. So, they will have become more sort of not exactly just get what they want but they have to come together and say look I want 9 years bond and I want 11 years bonds will do 10-year bond and will package it up and maybe have to do some swaps. So, fundamentally it won’t be as easy as getting tailored funding” (GLA Strategic Adviser).*

While a single lane option offers issuers more control on when and how they issue their debt, working with aggregator would mean working within a timetable and no fixed date. Such specific timetable is not always guaranteed due to many variables *(HA3)*. Practically, however, THFC often lend to HAs on a completely matched term to its borrowers’ needs *(THFC)*.

This position was supported by an interviewee from MHCLG who stated that the timing difference between LA borrowing needs might represent a significant challenge. This may create “*difficult discipline”* for some local authorities, as they are historically used to the flexibility of PWLB funding being available as and when required. So, with pooled issuance, LAs have to learn how to work with other local authorities to coordinate the collective debt requirements and timing *“local authorities they have to think differently not only when I need cash but once as well my neighbour want cash or whatever. So, it is sort of work with other local authorities to think about the debt service and cost at the same time which is different way of thinking I don’t think they are used to it” (MHCLG).*

An intermediary explained a further limitation of the potential benefits from pooled issuance being that the market does not look at different nations, regions, and LAs in the UK in the same way. This would normally result in different appetite and risk assessment from the banking and investment sectors. *“Scotland is still seen in the market as very separate. We have a separate, certainly from a banking perspective, we have a different appetite, depending on a different market and asset and sector, whether it be Scotland, whether it be the North of England, London, Wales, all over. So, it varies” (Intermediaries, 2).* Therefore, pool issuance for local authorities in different countries across the UK might affect the risk assessment, and would not be an efficient method as it would result in some LAs paying higher coupons *“If you then try and mix it, then the risk will look very different because Scotland might be seen as higher risk, London low risk. If you mix it “London” with Scotland, that is increasing the risk on a blended rate” (Intermediaries, 2).* Such reason might be behind Aberdeen City Council’s single lane issuance without seeking UKMBA’s assistance. This allowed them a more efficient issuance by not joining other LAs with higher risk profiles, which would make it more expensive for Aberdeen City Council. The same applies should Aberdeen City Council join other LAs with lower risk, it would make it less efficient for the latter. Similar practices were found in the housing sector, whereby mixed risks affect the overall efficiency *(Intermediary 2, THFC, CIH2)*.

## 6.3.4 Joint and Several Guarantee Scheme

Many interviewees agreed that the pooled issuance method set by the UKMBA is associated with the problematic aspect of the joint and several guarantee scheme (JAS) that UKMBA is applying *(GLA strategic advisor, MHCLG, PFM, Urban economic advisor, Intermediary 1, Intermediary 2)*. The first challenge this scheme poses is the *“level of monitoring”,* as the approach may result in unwanted outcomes, such decreased market monitoring, as it may become an automatic process over time. This would reverse the UKMBA potential of offering a more balanced cost monitoring trade off, compared to the PWLB. *(GLA Strategic Adviser)*.

Another challenge is related to structural problems that normally result from combined efforts of different entities. Despite the fact that no legislative encounters are taking place specific to local authorities, there are, however, the normal challenges of whenever different legal entities come together to undertake a joint venture. The evidence thus far is that JAS represented a challenge for some LAs to explain and justify to their members, and therefore obtain approval. The general financial framework for local authorities is based on personal responsibility of key officers in each local authority. Each of these officers need to be personally satisfied they are fulfilling their duty; with the joint and several guarantee, that can be quite difficult thing for them to assure themselves of *(PFM, MHCLG)*.

Based on that, the JAS was seen as one of the main reasons behind the delays in the UKMBA lending as LA’s are divided into two camps *“those that are quite relaxed about it and those that really won’t go anywhere near it” (PFM)*. Even within the UKMBA, there is already a mismatch amongst the shareholders whereby some are risky LAs *“Woking is a shareholder. Northamptonshire is a shareholder. Reading was a shareholder which quietly had financial problems so Reading might be alright now, but I have not looked at it recently. Surrey is a shareholder. Lancashire is a shareholder. So, you can see there, there’s a group in there that have credit issues anyway” (PFM).*

Even in Sweden, where almost 95% of their LAs are members of the Kommuninvest, some LAs are still questioning the joint responsibility implications, which have resulted in some LAs issuing on a single lane basis. A Swedish LA representative advised that upon their discussion with a CRA representative about the JAS scheme in the Kommuninvest program, it was suggested that without this scheme the Kommuninvest rating would be lower, at AA instead of the current AAA rating. Considering that some large LAs already have AAA rating, there is a very little incentive for them to join the Agency. Therefore, the purpose and existence of this scheme, is put under scrutiny, as removing the burden of JAS would only result in achieving two notches below what currently is being achieved *(Sweden LA)*.

A PFM interviewee questioned the post-solvency actions (should it happen) even when this scheme is in place. If one default happens at a certain LA, and the others are requested to close their debt by (for example) £250m, then those guarantors would most likely issue their own Section 114 notice saying, *“Tough luck mate, see you in court”.* Therefore, the existence of the JAS guarantee scheme is not actually fit for the purpose it was created for.

## 6.3.5 Monitoring and Avoiding Borrowing Risks

A Strategic Advisor for GLA noted that UKMBA, as a body, is “*in funny position”* where the Treasury is not *“super keen”* on it. Although they are not against UKMBA, they do not have an interest in it. Therefore, UKMBA exists, but there is nothing for the Agency to rely on to help. Similarly, a PWLB representative stated that UKMBA does not enjoy Treasury support, as it does not suit central government plans.

An intermediary stated that the kind of support that would increase investor confidence, is to have UKMBA bonds backed by central government *(Intermediaries, 1)*. However, this view was not supported by a GLA Strategy Advisor who indicated that the worst support UKMBA could have is a government backed issuance which will put it in the same pot with PWLB *“this would undo what the UKMBA is trying to achieve”*. PWLB is incredibly efficient, and there is no reason to create similar, but less efficient, model using UKMBA government backed issuance. UKMBA should always aim to achieve what PWLB does not, which is better monitoring. The moment UKMBA starts being backed by central government then monitoring will almost disappear.

An intermediary went further to say that UKMBA should not be carrying the full responsibility on behalf of local authorities. This scenario would be that UKMBA is borrowing from the market, bearing the credit rating, guarantee the bonds, and doing everything on behalf of local authorities, and ending up being very similar to PWLB. Therefore, if there is an actual desire to make local authorities accountable for their own finance, then a change in the culture of LAs is needed to enable them to come to the market, bringing with them UKMBA, so they are able to issue effectively and efficiently *(Intermediaries, 2).*

## 6.3.6 Benchmark Size and Beating PWLB Rates

Based on both national and international bond applications, UKMBA has a good chance of becoming an efficient alternative to PWLB. Although many consider a single lane route to be excessively expensive, almost all those previous issues by English authorities have either equalled or beaten the PWLB rate *(UKMBA, PFM, LA 2)*. Similarly, an interviewee from Aberdeen City Council stated that they went with the bond program aiming for a cheaper funding compared to PWLB, which was achieved.

Considering that UKMBA and the market are at a very early stage, there was a general agreement across interviewees on two key points:

1. Currently, a single lane issuance option is limited to those authorities who enjoy being wealthy, having the needed in house capacities, ambitious leadership, and have the debt size that makes bonds efficient. For smaller LAs, a single lane option is too expensive. By pooling their debt, UKMBA can provide them with efficient borrowing, especially for those lacking the debt size *(UKMBA, PFM, Kommuninvest 1, CRA, Sweden LA, GLA strategic advisor, LA 2, Urban economic advisor, MHCLG, Core Cities Group, CIH 1 Intermediary 1, Intermediary 2)*. This would potentially be even cheaper for UKMBA shareholders as they would obtain a slightly better rate from UKMBA compared to a non-shareholder rate *(PFM).*
2. Small LAs, who would not necessarily enjoy a high credit rating, will be able to access to a much higher credit rating provided by the aggregator *(UKMBA, PFM, Sweden LA, Kommuninvest).* Similarly, an intermediary noted that even with considerable impact of PWLB on the credit rating, UKMBA still managed to achieve AA3 rating. This, theoretically, will guarantee a cheaper option than a single lane route, as most of local authorities will always be a notch below AA3 basis. Effectively, UKMBA have managed to enhance the rating at least by one notch, and by tapping a wider pool of liquidity. This also features in the cost, as it allows potentially an access to a wider range of investors for AA3 debt that might not be the same for a lower rated debt *(Intermediaries, 1)*. Almost the same view was shared by a Kommuninvest representative, stressing that in addition to the costs efficiency they offer, Kommuninvest provides its members with indirect access to the capital market by issuing bonds on their behalf, which again factored in the overall efficiency *(Kommuninvest 1).*

On achieving the benchmark size, a representative from UKMBA stated the following:

*“Some of the principal local authorities in England alone there are, I think, 353. That’s County Council, there is about 30-odd County Councils, 32 London Boroughs in the corporation of London and the counties, about 100 metropolitans in the borough and districts. So, just in England alone there are an awful lot of local authorities, so I guess the first barrier for the majority of local authorities to do a bond on their own is, they simply don’t have the volume of demand, the cash necessary in order to do a bond transaction. So, to do a benchmark cross transaction you need about ₤250 million of borrow requirement, and very few individual local authorities would meet that requirement. If you go back through the last several years, the Greater London Authority has done bond transactions. There have been a couple, they have done two. Transport for London, which effectively counts as the local authority in this context clearly had quite a sizeable bond programme for a number of years but outside of that you’ve had one-off transactions from individual Councils, for whatever reason” UKMBA.*

This view was strongly supported by a MHCLG representative, who explained that a main barrier facing LAs is the fact that their debt financing is not large enough for any of them individually to be attractive to the market. Similarly, a local authority Strategic Director gave an insight into their LA currently having a borrowing need of £50m - £60m, which is similar to many other LAannual needs. These borrowing needs are better situated under a larger umbrella, to achieve the attractive benchmark size of £250m to obtain a beneficial market price, of which a larger organisation such as UKMBA may be able to achieve.

By achieving a benchmark size, it is anticipated that UKMBA would, *“at a number of points in time”*, be able to fund below the PWLB rate. This is one of the major benefits hoped to be reaped from the whole bonds scheme *(UKMBA)*. This argument was supported by Kommuninvest practices. Their market share is constantly increasing, driven by their cost efficiency, and guaranteed maximum benefits for their members and customers. This is reflected in Kommuninvest having an overlapping 900 customers and 288 members, in addition to many other entities owned by those members, such as HAs, who arguably are their largest customers *(Kommuninvest)*. Likewise, in the housing sector in England, an aggregator is crucial for small HAs. Those HAs who lack the benchmark size and in house expertise were found to struggle to attract investor attention, without using aggregator services *(HA2, THFC)*.

Furthermore, an aggregator can bring further savings by exempting borrowers from the need to build in house expertise, and the human capacity needed to engage with the financial markets. Many LAs in England have not issued bonds before, mostly as they lack such expertise. Even for those who did a one or two bond programs, it is hard to imagine them to continue issuing bonds after such a lapse in time, as compared to their private peers who maintain a regular access to the capital market *(UKMBA, Kommuninvest 1, Core Cities Group)*. This view was shared by a Swedish LA representative who explained that their constant existence in the capital market allows them to keep connected to the market makers, brokers, and banks. This, in turn, enabled them to hunt the best possible deals in the market via the single lane route *(Sweden LA)*. Therefore, even for large LAs who issue irregularly, an aggregator, once active in the market, can offer its members constant market information and achieve savings by freeing up resources *(PFM, Kommuninvest 1).*

However, the benefits provided by aggregators are not cost-free. There is the considerable membership cost when any public body joins the Agency. One of the Swedish LAs explained the skepticism regarding the large fee and the capital contributions required for Kommuninvest membership, with the risk of demand in the future for further capital contributions. Thus, for them, the decision so far is to carry on with the single lane route that proved to be more efficient *(Sweden LA)*.

The expectations for England are different. After couple of issuances, and when they have managed to bring the price point down, it is anticipated that UKMBA would be cheaper even for large authorities *“when it (*[*UKMBA*](#_ENREF_295)*) expands the cap for the spread for a single line in credit, or a single issuer operating on their own beneath the PWLB because you would expect, all things being equal, the agency should always be the cheapest because it’s got the cross-guarantee and quite often you would expect one of the guarantors to also be big enough to do their own.” (PFM)*

However, the relationship between central government/Treasury and the UKMBA might still have negative impact on UKMBA functions even when they are successful in bringing their lending costs down to similar, or even cheaper, rates as PWLB. UKMBA is a body that does not enjoy Treasury support, or does not fit in easily with central government plans. So, in a scenario where UKMBA exceeds PWLB in efficiency, the central government might bring PWLB borrowing costs down to make bonds inefficient again. This might turn into a *“recurring challenge”* for UKMBA *(PWLB)*. This view was backed by a THFC representative who stated that, in 2011, the Treasury increased PWLB costs, aiming to push LAs to borrow from the financial markets as their borrowing was easily accessed with little discipline. Therefore, the aggregator was put in place by certain LAs, lobbying in response to the rise in the PWLB rates. Later on, when the UKMBA was very close to its first issuance, the PWLB went back to lower rates making bonds less attractive *(THFC)*.

Thus, the UKMBA provides an offering that sits between the single lane option and the direct government lending. Therefore, the UKMBA performance will always depend on the relationship between the Treasury and local authorities. If Treasury does not feel responsible to the local authorities, then it is likely that the Agency will be the most efficient. But if the Treasury is flexible, then it is very hard to see how borrowing and financing via bonds would work *(GLA Strategic Adviser)*. This potential impact of the PWLB existence was noted by one of the credit rating agencies, saying that the rating of UKMBA will always note the historical existence of PWLB as a *“strong incumbent in the market”.*

A Strategic Director of one of the local authorities argued that the best way for proving efficiency, is by issuing bonds to clear the confusion currently faced by LAs on which borrowing costs they will be bearing. *“There will be no better time than now”* for UKMBA to start; any delay will be damaging reputationally. Currently, local authorities are uncertain about different rates they are able to obtain, such as infrastructure rate, PWLB rate and other options in the market. Ascertaining which rate a Local Authority can achieve, and which streams go alongside that, is becoming increasingly *“convoluted”*. As a result, local authorities might end up going back to GLA complaining that the body they have set up is not fit for purpose *(LA 2).* Similarly, a Strategic Advisor for GLA noted that LAs are under pressure to justify the cost of their borrowing options to their taxpayers. For UKMBA to be a viable funding option for local authorities, and in the presence of PWLB, they need to prove in practice that they can secure cheaper funding as compared to what LA’s are currently obtaining.

### 6.3.7 UKMBA Delayed Start

A Strategic Director in one of the local authorities in England noted that UKMBA is perceived very positively both in his LA and the sector. One indicator of that is that some LAs, despite not having a current need to borrow, still helped with funding the establishment of the UKMBA. The only downside is that the Agency is yet to start. *“I think the frustration is that we have been told about this for last 4 years and nothing seems to happen”.* As UKMBA obtained its Moody’s rating, more positivity towards them is expected.When UKMBA is up and running, more LAs will be encouraged to join and use it as a viable alternative to PWLB *(MHCLG, LA 2)*. Thus, UKMBA has to prove its case by going out with the first issuance, rather than only selling the concept theoretically *(UKMBA).*

The talks about a UKMBA launch have been ongoing for a number of years, and the fact that they have not issued any debt demonstrates how difficult it has been for them to be in a position where they are ready to go to the market. This slow start might be an indication of either the lack of demand for issuance in a sufficient enough size to makes it affordable, or that the legal challenges associated with placing debt on the market are firm, or a combination of the two. Hence, when it comes to borrowing, LAs would find it easier to pick up the phone and speak to PWLB *(MHCLG, GLAH, CIH1).*

An interviewee from the Charted Institute of Housing shared the view by stating that *“I think getting an aggregator up and running is quite hard, because usually there’s sort of a first mover advantage. The PWLB is a really well-known brand. It has been present or a very long time. Lots of people just think, why would I not just carry on using the PWLB, especially because it also gets really good pricing? So, can anybody out compete that” (CIH2).*

In addition to that, the UKMBA being centrally led by LGA comes with its own problems, associated with bringing a mix of a different political parties together. This can, to a certain level, justify the slow movement of UKMBA compared to Kommuninvest in Sweden, where the latter represents a coalition of LAs who are motivated to band together and progress issuance *“I think if you had only 10 authorities who all said alright, we need to go to the market we are going to stick £20m pound in, in some way that is a bit easier than having it coordinated by the LGA” (LA, 2).* Despite the fact that LAs are not competing with each other, there is the reluctance of LAs and municipalities in England to work together.

The frustration of UKMBA moving slowly runs the risk of LAs proceeding with the other available options; PWLB or even single lane issuance, without having the debt size which might result in higher costs *(PFM, LA 2)*. With the sector treating PWLB as a targeted cost, and even with the potential of making it a number of basis points cheaper than PWLB, the bonds concept is at risk of being outrun by the simplicity of PWLB. *“Well, apart from the fact the issue costs, a loan would exceed that. It is a lot more work. So, 40 hours and a phone call versus a few hundred thousand, a prospectus, endless meetings, and a credit rating. If you are a local authority, you need rather more than a few basis points”* *(PFM).*

Nonetheless, what is perceived to be a sluggish UKMBA kick-off might be normal, as compared to other cases such as Kommuninvest. A PFM representative explained that it took Matts Anderson (who set up Kommuninvest) years to sell the concept to most LAs who lacked the scale *(PFM)*. This view that was confirmed by a Kommuninvest representative, who explained that this route was not very easy the in 1980s, but it worked as the decision was taken by a number of LAs to *“join forces”* and issue bonds collectively, despite a lot of skepticism about the idea from both the banking sector, who feared competition, and LAs who doubted the concept. There was a legal requirement stipulating that LAs had the right to provide explicit guarantee to each other. This resulted in more LAs and regions joining Kommuninvest, which has expanded to 288 members *(Kommuninvest)*. Similar evidence is found in the housing sector. When THFC recently tried to issue bonds under its new structure, it took eighteen months before its first issuance *(HA3)*.

In 2017, UKMBA’s first issuance was almost complete, but was delayed by one LA who needed to pass the framework agreement. By the time that happened, the market conditions had changed, and the investors had long gone. With the prevailing suitable market conditions, the potential role the UKMBA can play to simplify bonds and convince more LAs to join is not possible until its first issuance is complete, so it can show a success *(PFM)*. A THFC representative described aggregating HAs bonds as herding cats *“because cats are independent spirits, so what happens you get five cats through the cat flap, they come in for their supper, the first one’s out before you can do anything”* and LAs are even more difficult to aggregate. Therefore, THFC will aim for more than what is needed for a benchmark size, to make sure that even if half of HAs leave the pool, THFC can still go out and issue *(THFC)*.

## 6.3.8 UKMBA Moving Forward

There was a substantial agreement between respondents that the UKMBA needs to be proactive in identifying the places and authorities that bonds would be suitable for. Thus, UKMBA should take the initiative, and speak to LAs who might lack the capacities, skills, confidence, and certainty when it comes to issuing bonds. This is to avoid the banding together of all strong authorities, to the detriment of weaker ones *(Urban economic advisor, Core cities Group, MHCLG, LA 2, GLA strategic advisor)*.

On that point, an interviewee from Core Cities Group said, *“I don’t know what they are doing”*.He noted that no contact occurred between the Core Cities Group and the Agency, yet with reference to previous experiences, it suggests a lack of communication between governmental bodies in the UK. A former HA Treasurer stated that the Agency is not selling the concept well to the LAs *“Well, what are they doing? Why are they doing it? I do not understand. I do not have enough knowledge of what they do…. I’m sure they’re busy doing what they can but I’m not sure that everybody has understood what they can do” (HA5)*. Similarly, HAs are not always keen on using aggregators, or even to issue bonds at all. Therefore, THFC, with its thirty years’ experience and existence in the market, representatives continuously reach out to HAs in an attempt to simplify bonds and persuade that bonds issuance is a viable option *(THFC)*.

Based on that, a suggestion was put forward for UKMBA to use a *“sort of score card mechanism”* to allow them to identify and understand places where bonds could work and have not been considered yet due to the lack of understanding or risk tolerance “*They should not be waiting”*. Aberdeen City Council’s experience shows that there are some local authorities who are very capable, not lacking in risk knowledge, who have the need and mechanisms to enable them to come forward and issue bonds. But the ones that are not in similar position can be assessed and helped by UKMBA to come forward with a viable project *(Urban Economic Advisor)*. The UKMBA’s next step is to define the bonds barriers and suggest how to overcome them for those weaker LAs. Therefore, there is a clear need for UKMBA to speak directly with financial senior officers and development teams in local authorities to simplify and explain how bonds could work for each LA *(Core cities group)*.

# 6.3 Summary

This chapter covers the second level of the applied framework concerned with the analysis of the roles and relationships of the key actors involved in the development of the bond market in England. This chapter, in line with the framework of Healey (1992), covered the different agencies, actors and players that are most important in determining the progress and outcomes of developing the bond market in England. It also identified the most significant outcomes of such market development.

The analysis of the roles and relationships of the key actors showed that, in England, the central government, represented by the PWLB, and investors are the most powerful in controlling the development of the bond market. Secondly, banks and CRAs play pivotal role in the success of any bond program. Nevertheless, the UKMBA role is at the heart of the development of the bond market in England, and has greater impact on smaller LAs. UKMBA plays different roles in the development of the bond market in England such as simplifying bonds to LAs, diversifying their portfolio, providing financial products that suits LAs, enhancing LAs scrutiny levels and providing them with an efficient source of funding. The key to the success in delivering such benefits is by a more proactive UKMBA who is constantly speaking to potential LAs.

Both chapter 5 and 6 described how the institutional structure and the players and their roles and relationships impact on the development of the bond market in England. Nonetheless, it does not explain the reasons behind the players actions such as the bonds advantages and disadvantages for stakeholders, the barriers that affect LAs inclination towards bonds. The next chapter addresses those aspects by exploring the key characteristics of MB market, its barriers, and the methods to overcome such barriers.

# Chapter 7: The Barriers

The previous chapter identified the key actors, and their roles, in the bond market. This chapter, “The Barriers”, is next in line with the conceptual framework developed by Healey (1992) and utilized for this thesis. This chapter is an in-depth assessment of actors’ strategies and interests relating to the most significant sets of relationships whereby it identifies the key barriers and difficulties faced during the process of developing a bonds market. This will lead to an analysis of the formal and informal rules, ideas, and norms of municipal bond issuance to identify how it shapes and affects different actors’ roles, how they play such roles, and how their relationships have developed. This would give a clear idea of how those barriers and roles shape actor and stakeholder strategies and interests and suggest methods to overcome those barriers. This chapter will start with an in-depth analysis of the key advantages and disadvantages of municipal bonds.

# 7.1 Municipal Bonds Advantages.

Although MBs are relatively new to the UK and English local authorities, there are much more developed MB markets, such as the housing sector in England and the municipal bonds in Sweden. Therefore, the advantages discussed in this chapter inform on how bonds would work for LAs in England by drawing evidence from practices and outcomes related to more developed bond markets.

The main advantages discussed include direct impact elements such as flexibility, risk reduction, and more efficiency. Other advantages are based on a long term analysis, and associated with growing a well-developed market include achieving better discipline and building a stronger internal structure in the LA sector.

## 7.1.1. Better Discipline and Risk Management

There was a wide agreement on bonds positive impact on LA discipline and internal governance *(UKMBA, PFM, Core Cities Group, MHCLG, Intermediary 1, LA Strategic Economic Advisor, LA 2, Kommuninvest, Sweden LA)*. When seeking to issue bonds, LAs would benefit from enhancing their internal governance, as they must take decisions in accordance with their standing orders and legal liabilities similar to corporate entities in the market. In the longer run LAs, by having a financial partner such as UKMBA and having the ability to meet their debt in a more structured and preferential way, will be prompted to constantly seek more efficient financing structures and ultimately expand their knowledge *(UKMBA).*

A representative from MHCLG explained that when it comes to bonds, all LAs have to go through the standard market discipline. Currently, almost all single upper tier and principal local authority has opted up to professional status methods anyway; those who did not are smaller districts who do not have a big enough portfolio to make it worthwhile. Once UKMBA is active, more LAs will be attracted to the idea, and that will motivate them to meet the professional status methods *(MHCLG).* Ultimately, whether going with the UKMBA or a single-lane option, LA credit ratings will be checked. This is one of the key advantages of bonds as it will increase or enhance the accountability of those local authorities *(Intermediary, 1).* Furthermore, there is a public interest around market scrutiny resulting from central government’s (represented by PWLB) lack of monitoring LAs. With bonds, the market is always going to watch in some way, shape, or form the credit worthiness of its borrowers, whether it is CRA, a bank, or credit monitoring department *(PFM, GLA strategic advisor, HA5)*.

Another advantage is the empowerment of local authorities who would have more autonomy away from central government and a greater level of control. This, in turn, would allow easier communication between LAs and their public as they both develop a better understanding locally on where the funding is coming from *(LA 2)*.

Better risk management is seen as an advantage associated with bonds, as they offer less risk and more certainty when it comes to interest rate fluctuations. With the possibility of issuing bonds with a floating interest rate, it allows LAs to overcome bank lending at a reviewable fixed rate. Furthermore, bonds offer less risk due to the ease of cancelation of the current rate and moving to a better one. Long term bank loans, on the other hand, are subject to rearrangements every few of years *(PFM, Sweden LA)*, and even though a 1% or 0.5% cost is due every time bonds are being rearranged, bonds are still superior to banks by allowing a better risk management due to associated flexibilities *(Intermediary 2, Kommuninvest 1, PFM, Sweden LA).*

UKMBA will allow LAs better risk management as they would have the ability of placing risk, to some extent, outside their organisation *(Core Cities Group)*. Further risk reductions are brought forward by the strong risk control framework applied by the UKMBA *“It’s overriding principle, aside from keeping the worst credit out, is really just to fully match all the way through. So, whatever it takes, it passes on in terms of risk whether it is default risk, interest rate risk, it cannot take derivatives on its own account, for example. So, its policies are very, very conservative internally”* *(PFM).* Please see ([Blakeley, 2017](#_ENREF_31)) & ([Aidan et al., 2014](#_ENREF_9)) and the wider discussion about risk management in pages 43-44.

## 7.1.2 Flexibility and its Cost Efficiencies

Adding bonds as a borrowing option to existing sources would give LAs further flexibility, as well as allowing them to diversify their portfolio. Potentially, this will result in a favorable broadening for the types of structure that LAs could finance (*Sweden LA, Kommuninvest 1, UKMBA, PFM, Core Cities Group, MHCLG, LA 1, CRA)*.

Over time, an aggregator like UKMBA should be able to widen the range of products offered to LAs, providing further flexibility that would outrun the limitations of PWLB and most bank lending products (*PFM, UKMBA*). Even without the UKMBA, unlike banks and PWLB, bonds allow borrowing for less than a year, or longer than four years, both of which are necessary for LAs short and long-term finance *(PFM, UKMBA, Sweden LA, HA2, HA1)*.

Further flexibility is found in bonds finance with the possibility of swapping interest rates when bonds are on a floating interest rate instead of fixed rates, such as is found in PWLB and bank lending *(PFM, Sweden LA).*

Bonds offer borrowers two key flexibilities, being repayment adjustment and early repayment. The first feature allows the borrower to match their repayment with their project income streams by delaying the start of repayment, allowing them to deliver long-term projects *(UKMBA, PFM, HA3, GLAH, HA5, CIH2, THFC)*. Such long-term projects often require adjustments down the line, and bonds allow borrowers to adjust their debt at any point of time in the future *(UKMBA, PFM)*. The second feature is associated with early repayment costs. Compared to other available lenders. such as banks and PWLB, the early repayment charges of bonds are considerably lower *(PFM)*.

In the housing sector, bonds are designed and tailored to cover the duration of an asset, and so it offers the flexibility needed to match assets with liabilities for the longer-term funding needed by the sector *(HA1, HA3, THFC, HA5)*. Nevertheless, the fact that bonds are designed to last and not to be repaid, might indicate some inflexibilities in its nature. Thus, when the need to repay arises it can be quite expensive *(HA3)*.

Another flexibility was indicated by an interviewee at a Swedish LA, whereby a LA can borrow on a single lane, not only for itself but for its internal companies such as housing associations, energy companies, waste companies etc. As the LA is AAA rated, it is much easier and cheaper for it to issue bonds and lend the money back to those companies, as they are much smaller and will not be in position of having AAA rating. However, when lending money to its smaller companies, to comply with the EU regulations, the LA charges them the interest rate they would have been charged had they had gone directly to the market and borrowed individually. This allows the local authority to have total risk control for all its companies. Moreover, by doing so, those companies, instead of paying the margin to external banks or another lender, pay them to the LA. Therefore, economics of scale and savings occur here instead of the requirements for each company to have its own rating, borrowing arrangements, and separate management programs *(Sweden LA).* A similar practice was undertaken by Warrington City Council, who borrowed using bonds and lent the money back to one of its HAs. Nevertheless, a THFC interviewee was skeptical about such practices in England *“So, to me, logically, there’s no need for, we’re a bond aggregator for a start, there are other bond aggregators that service housing associations, they can do it themselves, they can borrow from banks, there’s very little value added”* *(THFC)*.

## 7.1.3 The possibility of Bonds not being on National Debt Sheet.

A possible advantage is seen in the early discussions as to whether bonds can be taken off of the national debt records. However, different perspectives were introduced from different interviewees concerning such a possibility. According to a senior member of the Core Cities Group, the possibility is remote, but if it were to occur then it would give a very strong advantage to MBs as compared to other sources of funding.

An interviewee who works as a Housing Association Finance Expert advised that LGA, when they were setting up the UKMBA, could established the business so as its debt to not show on the national debt sheets, but they did not. This would have made bonds a much more attractive option compared to PWLB, lending that is recorded as part of the central government debt *(CIH 1)*. From a central government perspective, the HAs USP is that, unlike LAs, HAs can borrow off the national government balance sheet *(THFC, CIH2)*. HA debt was reclassified twice in the last five years. While at first it was put onto the government balance sheet, shortly afterwards it was reclassified again to be off of government balance sheet. The main reason behind the latest change was not the added debt, as by itself it was not significant, but its direct impact on the UK cost of servicing debt which increased by almost 10% *(THFC).*

However, two representatives from UKMBA and PFM strongly opposed the off-balance sheet possibility, and explained that this was never an option considering the prevailed EU accounting rules and regulations. Under these rules, the national debt comprises of any borrowing by central government and/or by anybody that is part of the state. Therefore, any debt raised by LAs is counted as part of the national debt, regardless of whether the lender is EIB, PWLB, banks, bonds, or any other source *(UKMBA, PFM)*. According to IMF rules, the only way to get the debt off of the government’s balance sheet is *“to transfer the risk of the loan”,* which is why the Private Finance Initiative debt appears on the LAs’ balance sheets but not on the central government’s *(PFM)*.

A CIH representative stated that LA borrowing being off national debt is prevented by UK regulations, and not the EU “*it’s called the Post Net Cash Requirement. But the PSBR is what everybody calls it, which we adopted in 1966. It takes a different view about what counts as public and what counts as private than the definition used by the rest of Europe basically”* *(CIH2)*. In Europe, General Governmental Deficit or GGD, differentiates between debt for non-trading activities, which is recorded part of the central government debt, and the debt for trading activities that is not. That is why many French electricity generating companies and Italian railway companies are buying large parts of the UK national infrastructure. Housing debt is classified as trading activity in Europe, and therefore it does not score on the national debt; but in the UK it does *“the only distinction that matters is, is it public or is it private? And the definition of public covers all public bodies and extends as far as anything that has got a third control or more of the entity, and in the case of housing associations, housing associations were reclassified as public bodies temporarily by the office of national statistics, on the grounds that when they looked at the regulatory framework, they didn’t think that housing associations had a suitable degree of managerial independence” (CIH2).*

[Perry (2018)](#_ENREF_225) explained that the solution lies in adapting to international accounting conventions that could potentially take some LA investments out of the central government debt. [Perry (2013)](#_ENREF_224) stated that some public corporations such as tram companies, airports, and bus companies, are not classified as part of the local government. Therefore, some changes of the rules in the UK, in line with the EU, could potentially take those corporations debt off of the central government national debt. In addition to the administrative complications, Perry noted that the problem might persist due to the existence of the PWLB. Some of those corporations might find the PWLB cheaper than other alternatives and thus their borrowing can be put back on the national balance sheet since all PWLB loans are part of the government debt ([Perry, 2013](#_ENREF_224)). Nevertheless, a PFM representative disagreed with this possibility, as the current prudential code rules state that if the LA is paying for future taxation revenue, then the risk still lies with the local government. Therefore, any LA borrowing secured by future tax revenue is not going to be off the balance sheet*. “So, securitisation of work that any flow-through guarantee structure or anything secured on revenue, stays on the balance sheet, so TIF, (tax increment financing), for example in this country, would still be on the government’s balance sheet”.* Based on the current IMF rules, mainly paragraph (A364) where it was quoted that *“no asset securitisation involves securitisation of future revenue streams … no true sale has taken place and no transfer of risk’ if you’ve got any residual interest”*. Therefore, even in the case of pooled issuance where any pooled excessive funds were returned back to the local authority, this would still be considered as a residual interest and therefore it cannot be taken off the balance sheet *(PFM).*

Despite the agreement that MBs, as they stand, would count as part of the UK national debt, changes in housing sector debt classifications might mean that a change is possible in the future. Should a change occur, PWLB may limit LAs strategic choices as compared to MBs. This is mainly because, even if the rules were changed to put LAs debt off the national debt, the measurement is not only applied to the recipient entity, but also the issuing entity, the PWLB. Therefore, it might be justified for LAs to bear extra cost to launch bonds if they believe that in the future parts of their debt will be reclassified *(CIH2).*

# 7.2 Municipal Bonds Disadvantages:

Different stakeholders confirmed that the main disadvantages associated with bonds is that they are seen as complicated, time consuming, costly, and untested, and as well, there is the need for many parties and stakeholders to be involved in coordinating the issuance *(GLA Strategic Advisor, Core Cities Group, Urban Economic Advisor, Intermediary 2, MHCLG)*.

## 7.2.1 Complicated and Costly

The main disadvantage of bonds applications in England, is that they are not well known or well tested by LAs, which means they require very specific skills to make them successful *(Core Cities Group, GLAH, HA1)*. A UKMBA representative explained, however, that the Agency is being set up to simplify the process. Therefore, the process of borrowing via the UKMBA is a *“very simple 5 steps”*.

1. It starts with signing the joint and several guarantee and its framework for any member.
2. This is followed by UKMBA performing the necessary credit checks. The credit check is not to grade LAs or conduct rigorous and time-consuming credit rating checks, but to discount the weaker LAs.
3. Once the funding is available, the council signs an irrevocable commitment to borrow from UKMBA within certain parameters. Once those parameters are met, the funding will be provided by UKMBA.
4. The council then formally accedes to the joint and several guarantee *(UKMBA)*. The argument is that this process might seem complex compared to the PWLB process, but only initially.
5. Afterwards it is a simple decision whether a borrower wants to participate in the debt or not *(UKMBA, PFM, HA3).*

Nevertheless, for now at least, the main disadvantage of UKMBA bonds is the much more complex process, as compared to PWLB. Therefore, why UKMBA is taking time to take off the ground with the need for councils to do extra efforts compared to PWLB. This is why there will be a considerable amount of time before UKBMA is a successful agency that has a substantial bond program and provides a high level of flexibility, like its sisters such as Kommuninvest *(UKMBA)*.

One of the disadvantages of bonds is the reoccurring high upfront costs of an advisor to do the preparational process, investment bank, brokers, broachers, and marketing efforts. Even in the US when large issuances are taking place, the cost of a single lane issuance is still high. Despite the possibility to drive the costs down in the next issuances by using a median MTN program (Medium-Term Note Program), it is still a very expensive and complicated process *(GLA Strategic Advisor)*. On the other hand, post-issuance, there is a considerable amount of efforts and costs to keep an accurate debt management record. This results in a considerable added cost for the issuer to be confident that they can manage the debt after the issuance *(Intermediary 1, Core Cities Group)*. A view that was supported by an Aberdeen City Council interviewee is that although at the time of bond issuance, it was relatively cheaper than other options, such as PWLB, there is an element of considerable continuous costs for maintaining and managing the debt paperwork thereafter *(LA1)*. UKMBA, however, is capable reducing both complexity and costs of scattered single lane issuances. LAs, after their first credit rating and preparational work with UKMBA, should be able to save the time and costs in subsequent issuances as they build a long-term relationship with UKMBA *(HA2, GLAH, UKMBA).*

The view from the housing sector differed drastically from the above, whereby different interviewees considered bonds as a simple and straightforward financial product *“So, a bond, it’s a simple instrument” (HA4).* Another interviewee said:

*“Bond, it is just such a simple financial instrument, you, you haven’t got to take out any sort of kind of standalone derivatives. You don’t have to sort of edge against sort of rate movements and, and that kind of thing, a lot of housing associations I spoke to certainly felt that bond finance was complex, but I think that’s fair enough, because everyone has a bank account. And, and, and they’re familiar with sort of bank parliaments If you like, then but, but, you know, I, I would always say that, in terms of the bond, it, it’s so, so simple, you know, you go into market” (HA3)*.

Bond rates are very similar to how individuals fix their mortgage rates with commercial banks; they can be on a fixed or variable rate over a certain period of time. Instead of one property, the bond is secured over many properties. Such simplifications are used by THFC when convincing its borrowers about bonds *(HA2)*. This is why it is believed that there is value in having an aggregator who is capable of simplifying bonds to LAs *(GLAH)*.

## 7.2.2 Technical Problems

An Urban Economic Advisor mentioned that some *“technical constraints”* might be attached to MBs, preventing some local authorities from having bonds as an option. The public-private-partnership experience, which is mostly about *“risk reallocation from public to private sector”,* shows, in some cases, a misunderstanding or a misallocation of the risks. Such misunderstanding might happen again in a bond market scenario as well. When it comes to bonds, LAs might not be ready in-full for the immediate control or the change such as in their creditworthiness. This might be a significant block preventing LAs from accessing bonds. To some extent, this can ‘level up’ to cover the risks associated with the joint and several guarantee scheme, which caused some LAs to be reluctant to join the UKMBA *(UKMBA)*.

The ultimate technical problem from a Kommuninvest perspective is the continuous improvement of the competitive landscape for municipal borrowing *“so if we are so successful that we get 100% of the funding base, you could theoretically invest in these sorts of situations whereby competition becomes more limited, which could be negative for their, the local governments, but we are not there yet” (Kommuninvest)*. For English LAs, however, since UKMBA is yet to start its program, then this problem seems to be part of a future consideration rather than requiring immediate action. Even over time, if the PWLB continues to exist, the matter of competitiveness and continuous improvement from the UKMBA are at the core of its functions and therefore may not be an issue.

## 7.2.3 PWLB

There was a wide consensus that bonds are disadvantaged by the existence of the PWLB *(MHCLG, LA 2, Intermediary 1, GLA Strategic Advisor, PWLB, Intermediary 2)*. PWLB, being a quick facilitated option, offers more certainty about debt costs and price attached to the bonds. Bonds, being associated with a long and complicated process, would limit LA certainty, as it is hard to ascertain the actual interest rate until the last minute *(PWLB, HA2).*

By using a PWLB product, LAs can obtain their funding when they want it, due to the simplicity of the process. With bonds, it takes time to place the debt, subject to market conditions, and does not always guarantee that LAs can get the money when needed *(PWLB).* This view was supported by various stakeholder interviews. One view was directly linked to the name of PWLB, suggesting that its role is to provide LAs with an *“easy and quick resource of finance”* guarantees an access to debt financing necessary to constructing assets and funding service delivery *“in an efficient and value for many way”*. PWLB has the advantage of bringing local authorities borrowing down to the central government cost of borrowing *(MHCLG).*

PWLB is seen as an easy and cheap option that is always available with a simplified access, means that bonds can be perceived as a much more complicated option *(Core Cities Group, GLA Strategic Advisor, Intermediary 1, UKMBA, PFM).* Even for LAs who are keen on bonds, the amount of preparatory work to get a single lane bond off the ground makes it much less favourable that PWLB funding, which underlines the vital role of UKMBA in simplifying bonds *(LA, 2).*

Debt timing is much more convenient when LAs use the PWLB, as they can get the money as and when they need it and on short notice, leading to LAs having *“no appetite for anything more onerous”*. In addition to the bonds issuance timeframe, and even with the existence of UKMBA, there is the fact that any LA has to wait for other LAs to join a pooled issuance, which is not what they are used to *(PFM)*. This increases the uncertainty LAs face in terms of when, and at what price, they will receive their borrowing *(UKMB1, PFM, PWLB)*. PWLB rates are daily based accessible by all LAs, which allows them to borrow when they perceive the rate is most favourable. The Agency role is to mitigate this uncertainty by looking for a *“window”* and say to LAs that *“within this window and subject to an overall interest rate price comparison to the PWLB you have got to borrow”*. The agency would be trying to almost *“replicate”* that daily rate offered by PWLB *(PFM).*

## 7.2.4 Market Dependent

Another disadvantage for bonds is their very nature, as they are directly linked to market conditions more than the issuer profile. The risk increases when the market is mainly controlled by a small number of investors *(UKMBA, PWLB, Sweden LA, Kommuninvest,)*. The impact is even wider in the UK where a small number of large investors represent the bulk of the demand in the market (*HA1, HA3*). This is not something LAs can always handle, especially not knowing for certain whether they will be successful in issuing their bond at all, when the market will be closed, and how to deal with that *(UKMBA)*.

Even corporate bonds are dependent on the timing dictated by the market, and not by when the issuer requires their funds. This is a disadvantage of bonds as compared other sources of funds such as banks *(PWLB)*.

An interviewee from one of the Swedish LAs reflected on market activities as part of her LA single lane issuance; the financial market is *“impressionable or risky”* and *“Kind of moody”*. One example is the November to December timeframe in 2018 where the market witnessed a *“really strong downturn”* where the market basically *“crashed”*. This required intervention from the Swedish Risk Bank who raised industry and the government rates. On the other hand, during autumn, large international investors came to the Swedish market and bought all the Swedish short-term papers *“when they went the market died” (Sweden LA)*.

Similar practice was reported in the housing bonds market, as it *“can shut down at any moment but it can also open up at any moment in time”* *(HA1)*. At the same time, a THFC representative warned that the answer should not be the overreliance on international investors who might not be as knowledgeable as domestic investors of the sector strengths. An example of such risks is found in the 1980s where, along with the first signs of housing recession, Japanese investors altogether started asking for their money back *(THFC)*.

Although the Swedish bond market is well developed, issuers bear the risk in being forced to follow investors’ rules sometimes. However, specifically in those *“moody market conditions”*, an aggregator such as Kommuninvest or UKMBA can be very useful because it *“would always lend us money”* *(Sweden LA)*. A similar view was shared by an interviewee from Kommuninvest who stated that despite agreeing with most of the disadvantages of bonds, most if not all of them were mitigated by proactive lobbying activities to justify and explain the economic benefits of having institutions like Kommuninvest *(Kommuninvest)*. The Swedish and Norwegian experiences show that even with a single lane route a common practice was developed as a way of providing market information to issuers using intermediary channels. On the official side, there are weekly emails from most banks providing market activities and statistics about other issuers, the amount of each issue and its price. This enables issuers to access pre-issuance information regarding which investors are currently buying bonds. When it comes to international market activities, specifically the USD and Euro, the market is not very transparent. Therefore, LAs connect with dealers around the globe to get clearer picture on where bonds with certain credit fit within current market activities *(Sweden LA)*.

# 7.3 Barriers to Municipal Bonds Market

In this section the main barriers that faces LAs in England when accessing bonds will be assessed and discussed in depth, in an attempt to understand the impact of each barrier on the development of a bond market in England. Along with that, this section will assess other MB applications and discuss the methods by which LAs can overcome said barriers. This section will cover the main barriers as suggested by the literature review, being

1. Transparency
2. Certainty
3. Credit rating
4. Costs and,
5. Liquidity associated with the municipal bond market development and activities

## 7.3.1 The impact of transparency on bond issuance in England

Different views were presented by interviewees in relation to English LAs existing levels of transparency; both transparency towards investors, and transparency towards the UKMBA and fellow LAs.

### 7.3.1.1 Existing levels of transparency

There was a general consensus amongst interviewees that in England, the Local Authority sector enjoys a good level of transparency and provides adequate level of information that are mostly publicly available *(Core Cities Group, MHCLG, PWLB, LA2, Intermediary 1)*.

An interviewee from MHCLG argued that one of the key things MHCLG have been concerned about for a number of years is the need for LAs to be more transparent, particularly with their capital finance. LAs were encouraged by MHCLG to continuously explain their actions both on the borrowing and investment sides. Due to some non-compliance, recent statutory codes such as the Prudential Code, the Project Management Code, the Minimum Revenue Provision Guidance, and the Investment Guidance were enforced by the CIPFA and MHCLG to enhance overall transparency. Those steps led to enhanced transparency standards by forcing LAs to be more open about their risks and opportunities and making them provide clearer justifications on why certain decisions are made *(MHCLG)*. This view was confirmed by a member of the Core Cities Group who stated that, considering the nature of bonds being the same as any other type of debt, all LAs would go through the same procedure of prudential borrowing. Therefore, it will be an automatically transparent process making it very hard to imagine something which is less than transparent in the current system.

A representative from one of the LAs welcomed the impact of those measures in enhancing transparency that ultimately led to them to be ready to carry out their credit rating assessment *(LA 2)*. A senior member of one of the CRAs explained how important transparency is for the credit rating purpose. When it comes to credit assessment, transparency represents a big part of the “*governance and management”* process for the CRAs carrying the assessment. Transparency assessment is carried out on two levels, the overall existing transparency of a local authority, and the transparency offered when the credit assessment is being carried out. Therefore, clear information is needed to explain how decisions are made in the local authority. The credit rating process requires the LA to supply a list of information in advance, such as a five year budget, a financial plan, committee memos, debt reports etc. This is followed by a meeting with the Chief Executive, leader of the Council and Finance Treasury to explain the numbers, governance and political structure, why the money is being borrowed, as well as information about the borrower treasury, liquidity, cash flow, efficiency levels and overall financial health. Only then the CRA can start conducting their own research and analysis to assess the overall condition of the LA. Therefore, the credit rating process is built around the availability of information and the assessment of said information *(CRA)*.

This view was confirmed by Aberdeen City Council’s bonds presentation document. It was explained that obtaining a credit rating required a considerable amount, and various types of documents, the complexities of which should not be underestimated. While some information was needed to demonstrate the council’s political and financial governance, other information, such as detailed information outlining the institutional framework in which Scottish local authorities operate was required, as this was the first time a Scottish LA is being rated. Further information was requested about the Council’s local governance framework, political make-up, committee structure, executive structure, decision making process and its key functions and responsibilities, and a wealth of economic information about the city and the wider city region, outlining both its economic performance and potential ([Room151, 2017](#_ENREF_243)).

A UKMBA representative explained that all required information, and more, was already available publicly; debt levels, spending, annual internal audit reports, annual financial statements, and treasury strategies along with LAs major financial plans are all in the public sphere. It might be an issue for some to know where to obtain such information, but when it comes to UKMBA’s credit assessment, it is only a matter of LAs validating the information published. If it comes to confidential plans that are not publicly available, then it is a matter of asking the LA for the required documents *(UKMBA).*

Even compared to other public bodies like NHS it is argued that there is too much transparency when it comes to LAs. LAs publish excessive information, as they provide all their finance and budgeting information and internal meetings discussions. Corporates, on the other hand, provide half-yearly and end of year announcements only, which might make them easier to access and assess compared to LAs, especially for those who don’t know where to find them *(UKMBA, PFM, HA2)*. Thus, the UKMBA is not there to increase the level of information available, as it is more than sufficient, but possibly to facilitate the information being more accessible *“I’m not convinced the agency can enhance it so much as just make it easier” (PFM)*. Similarly, public entity transparency was described as *“natural”* in Kommuninvest and Swedish LAs who are active in the capital market *(Kommuninvest)*.

### 7.3.1.3 Required Transparency

#### Towards Investors

Transparency towards investors was presented by different stakeholders as a key aspect in the whole MB process *(CRA, Intermediary2, intermediary1, urban economic advisor, HA1, HA2, HA3, GLA strategic advisor)*. Despite the suggestions that pre-investment, investors are not going to require copious amounts of information, it is unlikely that investors will engage in something that they don’t fully understand, due to vague or lack of information available about the issuer *(Intermediary 2, Urban economics advisor)*. In the housing sector, more investors are demanding more transparency from HAs *(HA1, HA3)*, which has resulted in more HAs publishing half-yearly results post-issuance to keep their investors informed *(HA3).*

*“We think it’s right that our investors, who are stakeholders in our opinion, should be able to see how we’re performing and that’s about it. I think that the benefits most certainly outweigh the cons” (HA1)*

Transparency towards investors was described as crucial to build long-term relationships and trust, whereby investors are well informed about the sector strengths and issuer plans, strategy, risk, and monitoring practices. This would result in investors being more transparent towards issuers during the initial price talks, and so, issuers can utilize true and meaningful feedback from investors to guide their issuance *(HA1).*

By going through the credit rating process, municipal bonds, like any other corporate bond, all LA accounts will be checked and will be made available online. Ongoing information, however, is as important as doing due diligence upfront, as investors would like to see continuity and LA sources of income. *(Intermediary 2, Urban economics advisor)*. An interviewee from the Aberdeen City Council explained that transparency is already implemented in the UK, with the Freedom of Information Act (2000) in place. The Council have a very good level of information that is available publicly. Nevertheless, this transparency represented a crucial part of the successful bond issuance undertaken in 2016. Post-issuance transparency required time and resources from the Council to continuously provide information regarding the council and the stock market performance, which was described as *“not a major issue so far” (LA1)*.

#### Within the Group

When it comes to pooled issuance via UKMBA, the Joint and Several Guarantee Scheme requires another level of transparency, which is each LA sharing enough information with the other LAs who are part of the pool. This allows a *‘transparency monitoring’* that should be undertaken by other members of the Agency and not only by the Agency itself *(LA2, GLA Strategic Advisor, Intermediary 1).* The high level of transparency required in the group works as the first line of monitoring between LAs sharing the risk in the pooled issuance *“if you are a risky authority and I am a safe one and I have given you a joint and several guarantee it is my duty to keep an eye on you” (GLA Strategic Advisor).* This can be seen as more important than transparency towards the investors. When at least one strong LA is part of a pooled issuance, along with multiple weak authorities, investors are assured that their money is safe with the joint and several guarantee in place *(GLA Strategic Adviser).* Please see ([Aidan et al., 2014](#_ENREF_9)) & ([Brady, 2018d](#_ENREF_38)) page 62.

### 7.3.1.3 Methods to Enhance the Transparency

An interviewee from MHCLG explained that the statutory codes in place guarantee that enough disclosure and appropriately high transparency levels are provided by all LAs. Although these codes are not bond-oriented in their purpose, they generally encourage all LAs to show the best levels of transparency *(MHCLG)*. However, an intermediary suggested that there is value in having a *“code of practice to achieve a sort of consistency”* specifically for MBs. This would enhance the clarity whereby both LAs and investors do not have to think about separate issues as there will be a standard practice that will be followed in terms of disclosure *(Intermediaries, 1)*. Thus, listing bonds by the issuer LA is important, as the disclosure requirements, like any corporate bonds, would offer more information on the issuer and “*will give people better availability of information” (Intermediaries, 1)*.

On that point, a UKMBA representative explained that despite in theory, disclosure requirements are similar between LA bonds and corporate bonds, LAs are particularly less burdened due to the *“Prospectus Exemption Regulation”*; they have reduced disclosure requirements compared to corporates. Borrowing from the UKMBA is even more advantageous as they offer essentially *'one shot documentation'*. Thereafter, LAs can borrow from the Agency, subject only to annual or pre issue credit check and re-signing of relevant documentation. With *‘one shot documentation’* in place, and considering that LAs currently have few in-house bond lawyers, the Agency can reduce costs and effort associated with disclosure required for the bonds market *(UKMBA)*.

The housing sector provides further insights into the difference between a single lane bond and an aggregator bond. The single lane requires a road show and a team to communicate the data to investors that can be a very detailed and costly exercise. While an aggregator such as THFC would do all of that and effectively, any borrower in the pool is *“taking a loan”* without the need for extra public disclosure. As a result, better information management by THFC, along with the existing regulator rules for quarterly and annual information, release enhanced the overall quality of information provided *(HA3, HA2).*

## 7.3.2 The Impact of Certainty on Bonds Issuance in England

This section will address various aspects of uncertainty, seen as a barrier to municipal bonds issuance. This will be followed by identifying the key requirements to enhance issuer certainty. According to interviewee responses, there are three categories of uncertainty, being;

1. Price and demand certainty,
2. Central-local relationship, and
3. UKMBA role

It will then be discussed which methods and practices LAs can incorporate to enhance their certainty levels in the bond market.

### 7.3.2.1 Price and Demand Certainty

There was a widely shared view amongst different stakeholders that, certainty, or the lack of, has a great impact on local authorities’ decision when considering the bond option. The impact is amplified in England due to LAs long reliance on the PWLB and its available certainty *(Core Cities Group, Intermediary 1, Urban Economic Advisor, PFM, PWLB, CIH 1, GLA Strategic Advisor, LA 2, MHCLG).*

The evidence from the housing sector in England shows a correlation between demand and price certainties. Demand certainty is directly linked to the price offered. Therefore, as long as the price fits with investor demand, then the demand would undoubtedly be sufficient *(HA1, HA3, THFC)*. As the price at any moment reflects the market price or investor demand *(HA1, HA3)*, and the underlying cost of government security *(THFC)*, success will be subject to competitive positioning compared to other issuers in the same sector. Therefore, when borrowing a £250m over 30 years, each extra basis point cost is significant to the issuer *(HA5, THFC)*. The barrier is not around access to the market but access at what cost *(HA1)*.

A Local Authority has to take into consideration that the financial market may be impacted by external changes, such as EU or Asian market crises, even if the market is relatively stable. This means that the price may differ immensely from what the issuer was first advised it could achieve, and this may be too late in the process and major costs have already been incurred. This will ultimately affect LA long-term planning capabilities *(PWLB, Core Cities Group)*. This is similar to Swedish municipalities, where fluctuations led to periods of market downturn, and sudden spikes in demand on bonds in other times. Thus, price certainly is seen as one of the key features that the bond market lacks.

*“I don’t think anything’s agreed until it actually happens. The market changes, I don’t think you really get any huge amount of certainty until the day”* *(Intermediaries, 2)*.

*“nobody’s bitten at the right price so until somebody bites at the right price”* *(PFM).*

The long process of bond issuance and its associated pricing uncertainties makes bonds unattractive to most LAs who are used to the PWBL’s daily rates and quick lending *(PFM)*. When discussing Aberdeen City Council’s MB issuance, a PFM representative suggested that the final price was not well justified. The only explanation might be is that they *“probably got deal fixation or they decided they were too far down the line to abort. It is very hard to turn around and just tell HSBC at that point to say I will just pay the lawyers”.*

### 7.3.2.2 Ways to Enhance LA Certainty

#### UKMBA

There was a general consensus regarding the key role UKMBA can play to reduce the risk associated with bonds’ uncertainties *(Core Cities Group, Urban Economic Advisor, PWLB, GLA Strategic Advisor, LA 2, Intermediary 2, UKMBA, PFM, Sweden LA, Kommuninvest, THFC).* As the UKMBA is at the heart of the bond process, it might be able to help local authorities to understand the possibilities of obtaining certain interest rates and thus *‘de-risk’* the process *(Core Cities Group)*.

An aggregator such as UKMBA should offer a faster route than single lane by having all documentations in place, which would be of benefit to LAs as it would enhance timing certainty. This would help in reducing the risk associated with the quick changes in the cost of finance *(PWLB, UKMBA, THFC, HA5)*.

Internationally, most aggregators offer enhanced certainty as they have a regular program indicating how much the borrowing costs will be. Despite assumptions that the first one or two issuances may be difficult to undertake, it is expected that LA would be offered more certainty by UKMBA for future issuances *(GLA Strategic Advisor)*. For now, as UKMBA is still inactive, small LAs would be uncertain about the viability of bonds and would lack the ability to undertake single lane route issuance *(PWLB, LA 2)*.

Practically, the UKMBA will never be able provide a 100% certainty, as the PWLB can with their daily rates, but it can set a price window that almost imitates the PWLB rate. Although such practice is not normally undertaken by banks in a single lane issuance, UKMBA is in better position to give that ‘price window’ as a big market player. This is because UKMBA is promising a regular program and more issues in the future. Therefore, UKMBA can bring more certainty as a result of obtaining market makers and bank cooperation. To increase certainty, the Agency would initially be able to guarantee a price differential and the maximum rate to try to cut some of that risk *(PFM)*.

In 2019, reports emerged about the UKMBA plan to replicate the PWLB offering to LAs. In this plan, the UKMBA proposed to facilitate LA short-term borrowing. This was an attempt by the Agency to allow its members to fund their current project capital needs, until enough demand is in place to allow them to issue their first bonds. It was suggested that UKMBA obtain credit from banks and lend it forward to its members which would allow the Agency to meet short-term debt demand and provide loans in days to LAs. The key difference is the scrutiny level undertaken by UKMBA due to its *“stricter”* credit process ([Marrs, 2019e](#_ENREF_173)). A Kommuninvest representative explained the role as being available to provide members with cost efficient and stable funding. Despite the importance of efficiency, the certainty associated with the stable funding offer is highly valued by its members. Even in the extreme GFC that resulted in cancellation of LA borrowing by commercial banks, Kommuninvest continued to lend to its members *(Sweden LA, Kommuninvest)*.

#### Market Makers

An intermediary explained that market makers, such as banks, have a considerable role in increasing demand certainty levels. When there is a desperate need for certainty, LAs can enter into a possible arrangement with an underwriter, such as a bank, that can offer a ‘buying off’ of the bonds in the case of no demand at the time of issuance. This ‘buying off’ may occur at a discounted price, but would guarantee that bonds will be sold *(Intermediaries, 2).*

Market makers are constantly in the market, and can offer issuers up-to-date information and indications about investor demand and market prices. Therefore, continuous communication and the building of a long, honest, and meaningful relationship with banks, book runners, and intermediaries is a significant key to any bond issue and can reduce market uncertainties *(HA1, Sweden LA, HA3)*.

This view was strongly supported by an interviewee from Aberdeen City Council, stating that external advisors and banks played a considerable role as part of their issuance. These external advisors increased confidence in the bond program success and therefore its associated certainties. This proved to be vital, as it left the Council with no doubts about their program and assured them to continue and pursue their bond issuance *(LA1)*.

In line with that, different reports discussed the role played by book-runners, banks, and the council representatives to promote Aberdeen City Council’s bond program. Market makers facilitated Council meetings with different investors across the UK. This reportedly helped the Council to assess the potential demand and price attached to their issuance ([Room151, 2017](#_ENREF_243), [Whyte and Stewart, 2016](#_ENREF_310)).

Even UKMBA had to turn to the private sector to find solutions for its delayed start. In 2019, the Agency announced that it would outsource its management and operations to external provider, later named as Public Finance Management, to enable issuance of its first bonds. The expectation was that that this new provider would manage the execution of debt issuance activities, administer lending, develop performance indicators, and provide marketing services to LAs ([Marrs, 2019q](#_ENREF_185)).

Increased certainty could be achieved when issuers understand and adjust in line with the market and investor demands. In Sweden, although many municipalities are in need for a 30 years’ debt, almost all LAs work on the 5 years plan, based on consultation with market makers. Therefore, they are able to reduce bond uncertainty in the long run, considering that today’s debt evaluation may change over the next years, as affected by change in politics or even a change in the local economy. Most issuers found that a practical way of dealing with this is by not tying themselves to a 30 year debt, instead, work on a five year period which represents a *“sweet-spot”* for most investors *(Sweden LA)*.

Another view was put forward regarding the responsibilities of the public sector, and LAs, to make investors aware of LA space and the strength of LA and HA credit. Bond issuers in both sectors need to be proactive in educating the international investor base in terms of who they are, how they operate, and how regulated they are *(UKMBA, HA1)*.

Both TFL and universities in the UK executed a number of bond programmes and brought in investors by making them aware of what the sector looked like and broadening their knowledge of the sector. What does not help is the *“noise”* at the macro level that makes investors uncomfortable, such as the talks that all LA’s *“would go bust”* and complaining that their revenue settlement is unfair. This would have an adverse impact on investors who would like to lend money to LAs, and not have *“nasty headlines”* destroying their confidence and ultimately persuading them against investment *(PFM)*. Therefore, the UKMBA has a role to incentivise investors by explaining that this noise is a normal result of the political process, and does not necessarily indicate *“impending doom”* from a credit perspective *(UKMBA)*.

#### Project

Another way of enhancing MB certainty is by linking them to appropriate projects, as most of the uncertainties are related to project and the income streams available *(Urban Economic Advisor, Core Cities Group)*. Therefore, LAs should be having internal discussions prior to committing to a bonds option, such as *“why you are issuing a bond and what are you going to do with this money what are you spending it on?”.* Bonds can be utilised for projects such as housing, which enjoys high asset value, high absorption rate and population growth. This means that returns are realized quickly, resulting in the ability to repay the debt. However, building a road, hospital or new utilities infrastructure that does not generate immediate income might not be suited to a bond program. Therefore, linking the right project to the right funding source is one of the key considerations in place *(Urban Economics Advisor).*

This view was supported by an opinion presented by sector experts. Colin Lowen, Local Government Director at NatWest, explained that lenders are likely to differentiate between different loan applications. The overall decision of lending would be very much affected by the type of project funded by the loan “*If it’s an infrastructure project or regeneration or the things that you do as part of your normal day-to-day business, then that’s probably easier for us than something that’s more speculative… So, if you’re looking at a speculative commercial investment, I think it’s a very, very different credit assessment”* ([Marrs, 2020g](#_ENREF_196)). The view from housing experts is that bond certainty is positive when linked with housing projects. Unlike LAs, HAs are active in building and planning housing projects, have the in-house expertise, and are experienced in the bonds market which puts them ahead of most LAs. With more pressure on LAs to build and supply, while owning most of the vacant land that could be turned into housing projects, a strategic partnership with housing associations might prove necessary *(HA1, HA2, CIH1, GLAH).*

In the UK, and because of the PWLB sitting in the background, it was felt that LAs need to look at bonds as opportunistic. Thus, when the cost of issuance is cheaper, they can utilise it, and when it is more expensive, there is the PWLB option. This, to a certain level, makes the UK credit structure different to other nations, who would have a real funding problem if the markets were closed *(UKMBA)*. Conversely, David Blake, Strategic Director at Treasury Manager Arlingclose told Room151 that his advice to LAs is to think about what they need and what is available. To enhance their chances, there is a need for them to be prepared with a plan, before speaking to investors, and to think strategically rather than responding to opportunistic offers presented in the market ([Marrs, 2019a](#_ENREF_169)).

## 7.3.3 The impact of Credit Rating

In this section, credit rating as a barrier is discussed using different stakeholder perspectives. This section will be divided into two subsections. The first discusses credit rating importance, as well as key players impact on credit rating outcomes. The second section evaluates credit rating validity, as well as the role of credit rating agencies.

#### 7.3.3.1 Credit rating assessment.

There was a consensus from most interviewees that credit rating is an important aspect and crucial element on the success of any municipal bond issuance *(Core Cities Group, MHCLG, PFM, GLA Strategic Advisor, CRA, Intermediary 1, intermediary 2, Sweden LA, Urban Economic Advisor, LA2, Kommuninvest, UKMBA)*.

The current credit rating held by some LAs is directly linked to the framework whereby their debt servicing costs take precedent over new contractual arrangements (eg, future service delivery) and any other existing contractual arrangements. This framework stands behind English LA creditworthiness and makes them less risky *(MHCLG, intermediary 1)*. The English LAs who are rated have received a very good rating, and it is expected that similar ratings would apply to new local authorities seeking rating *(Core Cities Group, MHCLG, GLA Strategic Advisor)*.

A senior member of the Core Cities Group warned that any current rating status might be downgraded in line with the continual austerity measures faced by LAs. As social care continues to absorb a high percentage of LA budgets, their revenue base, not capital base, has been hit hard. Both bases, capital and revenue, are related, and in most cases lead to financial unsustainabilitywhich will consequently affect their credit rating*.* Therefore, there is an urgent need to provide LAs with more resources and more revenue streams which would enhance their credit rating or, at a minimum, sustain their current rating *(Core Cities Group)*.

##### Investors.

It was discussed by two intermediaries that MB credit rating impact should be somehow linked to investor appetite. Many investors have certain criteria for investing in bonds, meaning that they would not invest in bonds that are less than a certain rating threshold. For issuers, this indicates that their pool of investors is reduced and extended in line with their credit rating outcome *(Intermediary 2, Urban Economic Advisor, HA1)*.

Even post issuance, some investors would demand more returns should the issuer credit rating drop. Others may possibly sell and exit an investment if the issuer rating dropped beyond their threshold *(Intermediary 2, Urban Economic Advisor, HA1, HA3)*.

Differentiating central government bonds from municipal bonds might prove to be difficult, and an intermediary stated, *“one of the reasons could well be market sentiment”*. Investors might question the need to invest in a new municipal bond trend and not in central government bonds, especially if both provide the same returns on investment. Therefore, MBs may have to offer more returns to attract investors, who are more used to investing in central government bonds *(Intermediary 2)*. Similar view was presented by MHCLG representative by arguing that MB might not appeal to investors when central government gilts are available (as a safer investment) unless MB would offer more returns.

In Sweden, the Kommuninvest credit rating matches the Swedish central government rating. Kommuninvest is currently rated as AAA which is described as a *“key pillar”* for their funding model. Such rating made Kommuninvest bonds *“the sovereign in proxy”* in that they mainly provide the same type of credit risk as the gilts. This dictates to whom Kommuninvest will potentially sell its bonds *(Kommuninvest)*.

When looking at the current UKMBA rating, they are one notch below the central government. Like Kommuninvest, when UKMBA holds larger debt books, the result will be preferential liquidity levels. This will lead to UKMBA to be trending towards sovereign gilts. Therefore, it may well be that the previous risks associated with the UK market may only exist in early issuances, and would ultimately be reduced with the enhancement of UKMBA credit rating *(UKMBA)*.

An intermediary suggested that the austerity faced by English LAs, despite being harsh on most of them, proved that national and subnational debt for most developed nations is much safer than their rating suggests, especially compared to corporate debt *(Intermediary 1).* This view was supported by an English LA representative stating that *“Even that we have Northamptonshire (County Council) having problems, we still are a heavily regulated sector and we have got a history of pretty decent financial management”*.

Furthermore, investors are struggling to find safe investments with a reliable return, and they are well aware of the sector and governance strengths. Market competition, not credit rating agency activity, would drive investors decisions *(LA 2)*. A very similar view was stated by one of the leading CRAs, who explained that market conditions are much stronger than the credit rating status. In some cases, when the market is keen for long-term debt, the demand can be high for municipal bonds, regardless of the rating. Even when the rating is low, an issuance might still be oversubscribed. With the specialised lenders, such as Kommuninvest and UKMBA, a CRA representative stated, *“I would not say it is trophy asset but there are not very many issuers that are like that”,* particularly for long dated debt, there is not much issuing in that space. Therefore, investors for long term debt are *“very hungry for those kind of opportunities”*, so rating is not the only factor in place *(CRA)*. When such high demand exists, not only does this reduce the impact of credit rating but it also gives issuers a stronger position to negotiate the price *(HA3)*.

#### UKMBA

The UKMBA was rated AA3 by Moody’s in 2016. It was discussed that it is hard to imagine better than the achieved rating, considering that the UKBMA is at a very early stage and its books represent very little in terms of capital.

*“I think they have done very well in terms of rating. And I do not think it is possible to do any better, but I think it is not clear that it is that easy or worth trying to get much better. But getting a bigger pool and that is sensible to get better rating. Just sitting on a big pile of cash is not clear to me that it is very efficient way to get in improving your rating” (GLA Strategic Adviser)*.

A similar view is found in the housing sector*, “I don’t think we can better credit ratings, we can only reflect what’s going on in our sector”* *(THFC)*.

Practically, UKMBA has achieved a good rating when compared to THFC, and unlike the latter, UKMBA cannot pledge assets as security. Both UKMBA and LAs can only obtain credit rating based on their revenue which is in statute. HAs, on the other hand, borrow on a secured basis, using property as assets to guarantee the debt *(PFM, CIH1, HA1).* Thus, LA credit rating might prove to be harder to obtain compared to HAs, *“That one’s a little bit harder because you can’t just grab a bunch of houses and run off with them” (PFM)*.

A Strategic Director of an English LA explained that the fact that UKMBA has a AA3 rating makes it much easier for councils to sell to their politicians. At the same time, fears regarding councils such as Northamptonshire County Council in the pool makes many LAs nervous about being pooled together. Councils would be “*betting off fellow local authorities”*. The least desirable outcome after a UKMBA issuance is a Local Authority defaulting on repayment *(LA2)*. However, a PFM representative explained that UKMBA has its own credit process that it applies to its members, allowing UKMBA to keep any LA with poor credit out of the pool. This means that the UKMBA is effectively removing the default risk *(PFM).* Similarly, it is well known that THFC has a *“heavy touch”* on borrower credit checks, and that by having the right resources, they manage to keep risky HAs out of the pool *(THFC, HA3)*.

Despite all these considerations, it is true that in every instance, an aggregator will be better rated than single authorities. An aggregator represents a different risk profile, a *“collective risk”* of the whole sector, but also much bigger scale, liquidity, swaps, and counter party risk. In addition to that, when rating is undertaken, the ability to match assets and liabilities is something that rating agencies would take into consideration as well. It is different from single issuer rating, although the methodology is not totally different, as part of UKMBA’s own rating will be the individual rating assessments. CRAs call aggregator bonds *‘pool and concentration risk’*. Part of a CRA assessment is to take a view on the aggregator sector, borrowing timeframe and, more importantly, legal terms that clearly set out at which stage the aggregator will step in to bail out a Local Authority in delayed/missed payment. *(CRA)*.

The highest credit rating any LA would be able to achieve is AAA, or close to a AAA rating, which is the AA3 achieved by the UKMBA. With the joint and several guarantee in place, the bigger the group, the better the rating. As it stands, it guarantees any LA to access borrowing on a better rating via the Agency as compared to a single lane issuance *(GLA Strategic Adviser)*. In addition, the UKMBA as an aggregator has its own *“contribution mechanism”* and structural features that allow the Agency to be rated differently, compared to single authority rating. This would enable its members to benefit from accessing bonds at a better credit rating standard *(PFM)*. This view was confirmed by a representative from one of the CRAs. It was stated that the UKMBA rating allows smaller and weaker rated LAs to access borrowing from UKMBA, which in turn reflects the risk of the pool. While it does not mean that the individual rating for the issuance has enhanced, it empowers those smaller LAs with the *“ability to act”*, which is the reason behind UKMBA’s existence *(CRA)*. Please see UKMBA and credit rating page 59.

#### 7.3.3.2 Credit Validity and Credibility

This section will discuss the need for, and the actual value of, a credit rating for a LA, as well as the validity of the credit rating agency’s practices and methods.

##### Can LAs go Bankrupt?

Despite the general agreement on the importance of credit rating for a successful municipal bond issuance, many stakeholders suggested that MBs credit rating is not needed in some countries, such as Sweden and the UK *(Intermediary 1, PFM, Academic 1, Sweden LA, Kommuninvest, MHCLG, PWLB)*. An intermediary explained that a rating might only be justified because of the lack of clarity as to whether LAs can become insolvent or be made bankrupt or not. This is a result of lack of clearness on what exactly is the LAs power to borrow *(Intermediary 1)*.

*“local authorities should not be rated at that because, effectively, they can never go bust because they can always go out and raise tax. There may be some views about the raising of that tax, but they have that power, so while you’ve got that power, who’s going to constrain you, in reality”* *(HA5)*

Similarly, a PFM representative stated, *“LAs’ security is better because it’s all statutory taxational money from government but it’s a more difficult process to explain because everyone understands a mortgage, not everyone understands appointing a receiver to a local authority that can’t go bankrupt”.* For a LA to be created or dissolved in the UK there is a need for an Act of Parliament, or at least some form of secondary legislation or parliamentary approval. Therefore, the default risk is somewhat theoretical, especially when considering the fact that no English LA has ever defaulted, and the oldest one is Corporation London which was granted its charter in 1067 *(PFM)*. He added:

*“They cannot go bankrupt. In practical terms they can have a receiver appointed but the receiver is really just paying out bond holders at that point and the government will always intervene, as we have seen with Northamptonshire. Faced with a crisis, it is going through all kinds of mental gyrations to keep Northamptonshire afloat, and Northamptonshire is still paying its debts. The social workers are still going out” (PFM).*

The possibility of LAs defaulting on their debt confirmed by a Kommuninvest representative who argued that the right of taxation at local level implies unlimited power to raise tax, and puts local debt and central debt in the same pot in terms of risk assessment *(Kommuninvest 1)*. LA ability to raise taxes shows that liquidity will never be a problem for them, as there always ways for them to *“get their hands on cash”.* Therefore, from an investor perspective, bonds would not be a risk as long as the price is attractive *(Intermediary 1, MHCLG)*.

Instead of defaulting on their debt, LAs are able to reschedule or refinance their debt. This might appeal to certain investors who are attracted to the idea of an insolvent borrower, but at the same time recognise that it does not necessarily mean they are getting their money back in a timely manner, should rescheduling or refinancing takes place *(Intermediary 1)*. Nevertheless, from a CRA perspective, both non-payment and late payment of interest are treated as a default, which will ultimately affect the credit rating *(CRA)*.

##### Central Government

With the existence of the PWLB as a last resort lender, a credit rating score for English LAs is not always justified as they can always borrow to repay their debt *(PWLB).* This view was supported by different interviewees, arguing that it is relatively reasonable to assume that the central government, unwilling to risk their reputation, would step in should a local authority, a university or a housing association become financially distressed. This indicates that the central government would not allow any LA bond to default, as such default would affect the confidence around central government bonds *(Intermediary 2, MHCLG, UKMBA, Core Cities Group, CRA)*.

English housing associations are no different, *“there is an element of sovereign support, so it’s a bit of a technical view but there is an aspect of the systemic support for housing associations that the two main rating agencies notch up credit ratings to reflect the fact that if something did go wrong the Government would facilitate some sort of orderly work”* *(THFC)*. There is, in effect, an implicit bond guarantee with HAs where they have not been allowed to fail *“So as a bond investor, you kind of can assume that the government will step in”* *(GLAH)*. In addition to that, the housing sector regulation has engineered a way for any HAs who gets close to bankruptcy can be ‘taken over’ by a larger HA *(HA3)*.

In Sweden, similar to the UK, there are no certain deals that guarantees central government support for distressed LAs. However, the general view is that it is impossible for a LA to go bankrupt because the state would involve themselves and support said LA. This intervention may take time to happen, but it is mostly certain. Hence, there has always been a question of why LAs need to be rated. The answer is merely to satisfy investors criteria *(Sweden LA)*.

This view was confirmed by a CRA representative explaining that the actual LA credit rating assessment reflects the likelihood of support, depending on the *“willingness and ability”* of central governments and not a guarantee. In addition, there are particular risks that speak to the issuer. An example of the latter risk is found in the case of Aberdeen City Council bond. The risk associated with this issuance was a capital expenditure risk as the borrowing is intended for building a conference centre *(CRA)*.

An intermediary noted the impact of geographic economic success on credit ratings. Despite the fact that UK municipalities would benefit from the UK perception around political stability, there will be fear in certain places where more extremist politics prevail. Revenue disparity between regions or cities would have a clear impact on credit rating outcomes. When it comes to the revenue received by the area or region, their ability to yield and retain a tax revenue would have its’ say on the final credit rating *(Intermediary, 1)*. Please see Can LAs go bankrupt? Section in page 60-62.

##### Credit Rating Agencies

The validity and credibility of credit rating agencies was questioned by different interviewees, as CRAs knowledge of local government varies markedly by market. In the US Fitch, Moody’s and SMP are all the same, they have built an experience and have their *“own idiosyncratic ways”* of looking at the market. As the market is well-developed *“They’ve looked at thousands of local authorities, thousands of times”.* When it comes to Europe and UK CRAs’ knowledge is *“much patchier”*, therefore, most of their credit ratings looks like an *“endorsement” (PFM).* This lack of understanding has led to CRAs playing a negative rolein the sector *(HA5)*.

There are also differences in CRA views on public sector indicators, level of understanding of the sector, and in their assessment methods *(LA 2, HA5, MHCLG)*. Indicators such as the amount of debt financing, portion of overall spent on borrowing, debt financing, and assessment of how indebted they are to the central government are used in the latest CIPFA consultation on the resilience of Local Authorities, which raises the question of how different CRAs would read those indicators and how differentiated they would be in their assessment *(LA 2)*.

Those concerns could be best addressed by a representative from one of the Swedish LAs, who discussed that recently, investors are demanding not only one credit rating but two from two different CRAs. This highlights the previous concerns regarding validity of credit rating and the sector’s understanding of CRAs, and shows that these concerns are felt by investors as well. From an issuer perspective, such request for double, or sometimes even triple, rating is an unjustified and unneeded burden as it adds another level of effort and cost on top of existing ones *(Sweden LA)*. Similar practices were found in the housing sector in England. One HA representative explained that they have three different ratings from different CRAs. The problem lies in the fact that issuers do not know how investors look at credit ratings when making their investment decisions *(HA1).*

One example in England is TFL, who obtained a rating from three different credit rating agencies. A considerable difference in the outcomes was evidenced by having AA+ by Standard & Poor, AA by Fitch, and AA2 by Moody’s ([Aidan et al., 2014](#_ENREF_9)). This, to a certain level, weakens the credibility of credit rating agencies as it reflects that each have their own methods and criteria, which consequently leads to different outcomes.

Furthermore, there was a suggestion that all CRAs follow the same routine; looking at the sovereign rating and giving its LAs a rating of one notch below that *(MHCLG, LA 2, Intermediary 1, UKMBA 1, PFM)*.

A MHCLG representative stated that *“Obviously the have got different methodologies but in both cases what they do is that they rate the local authority and then they basically they adjust the rating to one notch below the sovereign” (MHCLG)*.

*“I will be amazed if they moved away from whatever central government is at the moment minus 1 point let’s say” (LA, 2)*.

Similarly, in the housing sector *“rating agencies will apply government related methodology whereby they will be a one notch uplift, there or thereabouts. So, sovereign rating gets cut, we get cut, generically speaking”* *(HA1).*

The credit rating originally granted to Aberdeen City Council by Moody’s was one notch below the UK Government rating ([Whyte and Stewart, 2016](#_ENREF_310)). In 2017, Moody’s downgraded the UK’s long-term rating from AA1 to AA2 and in line with that, downgraded Aberdeen County Council’s credit rating to AA3 to once again be one notch below the UK Government rating ([Marrs, 2014](#_ENREF_164)).

A CRA representative explained that credit seekers may have an improved rating on their second assessment, but only because they may provide better information. However, this does not necessarily lead to a better rating *(CRA)*. Nevertheless, one HA representative explained that their accumulated knowledge of CRA methodology enabled them to act within its parameters *“our financial plan is based on risk appetite thresholds and risk tolerance thresholds that are linked to all of the criteria that the rating agencies use. So, we will say the level of Capex (Capital expenditures) that we are prepared to undertake will be determined based on risk appetite levels using metrics that the credit rating agencies will use”* *(HA1)*.

The fact that there are very few CRAs means that there is very little competition in the market, making it very hard to scrutinise their processes, methods, and assessment *(Urban Economic Advisor, HA2)*. An Academic explained that the main problem with CRAs is that they are private entities serving investment banks; there are a lot of *“moral hazards”*. Therefore, the carrying out of a credit rating is better undertaken by a trustworthy, in-house public authority, such as the Financial Conduct Authority who would be in much better position to oversee the risks of the public sector *(Academic, 1)*.

Despite the scepticism around the need for a credit rating, it is a necessity to have a rating in place that would meet investors’ policies and guidelines *(Sweden LA, HA2)*. Credit rating is essential, especially considering that in a case of a non-rated issuer, or where rating is provided by a poorly established CRA, the issuer has to pay much more than normal credit costs to secure an investor for their borrowing needs *(Sweden LA)*.

### 7.3.4 The Impact of Costs on Bonds Issuance in England.

There was a consensus that bond cost formulates a cornerstone in decision making for LAs when choosing bonds over any other alternative. Therefore, the cost associated with bonds has a direct impact on their popularity and use. When looking at bonds from an English LA point of view, whether being part of UKMBA or a single-lane issuance, they must present potential efficiency compared to funding via PWLB and commercial banks *(Core Cities Group, UKMBA, PFM, Urban Economic Advisor, GLA Strategic Advisor, LA 2, Kommuninvest, HA5, PWLB, Sweden LA, Academic 1, Intermediary 1, Intermediary 2).* This section will discuss the costs associated with bonds, and the ways and methods in which bonds can lead to efficiencies for LAs in England.

#### 7.3.4.1 Bond Costs and the UKMBA Role.

##### PWLB

In England, bond pricing and costs has, and likely to continue to be linked to PWLB costs *(MHCLG, LA 2, GLA Strategic Advisor, PWLB, Intermediary 1, UKMBA, PFM)*. A representative from MHCLG argued that where PWLB exists with a *“zero cost of compliance it is always going to be challenging”*. This may be the view of most LAs seeking UKMBA membership, where they may well feel burdened by the hefty premium and the additional compliance upfront cost to establish a new participant in the market such as UKMBA *(MHCLG, Intermediary 1)*.

In addition to that, ambiguity about UKMBA’s performance is one of the biggest problems at the moment, where costs are more of a ‘guessing game’ *(UKMBA, LA 2, PFM, PWLB, Intermediary 1)*; *“nobody’s bitten at the right price so until somebody bites at the right price”* *(PFM)*. This is mainly because MBs are relatively new and untested in England, therefore they may encounter unexpected costs further down the road. Nevertheless, PWLB presents a very strong comparative basis with low cost and easy access *(Intermediary 1)*, even though the rationale behind establishing the UKMBA in the long term is to provide a funding source that is cheaper than PWLB *(LA 2)*. Having the PWLB in place as a central government tool means that it is quite difficult to see bonds performing well *(Intermediary 1)*, especially with the expectation that the Treasury would always aim to make PWBL cheaper than other alternatives *(PWLB)*. The problem lies in the attempt to achieve the *“right price”*, being below the PWLB rate, which is an *“arbitrary”* rate set by the government and no bank or financial institution would accept such rate as a reference rate for their actions *(PFM)*.

Nevertheless, when reviewing previous bond issues in the UK, all issues *“either beaten or equalled the 80 basis points over the gilt that PWLB does [offers]”* *(UKMBA).* The Aberdeen City Council bond program came as a result of thorough assessment of available funding options, including PWLB, and concluded that bonds would provide cheaper borrowing *(LA1)*.

PWLB may not be the only competitive source of funding for small and medium sized LAs. The European Investment Bank (EIB) have been a very competitive alternative. For places like Manchester seeking to borrow for building its metropolitan train system, EIB has always been a 30-40 basis points above the gilt, and therefore it would be extremely difficult for any council of that size to issue bonds on a single lane route more efficiently *(UKMBA).*

##### Project

Different interviewees agreed with the idea that, despite the significant cost associated with bonds compared to the PWLB, it should not be the only factor for decision making. Neither bonds nor PWLB would be the most efficient funding source for each and every financial need. Efficiency can be achieved by guaranteeing the right match between the project in place and the source of funding *(Core Cities Group, MHCLG, Urban Economic Advisor).*

The Warrington Borough Council bond program was linked to a project, and funds were lent back to their HAs “*So, it is a specific program with a separate risk profile which obviously made it worthwhile” (MHCLG)*. Similarly, bonds were successful for Aberdeen City Council, as the funds were linked to building an asset efficiently *(Urban economic advisor)*. On the Swedish side, green projects proved to be efficiently funded using bonds, due to high demand from investors of green bonds. It was stated that the demand was even higher than supply, which always drives the costs down for the issuer *(Sweden LA)*.

Therefore, bonds can present an efficient source only if both LA and central government develop further understanding to differentiate between projects efficiently funded by either UKMBA or PWLB *(Urban Economic Advisor)*. Hence, the argument that LAs aim to better the PWLB rate is not always justified. Flexibility, suitability, and fairness of an alternative should also be considered. ([Marrs, 2019a](#_ENREF_169)).

##### Compliance

Another aspect of costs associated with bonds is related to compliance and transparency costs *(PFM, MHCLG, LA1)*. A MHCLG representative explained that under the current Financial Conduct Authority rules and the current regulatory environment for general bonds issuance and market participations, the question is what can be done to make bonds more efficient? The costs issue arises once a local authority becomes a financial market participant, as compliance with the market rules is required in full *“more compliance obviously is going to increase costs” (MHCLG)*. This view was confirmed by a representative of Aberdeen City Council who stated that the continuous paperwork and compliance requirements post-issuance resulted in more unexpected costs and efforts required for the terms of the borrowing *(LA1)*. Furthermore, a single lane issuance would require providing prospectus documentation and agreements every time the LA were to look at issuing bonds. With very few in-house bond lawyers available for LAs, it is a matter of extra cost for legal compliance for each issuance *(Core Cities Group).*

##### UKMBA

Reducing MB costs, and thus achieving efficiencies, were presented by many interviewees as one of the key reasons behind establishing an aggregator such as UKMBA or Kommuninvest. There was an accord that for most LAs, UKMBA will be a much more efficient funding source compared to single lane issuance. Its efficiency is particularly achievable and useful for those small LAs who cannot go to the financial markets directly as they, individually, lack the attractive debt size, the in-house expertise, the market knowledge and connections and it would be highly costly for them to put all of that in place. UKMBA, by creating a pooled funding vehicle, enables and empowers these authorities to utilise MBs by allowing them an indirect access to wider capital markets, and more investors at lower costs than a single lane route *(UKMBA, PFM, Academic 1, PWLB, CRA, LA2, GLAH, MHCLG, GLA strategic advisor, HA3, HA1, Kommuninvest, Sweden LA).*

However, a UKMBA representative explained that at this stage, UKMBA would only be able to offer a price that is market dependent. Once the UKMBA got its scale, it will be able to provide a more competitive pricing.

*“I think that the upscale, the advantages, access to broader range of funding, access to more bespoke funding structures, bringing more potential investors into the market, facilitating shared finances, facilitating a baseline transaction, facilitating transactions with sculpted funding profiles – doing all of that good stuff. Making that available to smaller local authorities that can never access all these structures and doing it at a very, very thin cost to the sector. That might be the long-term benefit of doing this” (UKMBA).*

The expectations for an aggregator are to trend towards, and match, sovereign bonds *(UKMBA, Kommuninvest)*. But even with costs up to 40 basis points over gilts, bonds would still be efficient due to the low fees imposed by the UKMBA *(UKMBA)*.

This view was widely supported by different interviewees, indicating the potential UKMBA has in providing LAs with reliable and cheap funding alternatives despite the expected costly start *(LA 2, PWLB, HA5, GLAH, Intermediary, GLA strategic advisor, PFM).* The justifications for the relatively expensive start and its associated inefficiencies varied amongst stakeholders. One reason presented was the high costs associated with the preparational work, and the time needed to be spent on those first issuances would be, in fact, mainly for testing the market and understanding how it works *(LA 2, GLAH, HA5)*. When knowing what the investors want and growing the market to an appropriate scale, aggregators will be able to offer products that not only suits borrowers, but also investors. With issues being oversubscribed, an aggregator will be able negotiate pricing, driving efficiencies *(HA1, HA3)*.

In the housing sector, both issuers and the market have had to develop understanding of each other over time *(PFM, PWLB)*. The start of the journey was costly for HAs. Now, when looking at market practices, the financial market is more familiar with the concept of HAs and their business model, and HAs have developed better market understanding, both of which have resulted in more efficient borrowing by utilizing “*fairly standard documentation and fairly standard pricing”* *(PWLB)*.

The same is expected to be achieved by the UKMBA; *“the agency should be essentially one-shot documentation and they can borrow from the agency for good after that, just subject to annual or pre-issue credit checks and re-signing relevant pieces of paper at the time just to say they’re taking the money, and that’s a two- or three-pages” (PFM)*. This view was supported by a UKMBA interviewee who confirmed that the UKMBA simplified documentation requirements and therefore reduced the costs associated with disclosure, compliance, and legal requirements.

The UKMBA role should not focus solely on reducing direct costs and improving pricing, but should also aim to improve the awareness of the sector qualities, educate stakeholders, and introduce LAs to the market. once sufficiently sized, UKMBA will be able to also create a market space for single lane issuance by establishing a *“floor-price from which single credits can then price off”*. By educating the sector, it is possible to see a scenario where a local authority in Westminster for example, as a single credit risk, would be priced at the same price as the Agency.

The general concept is that the bigger the issuer, the bigger the requirements, and therefore the cheaper the issuance *(PWLB, UKMBA, PFM, Sweden LA, Kommuninvest, GLA strategic advisor)*. This perspective was supported by interviewees from the Swedish MB market, and they noted that Kommuninvest and some of the large LAs with AAA rating, are all accessing bonds at similar prices *(Kommuninvest, Sweden LA)*. Nevertheless, Kommuninvest has beaten the price of LAs, even with AAA rating, as the former enjoys savings associated with economies of scale. Kommuninvest can obtain cheaper prices with *“5-8 basis points”* compared to some of the large LAs *(Kommuninvest, Sweden LA)*. Nevertheless, the substantial membership fee paid by Kommuninvest’s members overrides, if not exceeds, the stated savings *(Sweden LA).*

On this point, a UKMBA representative drew parallels with the Norwegian bonds agency (KBN). The KBN has about 50bn krone on its book, and their issuance costs were significantly lowered *“friction cost of three basis points. that is pretty trivial”*. These 3 basis points represents £15m. This is the cost of borrowing at such scale which is the aim for the UKMBA. Nevertheless, in the UK the UKMBA charges might be even less than the basis points *“I would struggle to see how we would spend so much money on it because it is really, really simple to manage this stuff. So, the friction costs for a scaled agency are absolutely de minimis” (UKMBA)*. Please see UKMBA and bonds efficiency page 53.

#### 7.3.4.2 Swapped Issuance

Swapped issuance was suggested by different interviewees as a way of increasing bond efficiency by achieving better pricing *(GLA strategic advisor, Sweden LA, Kommuninvest, PFM)*. Swapped issuance was defined as the ability of an issuer to issue in a foreign currency and then hedge/swap all the payments back into national currency. This process allows issuers to circumvent the inefficiency in the local markets by accessing cheaper borrowing and issuing in other currencies such as USD and Euros. This approach is fairly popular internationally, and borrowing happens at a reduced cost as issuers gain a few basis points more than what the local market and local currency offers *(GLA Strategic Advisor)*.

##### Currency Strengths

An Intermediary stated that the successful application of swapped issuance is subject to the national currency in place. While the Swedish Kroner is *“not a particularly widely recognised currency”,* the case is not the same for the EU, UK, and the US currencies; “*the pound has got perceived strength”,* and therefore, it is not fully justified for a LA to issue in foreign currency *(Intermediary 1)*.

APFM representative, while noting the strengths of the Pound Sterling, suggested that the Euro may be stronger in the bond market, and argued that funding costs vary for a country that is in the Eurozone as opposed to a country outside the Eurozone. Despite both Norwegian Krone and Pound Sterling being strong currencies, the relatively new French Agency (Agence France Locale) would always achieve better pricing compared to an issue in Kroner or in Pound Sterling as a result of the mere function of the number of investors in the market *(PFM)*. Swapped issuance is essential in markets where few large investors exist. Therefore, unless competition is introduced to the market by international investors, with the existing supply-demand dynamics, the small number of local investors will always negotiate higher returns, adding to the issuer costs *(HA1).*

In Sweden, LAs and Kommuninvest have the full freedom to issue debt in a foreign currency, subject to them hedging the funds immediately back to Swedish Kroner. In England, there are some legal restrictions which may prevent LAs from issuing in foreign currency *(GLA Strategic Advisor, MHCLG)*. [Moore (2016)](#_ENREF_207) explained that LAs have the full freedom to borrow from any willing borrower, but only if it is done in Sterling. This condition was clearly defined in Local Government Act (2003) stating that *“A local authority may not, without the consent of the Treasury, borrow otherwise than in sterling… this section applies to borrowing under any power for the time being available to a local authority under any enactment, whenever passed”* ([Parliament, 2003 ,P2](#_ENREF_223)).

##### UKMBA Role in Swapped issuance.

Both legal and currency risk barriers were discussed by a UKMBA representative. It was stated that UKMBA could help to overcome these legal complications and tap into international markets by swapping issuance from Dollars or Euro to Sterling. This might prove to be useful, especially considering that risks are low as currency volatility is not currently significant. This would bring further advantages of diversifying the funding sources, accessing a wider investor pool, and increasing the ability to follow market trends such as the recent popularity of Sterling and Euro *(UKMBA)*.

When bond terms are 10 years, the investor base is diverse enough to enjoy a good interest from bank treasury desks, corporate treasurers, and central banks. Thus, there will be more international investors with currency exposure who would be interested in buying the bonds. The case is much more difficult when trying to find an investor with 30-45 years of currency exposure. The only way to of doing this is when banks swap bonds at their end, instead of leaving it floating for such a long term. TFL issued bonds in Sterling, and the bond bankers (NOMURA), swapped on their side to sell to Japanese retail investors. If UKMBA is able to be in a position where its bankers are doing swaps on their side, then that would be a much more preferable and beneficial scenario *(PFM)*.

Kommuninvest has always been capable of reducing the costs via swapped issuance by offering access to USD market for large transactions. This provides a preferable access to certain type of investors who are not active in the bond markets where the currency market size is too small. Kommuninvest frequently issues $1-2m *‘slices’* that are largely bought by central banks, official institutions, and banks from all over the world. *“Investors would never buy bonds, small Swedish Kroner bonds issued by single municipalities, that would not be the case”* *(Kommuninvest)*. Swapped issuance is not marginal is Sweden, and it represents a significant part of the successful role Kommuninvest plays *“Half of our funding is conducted outside of Sweden, and we typically always swap the proceeds back to Swedish kroner”* *(Kommuninvest)*. Even big Swedish LAs, such as Malmo and Gothenburg, issue individually in currencies that achieve preferable pricing. This tactic is very efficient when having loan certificates that has a maturity that is under 12 months *(Sweden LA)*.

##### Risk

One argument is that swapped issuance can potentially increase risks, particularly cross-currency risk *(Intermediary 2, MHCLG)*. Furthermore, there is a risk-cost correlation in the swapped issuance, whereby both lenders and borrowers would face additional type of currency risk. The costs, therefore, cannot be isolated from the risk. Instead, it reflects the risk associated with swapped issuance. This means that the impact of swapped issuance on reducing borrower costs may be questionable *(MHCLG)*. Practically, international investors either look at the secondary trading spreads in Sterling and then charge its equivalent in Euro, or they use an *“arbitrage[[2]](#footnote-3)”* charge. Even if issuers wanted to follow a certain arbitrage charge, they have to issue quickly as the charge changes rapidly in the financial markets *(HA1).*

However, swapped issuance can reduce the risk associated with the lack of investors in the local market by allowing access to a wider investor base. This feature can make a difference in reducing costs associated with the lack of investors for certain currencies or longer maturities. *(PFM, Kommuninvest)*. The issuer currency risk totally vanishes the moment the issuance is swapped back to the national currency. So, for the issuer, the exchange rates risk is negated once the funds have been swapped back to the national currency *(GLA Strategic Advisor, HA1, Sweden LA)*.

The main barrier that prevents LAs from using swapped issuance is not the associated risk, but rather the lack of in-house expertise, and the lack of understanding of the terminology and market experience:

*“When we do issue in foreign currency, we also, we hedge it immediately. So we make sure if we borrow $50m we exchange it to Swedish Kroner because we don’t have any use for Dollars, so we make sure that we secure the forward rate, so when we pay, we know how much Swedish Kroner we have to pay when we pay back the Dollars, so it’s always 100% hedged. So, we don’t have any currency risks. If you look at our issuance in Norwegian Kroner, we do bonds in Norwegian Kroner, you have to secure every interest rate payment going forward, so we use cross currency swaps, for basis swaps, and I think just the terminology kind of puts some people, like what is a basis swap, what’s a cross currency swap? I do not know. So yeah, in house expertise is key for this” (Sweden LA).*

In England, the public sector can benefit from US investor demand in the bond market. Traditionally, heavy buyers from the US have purchased UK private placements. More recently, swapped issuance has found a demand from US life insurer MetLife, who bought £60m bonds over thirty years from Guy’s & St Thomas’s Charity ([GlobalCapital, 2016](#_ENREF_104)).

### 7.3.5 The Impact of Liquidity on Bonds

This section will cover municipal bond liquidity levels in both the primary and secondary market. In the primary market, liquidity will be discussed in relation to the attractiveness of the issuer and the issuance currency. The secondary market section will discuss the reasons behind the existing market illiquidity and the role of the UKMBA in enhancing bonds liquidity.

#### 7.5.3.1 Primary Market Liquidity

There was a general consensus that LAs in England enjoy a good level of liquidity. Therefore, MBs are expected to find a high investment demand *(Core Cities Group),* especially that it might be perceived as a *“safety”* investment *(Intermediaries, 2).* With that in mind, and with the continuous funding cuts, there is a risk as LAs lack the in-house skills that govern their projects, understand market conditions and their investors interests. Therefore, the fear is that LA projects are not being presented to investors in the right way, which heavily impacts the liquidity in the primary market *(Core Cities Group)*.

Both MB timing and market conditions are often seen as the two key elements decisive in determining the primary market liquidity *(Intermediaries, 2)*. Furthermore, for healthy primary market liquidity levels, there has to be an active market. Despite the potential of an oddity, in an established market, liquidity would always be better than a market that lacks the activity volume and frequency *(Intermediaries, 1)*.

In the UK, the only liquid bonds are gilts, due the lack of investors in the MB Sterling market. In the Euro market there is a much broader range of investors, which is why their non-sovereign debt market tends to be quite active compared to Sterling, a trend that applies to all other small currencies. However, the expectations are that, if the UKMBA can build larger books, then more investors are expected to come forward to the Sterling market *(UKMBA)*.

This matched with a PFM representative who explained that any Euro issuer would enjoy better liquidity than an issuer from outside the Eurozone as a mere result of the number of investors in the Euro market. Therefore, Sterling MBs would have the same problem as the market lacks the required volume of investors to achieve a primary market liquidity. However, in the short run, the Pound Sterling investor market should be able to take up to £30bn - £40bn, which would gradually enhance the market liquidity, however not significantly as the overall assessment suggests an *“extremely low levels of liquidity annually”*. Please see ([Knezevic, 2020](#_ENREF_135)) and ([GlobalCapital, 2016](#_ENREF_104)) page 66.

#### 7.5.3.2 Liquidity in the Secondary Market.

Secondary market liquidity (SML) is an important feature of any bond market, to the extent that it is factored in the credit rating assessment. However, generally speaking, MBs and HAs bonds are not very liquid anyway *(CRA, HA1, HA2, HA3, HA5)*. In the UK, SML either does not exist or is very low *(CRA, GLA Strategic Advisor, MHCLG, PFM, HA1, Core Cities Group, LA 2)*.

Nevertheless, SML levels are low due to the very nature of MB investors; primarily pension funds majorly practice a *“buy and hold”* approach which has a significant impact on the illiquidity of the secondary market. Therefore, most bond investors never trade their bonds, intending to keep them until their maturity as they form a part of a wider asset liability portfolio *(GLA Strategic Advisor, HA1, HA3, HA5, THFC)*.

*“So, you buy one of our bonds, a thirty-year bond, and you shove it in your bottom draw, and you forget about it”* *(THFC) “*

*If you’re an investor institution, you’re likely to be someone who’s looking for a steady return rather than a spectacular return so you’re likely to be more of the pension fund type approach and why would you get rid of an asset that’s going to give you that return, and particularly if you’ve got a progressively going upwards return? Why would you look to offload it unless you’ve got liquidity problems yourself and you have to get cash in quickly? (HA5)”*.

In Sweden, although good level of SML exists, certain bonds such as green bonds tend to be less liquid. This is merely because of how green bonds fit positively with investor portfolios; thus, they tend to hold their bonds until maturity *(Sweden LA)*.

##### Market Size

In England, the other factor contributing to the SML is the small size of the Sterling MB market, which directly leads to the current illiquidity *(MHCLG)*. The small Sterling market size is believed to be caused by either the lack of new MB issuances, or the rarity of repeat issues from the same LA after their first being successful. Despite the size of Aberdeen City Council, it was commented that *“I doubt very much that Aberdeen will do another bond”* *(PFM).*

Another participant stated the regularity of MB issuances will be dependent on the success of the very specific project it was used for, which will take time to prove itself*“So, if it is related to the housing market, how is the housing market performing over the first couple of years of that issue? If it is business sector, how is local business economic performing and so on? And if that looks like a good deal then you might be able to re-issue it as a secondary investment” (Core Cities).* This was backed by a LA representative who said that the nature of MB finance indicates that is highly likely to be invested in long-term assets. Therefore, issuance on a regular basis might prove to be difficult. However, LAs have different recurring needs where every time an asset comes to an end of its life it will continually need to be replenished *(LA 2)*.

The 2003 Act relating to capital expenditure in England aimed to bring LA financial practice in line with generally accepted accounting practice. Projects funded by LAs such as new roads, buildings, libraries, and residential homes are all classed as ‘capital expenditure’. The nature of these projects is usually very expensive with huge capital requirements and have a long use-life. Therefore, most of them are funded vial long-term borrowing ([Byrne, 2000](#_ENREF_52)). If bonds are used to fund those projects, it is sensible to assume that issuers would hold on to their debt until its maturity, which results in reduced secondary market liquidity. Similarly, investor expectations are usually to hold the bond for an indefinite period of time, until final redemption or maturity. Investors are aware of those risks and the risks associated with any future resale price, which may drop due to the lack of price indications or a change in the risk view. In some cases, the result would be a resale price lower than the offering price, or even lower than the fair market value. Although bonds might not be suitable for every investor, bond investors are not usually deterred by the lack of SLM ([Aidan et al., 2014](#_ENREF_9)).

##### Increasing SML

An increase in the number of issuances was identified as the most direct way of increasing SML *(GLAH, HA3, Core Cities Group, MHCLG, THFC)*. This might result automatically from a *“change in the framework”* necessary to grow the market to a level where such issuances are worthwhile. For issuers, those changes would be subject to at least a change of cost of MB issuance, or a change in ease of access to another source of funding, mainly the PWLB *(MHCLG, GLAH)*.

For investors, it needs a sudden change in the interest rates *(Core Cities Group)* or investors being encouraged to buy more bonds *(GLAH, HA1)*. The latter was found in the following comment.

*“three weeks ago, we had the Swiss National Bank as an investor, it’s a very unusual investor for us. Why would the Swiss Central Bank buy? They buy because they have an obligation between central banks to support different currencies, so they want Stirling based, long term, relatively safe assets that they can hold, sell, whatever else…. So, we like investors like that, they will create some sort of liquidity over time for us” (THFC).*

The lack of SML and secondary market information is not unusual for municipal bonds. In Sweden, Kommuninvest and some single lane issuers pay for services provided by market makers,such as commercial banks and brokers, to always provide secondary market pricing. They play a vital role in providing SML information and enhancing overall liquidity levels. Issuers who chose not to have this support in place might have significantly less SML associated with their bonds *(Kommuninvest, Sweden LA)*. Furthermore, having the support of market makers helps issuers avoid practices such as repurchasing their bonds. Although it is possible and would enhance the SML, repurchasing means that issuers might end up paying more than the nominal price, which is not practical *(Sweden LA).* Kommuninvest as an aggregator, along with its role to provide LAs with finance, acts as a market intermediary and has its own mechanisms in place to enhance existing SML levels *(Kommuninvest)*.

# 7.4 Summary

This chapter covers the third level of the applied framework concerned with the analysis. This chaptercarried out an assessment of the MB market in England. In line with to Healey (1992) framework. This level aims to carry out an assessment of the actors’ strategies and interests, particularly with respect to the most significant ones. The assessment is related to the resources, rules and ideas governing the development process.

Building on the description of the development of the bond market in England and its actors’ relationships and behaviours, this chapter went further to provide a thorough assessment of the key barriers, resources, and rules that affects the development of the bond market in England. This is done by analysing the key advantages and disadvantages associated with the development of the bond market in England. This was followed by an in-depth exploration of the main barriers that face bond market stakeholders, and investigated the ways of overcoming those barriers.

The key advantages bonds provide to local authorities can be summarised as

1. Enhanced governance discipline,
2. Improved risk management skills, and
3. Flexible borrowing that can lead to increased efficiencies

Bond disadvantages, on the other hand, can be summarised as

1. Too complicated and expensive for most single LAs to deal with solely,
2. Too risky for most LAs who lack the knowledge,
3. Inconvenient compared to PWLB, and
4. Too uncertain being dictated by the market not the issuers

The common barriers faced during the development of the bond market were analysed with the backdrop of English LAs socio-economic status for context. The barriers explored were, the bond market transparency and its requirements, uncertainties, credit rating requirements, associated costs, and liquidity in both elementary and secondary markets. The analysis revealed the complexity of the correlation between those barriers whereby each affects, and is affected by, other barriers.

Transparency requirements in the bond market can increase the overall bond program costs and forms a strong part of the credit rating process carried by CRAs. Under the current framework, English LAs already enjoy a very good level of transparency as part of their practices. Therefore, under the current framework, transparency should not be a barrier that stops LAs from accessing the capital market. English LAs might not necessarily be required to provide more information, instead they might need to be more organised in the way such information is published and submitted. Transparency towards bond investors (affecting their demand), and towards peer LAs when accessing the UKMBA (affecting the pool risk profile), is a must. Listing bonds on a well-known platform is seen as a way to enhance transparency, as it offers information about issuers.

Certainty is the second barrier explored in this chapter. Two elements of certainty were found, being price and demand certainties. Despite price and demand being correlated in their nature, the lengthy process required for LAs to issue bonds means that there is a high level of uncertainty related to the cost of debt. The significance of such uncertainty is greater, as English LAs are used to high certainty provided by PWLB with a quick funding and guaranteed and clear pricing. Such barrier, although not totally eliminated, can be reduced by accessing the bond market using the UKMBA, building strong and meaningful relationships with market makers, linking bonds to the right project that enhances investor appetite, and enhances communications between the public sector and its audience to improve the sector overall profile.

Credit rating is the third barrier that has significant impact on the development of the bond market. In England, under the prevailing framework and regulations, LAs should achieve a very good credit rating, enjoying almost a clear history from any LA default on debt. Investors follow their own credit criteria when buying bonds; they are expected to have a strong demand for LA bonds, and in some cases, even if the credit rating is not very high. Such anticipation is reinforced by the AA3 credit rating achieved by UKMBA who should be able to issue debt close to sovereign quality. In England, from an issuer perspective, credit rating is unnecessary and unjustified when considering the strengths of the sector embedded in the financial framework and current regulations, the possibility of the central government intervention to prevent any default on debt, and the existence of the PWLB as a last resort. Nevertheless, credit rating is essential for investors to demonstrate their investment risk, and is therefore reflected in the debt costs. The main concern about credit rating agencies is the poor knowledge of the public sector in England, which usually ends with a credit rating that is an adjustment of the central government own credit rating, rather than an actual assessment.

The fourth barrier is the costs associated with municipal bonds. In England, bond efficiency will always be measured against PWLB as a market maker. The problem lies in the fact that PWLB, although mostly providing cheap lending, is not governed by the capital market, but the Treasury, who use it to control LA borrowing by implementing big changes in its cost to encourage or discourage borrowing. In addition to the direct costs associated with bonds, compliance requirements add to the overall costs of any bond program. Although UKMBA’s offered prices are market dependent, for smaller LAs or those who lack the expertise, UKMBA has the potential to lower their borrowing costs due to economies of scale, in-house expertise, reducing the timeframe, and the reduced paperwork. Swapped issuance is a way that allows issuers to tap into the international investor pool, but requires issuing debt in foreign currency; English LAs do not have the freedom to do this. UKMBA, however, is not subject to the same regulations and can freely issue in foreign currency, allowing LAs the access to a cheaper borrowing.

The final barrier is related to municipal bond liquidity in both primary and secondary markets. Both liquidities require an active bond market with regular issuances, which is not the case of the bond market in England. The lack of market activities limits the market information available for different stakeholders, including investors. Secondary market liquidity is very low in England, or even does not exist at all. Nevertheless, the nature of bond issuers and investors suggests that it is normal for bonds not to be traded after being bought, which also contributes to the lack of market liquidity. However, to enhance such liquidity, there has to be more regular issuance in the market, which is what the UKMBA is attempting to do, and building long-term relationships with market makers and banks who can facilitate and provide more information about the market to different players, including investors.

The following chapter covers the final level, level four of Healey (1992) framework, and addresses the formal and informal rules, ideas and norms of the key players and main stakeholders in the bond market, and their impact on the development of such market in England.

# Chapter 8: Formal and Informal Rules and Ideas

This chapter covers the fourth level of the Healey (1992) framework. The previous chapter addressed the key barriers affecting LAs when trying to access the bond market and explored methods in which they can overcome those barriers. Naturally, this chapter comes to address the stakeholders’ behaviours prominent in the bond market. This highlights the available rules and ideas that affects the decision making, strategies, and interests of different stakeholders in the bond market. This analysis will then be used in the final chapter to observes and describes how key actors reproduce, reinforce, or transform social relations within the market.

This chapter is divided into two parts. While the first part addresses the role of the formal and informal variables and their impact on the MB market, the second part covers the impact of both social and green bonds on the strategies and interests of different actors.

# 8.1 Stakeholders

This section will discuss the role that rules, ideas and norms play in the development and application of the bond market in England, from different stakeholder groups points of view. Across all interviewee groups, there was a strong consensus that there is a definite impact from both formal and informal ideas and norms on the development of the bond market in England. Such ideas and norms are mainly experienced on the issuer side. They range from the issuers ability to understand bonds and the bond market, make presumptions about MBs, in-house expertise, risk appetite, structural barriers, *‘togetherness’*, and ambitions *(Core Cities Group, Kommuninvest, PFM, UKMBA 1, Urban Economic Advisor, Sweden LA, MHCLG, HA1, HA3, HA5, HA4, GLA Strategic Adviser, PWLB, Academic 1, CRA, Intermediary 1, Intermediary 2)*.

## 8.1.1 Understanding Bonds

Municipal bonds in England are faced with a lack of understanding about how and, indeed, whether they work. At a LA level, decision makers might lack the in-depth understanding of MBs, resulting in either believing that bonds would solve all of their problems, or perceiving bonds to be too complicated to do *(Core Cities Group)*. An urban economic advisor commented that *“They won’t have any idea whether it is relevant or possible. And most people would think oh that is too difficult” (Urban Economics Advisor)*. Presumptions about the documentation and rating workload, as well as the assumptions around bond being an expensive tool, might prove to be strong impediments that puts LAs off bonds, while PWLB sits in the background *(Kommuninvest,* *MHCLG, CIH1*). Therefore, the main risk is that some LAs would see bonds as an attractive idea, but once it results in extra work then *“Well, why don’t we just pick the phone up {to PWLB}?”* *(PFM)*.

Issuers may consider bonds as a more complicated option due to the lack of familiarity with the market-language *“you get very familiar with all that terminology. And you somehow think that sort of capital markets is for the sort of, you know rather ethereal experts, but it is not the case” (HA3).* An urban economics advisor pointed that not all LA senior managers speak the *“private sector language”*. Most LAs partner with private sector players, therefore the senior members in planning, development, construction, or advisory roles in LA, would need to have private sector experience to understand how bonds work. Places like Croydon Council and London in general are more likely to have those in house, but smaller LAs are unlikely to have the same experience level. It is harder for some LAs to understand and communicate using financial market language without being exposed to the experience of *“becoming commercial in profit-margin sector” (Urban economic advisor)*.

Similar evidence was found in Sweden, where dealing with bonds can be *“intimidating”* due to the large sums of money involved and the complicated terms. Therefore, LAs need to have seniors who are *“able to kind of speak the language of the brokers”* *(Sweden LA)*. One example of the language impact on decision making is found in Birmingham City Council, who dropped the idea of issuing bonds after a change in Council management. Instead, they borrowed via a private placement to a pension fund which is still a loan in its nature. The name *“bonds”* does not mean that is anything different to a loan, however, is still enough to put some LAs off issuing bonds *(PFM)*. This lack of familiarity was criticised by a HA representative *“thus I find that a lame, poor excuse, ‘I don’t know it’, ‘Well, find out about it’, would be my viewpoint. The banks are very experienced, advisors can add value, they can hold your hand through the process if needed-We’ve all been there, I remember doing my first foreign exchange trade or first commercial paper deal you learn, you have to learn, it’s part of the process and I think from a sector perspective” (HA1).*

The UKMBA had already considered all of those limitations, and thus its services include taking on all of those complexities *“off LAs shoulders deliberately”*. Initially, UKMBA followed a simplified framework agreement by taking care of the rating, and documentation associated with the single-lane. This would save LAs time and effort in dealing with CRAs, who would want to speak to LA leaders, CEOs, finance officers, and demand detailed financial plans and documentation *“we take that off their shoulders in that particular case, they don’t have to worry about that. That is our job. That is what we will get for our three basis points (UKMBA)”.*

An interviewee from Kommuninvest explained the role played by banks as market makers. Motivated by their interest to reduce their balance sheet exposure to LAs, commercial banks showed strong willingness to stimulate the market and assist LAs by simplifying bond complexities, rating, and documentation. With their help, a group of Swedish LAs successfully managed to overcome those barriers and created Kommuninvest *(Kommuninvest).*

Such concerns could be eased by increasing awareness and educating staff at the LA level regarding bond practices, as well as previous applications. This would aid LA decision makers to come to better conclusions about the use of bonds *(Core Cities Group, THFC, HA5, HA3)*. Such role is found in Kommuninvest practices whereby they act as an *‘information and training hub’*, offering various sorts of training as required by their LA members *(Kommuninvest).*

## 8.1.2 LA Size and Inhouse Expertise

Different stakeholders commented similarly on the role of ambition, experience, leadership, confidence, risk tolerance and other personal qualities on MB issuance and trade *(Urban Economic Advisor, Kommuninvest, PFM, Sweden LA, MHCLG)*. The availability and abundance of those characteristics varies considerably between different LAs in England. Large LAs would have in-house lawyers, a skilled management, and resources as a result of the existence of large-scale projects and therefore larger logistical responsibilities. All of this makes bonds an attractive option for larger Local Authorities, and not to small LAs *(Urban Economic Advisor)*.

The lack of expertise is a result of continuous funding cuts and/or the existence of the PWLB as an easy source of finance, therefore LAs have not had to develop such qualities *(Core Cities Group, MHCLG, GLAH, HA5)*. Most LAs would lack the necessary skills, training, debt volume or need to justify having the in-house skills needed for bonds. Therefore, for the majority of LAs, the risk of single-lane bonds versus UKMBA is just too high *“It is not like they are going to do a benchmark transaction this year and then next year, and then next year. I am not aware of any local authority borrowing £250 million a year for three years. I am just not aware of any of them doing it. The scale, complexity, cost, political risk; it is not realistic”* *(UKMBA)*.

In Sweden, large LAs were always able to borrow by issuing bonds directly to the market and without the need for Kommuninvest, as they internally have the competence and skills necessary to do the work needed for the single lane issuance *(Sweden LA)*. However, almost all smaller Local Authorities are members of Kommuninvest. This is not merely because they lack the debt-scale, but because as members, they have one Chief Financial Officer who generally undertakes a wide variety of duties and will not have the time to understand and work with the financial markets directly *(Kommuninvest, Sweden LA).* Any municipality active in the bonds market will always need *“the right knowledge and right skills”* to undertake bonds, whether via a single route issuance or Kommuninvest *(Sweden LA)*.

Specialism was presented as one of the key drivers for MB success. A representative from a Swedish LA mentioned the following: *“My role is a specialist role, so I don’t really deal with budgets or investments or such, my primary focus is the gain capital and making sure that we have it for a long time and also securing this capital with interests rate locked. So, I think that if the municipalities want to do this then they need to have a specialist working on it”*. Along with that comes experience. The interviewee stated that her background as a trader, and therefore being on *“the other side of the market”*, helped her enormously in understanding how the financial market functions. The interviewee’s background was a key reason for their being one of the only three municipalities in Sweden who are active in the Dollar market. Other municipalities stated that they are uncomfortable with currency swaps, and unsure on how to hedge the current exposure. *“They lack the knowledge needed to calculate the interest rates in swapped issuance”* which is undertaken by specific access to a real-time data that enables decision makers to monitor interest rates and therefore make decisions *(Sweden LA).*

Another factor cited was the ambition of each local authority. The abundance or scarcity of ambition at different LAs would strongly impact their decision to issue MBs *(HA1, Urban Economic Advisor, CIH2)*. LAs such as Manchester City Council, have *“Very ambitious leadership”*, which is why they have had success in terms of development and regeneration. Other LAs, such as Leeds County Council, are perceived to be more conservative and not seeking big changes. Therefore, they might not be so keen to undertake something rather adventurous, such as bonds *(Urban Economic Advisor)*.

## 8.1.3 Risk Tolerance

The lack of risk tolerance or risk appetite at the LA level was presented as one of the key reasons behind the lack of MB issuance in England *(UKMBA, PFM, Urban Economic Advisor, MHCLG)*. An interviewee, who is former treasurer for different LAs in England and current housing finance expert, explained treasurers’ appetite for risk as follows:

*“having been a treasurer for twenty-odd years, we’re very cautious people and anything new comes along we’re going, “Well, who is making the money out of that? Am I being done in this process?” I think there has almost been a lack of movement in trying it because, “Well, we’ve always been able to do it this way around with these.” Treasurers are always very nervous because of the Icelandic case, you know, the Icelandic Bank case and the others, that, “Let us always stick with PWLB because that’s safe. We know where that is”* *(HA5).*

Similarly, a representative from the CIH stated:

*“Let us put it this way; you probably don’t go into local government finance for the excitement. You know, people who want to do really kind of exciting and unusual stuff they would not normally gravitate to local authority finance. It's not to say some local authorities don’t innovate, but for very good reasons they are relatively risk-averse, they are restricted from doing some of the things, some of the quite mad stuff that private entities do” (CIH2)*

Nevertheless, some LAs had gone down the bonds route, assessed it carefully and worked hard to make it happen; indicating that they really believed that bonds are worth the risk *(MHCLG)*. Other LAs would fear the risk associated with the creditworthiness results, and/or being compared to other LAs who are much more capable of achieving a better rating. In other cases, a number of LAs may be aware that their credit rating would look weak so *“they are not bothered”* *(Urban Economic Advisor)*. Such caution might well be amplified by the way in which the UK media perceives commercial debt financing *(Urban Economic Advisor, PFM, MHCLG)*. In most cases, LAs are blamed for other parties’ faults, earning bad reputation; *“Local government is a convenient scapegoat for things and it’s always the council that gets the blame, even if it’s somebody’s else mistake such as police or hospitals” (PFM)*.

## 8.1.4 Structural Problems

### Issuer

Different structural problems were presented as issues by different interviewees. A UKMBA representative explained that some projects, such as the building of toll roads, which are usually funded by bonds, would work in almost every other country, but not in England due to the complex way municipalities are structured, and their lack of willingness to engage in *“accounting chicanery”* at the national level *(UKMBA)*.

Even when a certain LA has the qualities required at the senior level, they might be faced by different tiers of elected representatives and politicians who may have a different attitude towards risk, and be more conservative in their ideas; *“they may have aversion to market mechanisms, so they don’t want to be involved with financial markets”*. There may be a situation in which bonds could work very well, but the political situation does not allow an issuance to go ahead (*Urban Economics Advisor)*.

An intermediary stated that the way LA finance is structured is mostly dependent on the central government, as represented by PWLB, and suggests that some LAs would fear change, and the outcomes it brings. Even though the current regulatory and financial framework enables LAs to use MBs, and considering their ability to raise tax, the lack of MB issuance may well be because most LAs are struggling to see themselves responsible for their own funding. Currently LAs don’t know exactly the results of when they interfere with the central government funding. There might be a fear at the local level that if Local Authorities proved to be capable of raising funds themselves via bonds, the central government may stop or cut their financial grants *(Intermediary 1).*

### Investor

Bonds issued by LAs might be perceived to be boring by some investment banks because *“there is nothing sexy about local authorities”* *(PFM)*. In some countries, like the US, people might still have the *“civic-pride such as what happened in Pittsburgh for example where local people paid to keep the swimming pools open”*. Generally speaking, the mood around LAs is rarely great. This could be related to LAs being negatively perceived as a both a tax collector and providing poor services *(PFM).*

In the housing sector, investor practices showed that they look at HAs in a similar way as they see LAs. Therefore, investors do not always give HAs the *“best deal”*. When two issuers, a HA and a utility company, issue over the same terms with the same credit rating, the utility company would obtain a deal close to 40 basis points cheaper than the HA. The explanations were that investors are taking advantage of HAs being seen *“sub-LA”* entities and they can always obtain central government grants *“we are okay, we’re the good guys. Actually, we don’t mind paying up” (HA2)*.

When assessing the UK’s structural issues, two complexities were identified on both the local and national levels. On the local level, the structural complexities and the multi-layered system resulted in some LAs having a parish council, a district council, a county council, and a combined authority. The role and responsibility of each layer varies immensely, and this is not easily understood by investors. Therefore, investors would need to spend time, even with a rating is in place, to find exactly what is happening at each level. Consequently, the investors’ perception of LA is rather poor and changing that perception would prove not to be easy without extensive marketing efforts *(PFM)*.

On the national level, the UK structure consists of four countries, which brings further issues related to separate financial markets and different risk levels in each country. When asked whether the oversubscribed Aberdeen City Council issuance is a good indicator of investor demand, a CRA representative stated that *“it is hard to tell”*, acknowledging the impact of the issuance timing. Both Brexit and the Scottish Referendum makes it very difficult to interpret Aberdeen City Council’s issuance and understand investor behaviour *(CRA)*. Further limitations were identified by an intermediary who explained that the potential benefits of the pooled issuance method may be undermined by the fact that the market does not look at different countries, regions, and LAs in the UK in the same way. This would normally result in different appetites and risk assessments from the banking and investor sector. *“Scotland is still seen in the market as very separate. We have a separate, certainly from a banking perspective, we have a different appetite, depending on a different market and asset and sector, whether it be Scotland, whether it be the North of England, London, Wales, all over. So, it varies” (Intermediaries, 2).* Please see Structural problems page 69.

It was explained that even UKMBA would not necessarily find it efficient to pool LAs from different countries across the UK, as it might result in some LAs incurring increased costs because of the mixed risk in the pool. This could well be the reason why Aberdeen City Council have not even considered the UKMBA as an option *“If you then try and mix it, then the risk will look very different because Scotland might be seen as higher risk, London low risk. If you mix it “London” with Scotland, that is increasing the risk on a blended rate” (Intermediaries, 2).*

An Urban Economic Advisor added that different cities in the UK have different asset values. Therefore, a mix of cities in a pooled issuance conducted by UKMBA may not be the most efficient way to issue MBs. This view was partially supported by a UKMBA representative who explained that Aberdeen City Council did not ask the UKMBA for any support regarding their last issuance. This is mainly because UKMBA does not have the regulatory approval necessary to provide advice. When it comes to why Aberdeen City Council did not consider the UKBMA as an option, it was clarified that amongst many reasons, one is the structural limitations of both UKMBA and Aberdeen City Council. UKMBA is employed by the English local authority *“and we have not particularly marketed our services to Scottish local authorities”*, and Scottish LAs do not have the *“general power of competence”*, which means they cannot enter into a joint and several guarantee *(UKMBA)*.

## 8.1.5 Culture

Another point mentioned by different interviewees was the cultural differences between different nations and its impact on the MB market *(PFM, Urban economic advisor, GLA strategic advisor, CRA)*.

### Acting Together

It was mentioned that some of the best examples of LAs working together are found as a result of the organisational culture, the consensual society, and the tendency to agree on a collective way forward in each Local Authority *(PFM, Urban Economic Advisor)*. While in Sweden *“people … don’t like necessarily to disagree and they go with the consensus. And it a quite balanced society in that respect” (Urban Economic Advisor)*, in the US *“extreme individualistic and entrepreneuristic society”*,yet tax correlated finance is very popular there and works very well. England is neither *(GLA Strategic Advisor).*

Even though that some housing associations compete with each other in England, THFC have managed to pool their debt. This was driven mainly by achieving better pricing and more efficiency. At the same time, LAs in EU countries such as Denmark, Sweden, or Holland, despite regional politics naturally *“get along collectively”*. The fundamental difficulty in England is the *“mentality”* in the public sector, as LAs do not collaborate and meet collectively to discuss what local government needs to discharge its responsibility *(PFM, Urban economic advisor)*.

The view is that a very individualistic approach both in the public sector and society prevails in England *“We have a much more individualistic society here. And there are great examples of people working collectively and consensually. But culturally we are more individualistic and less likely to necessarily be collective as the people like to do their own things. So yes, there is a cultural reason why this may work well in Sweden. It may work well in the UK but I think in the Swedish situation there is probably a link between the application of this kind of a model and the cultural mind-set”* *(Urban Economics Advisor)*. This view was supported by a PFM interviewee who stated that the complication of this approach is being seen by the attitude of the GLA, the largest fund holder in the UKMBA. GLA, while trying to *“push the agency”*, was openly telling *“the end of the world was nigh for the sector financially. Yet they do not sit very comfortably together but of course they were in there lobbying for more money at that point so even an organisation with possibly the largest financial interest in the agency working, was also undermining its credit score at the same time for one reason or another” (PFM).*

The individualistic approach by some LAs was presented as one of the justifications to undertake the single-lane issuance. A CRA representative mentioned that single-lane issuances are sometimes driven by the motive *“to be out there first and you want to have signals about your ambition”*. This was criticised by a GLA strategic advisor, as UKMBA will always be cheaper. The motivations for a single lane issuance were questioned, due to the ease of PWLB borrowing, and it was felt that there was no clear evidence of its advantage:

*“I am slightly concerned about it. Sadly, there is this element in local authorities that there are finance officers who gain personal satisfaction from doing something complicated. And if I were a taxpayer then I would be troubled by that behaviour. But there is unfortunately a history of that happening. People doing things in a way that is too complicated too costly and that is arguably what happens. And the single lane issuance has always to do with the ego of the people involved in it. I have never seen an occasion where really there is a good argument for single lane issuance” (GLA Strategic Adviser)*

Similarly, a housing association representative stated:

*“there’s a lot of ego involved in this business as well in that people will try and do their own bonds, either for the financial officer’s CV to make it look good or it just is ego to say you did one. So, quite often the aggregator is commercially the better product” (HA2).*

A THFC representative explained that like HAs, LAs are *“very free spirits”*. There is a lot of rivalry between them as they are politically orientated and trying to prove to their *“political master”* that they can do better than their peers. Therefore, instead of aiming for a collective strategy, each LAs leadership aims to do things distinctively so investors can perceive them differently *(THFC)*.

On the same point, a CRA representative stated that *“the ethos of the UKMBA is about the sector exercising power and Con-solidarity and so it is about people being part of that” (CRA)*. However, the final decision between UKMBA, single-lane, or PWLB is very much driven by the decision makers in LAs. It was predicted that the very same reason that Kommuninvest enjoys a *“working-together”* culture might be the same reason behind the lack of momentum enjoyed by UKMBA *(CRA)*. This goes further in Sweden, as both single-lane and Kommuninvest have successfully managed to place pooled issuance that combines both LAs and HAs. Kommuninvest’s business module is built on having no link between borrowing and funding as they pool green, housing, LA’s and its subsidiaries’ borrowing all together *(Kommuninvest 1, Sweden LA)*.

# 8.2 Social and Green Bonds

This section covers how thematic bonds, mainly green and social bonds, would shape the strategies and interests of different levels of actor.

## 8.2.1 Green and Social Bond Investors

The strong presence, and therefore market demand, for Green and Social (GaS) bonds was a point of agreement for various stakeholders *(Urban Economic Advisor, Academic 1, PFM, Intermediary 1, Intermediary 2, MHCLG, Sweden LA, Kommuninvest)*.

### Existing Demand

It was agreed that the English market does not lack interest from investors who are keen for GaS investments, which have positive impact on the society, environment, and community *(Urban Economic Advisor, Academic 1, PFM, Intermediary 1, Intermediary 2, MHCLG)*. A comment from a PFM representative explained the market appetite for GaS bonds as follows *“There are big pools of green money out there that can’t find a home. There are people who have created funds for green investment and can’t find anywhere to put it” (PFM).*  This view was supported by an academic who stated that investors would prefer GaS features to be associated with their investments, as this provides its own rewards in investors feeling positive about their community and society contributions and not only for marketing perspective *(Academic 1)*.

### Demand Growth

The interest in green bonds in Sweden is constantly increasing due to the prevailing practice by investors to set aside specifically green bond portfolios. The green bond trend is being described as *“very strong”* in Sweden. The base of investors is not only large in terms of investor numbers, but also the scale, investors being either large entities or pension funds. This made it very easy for LAs to lower their debt costs because of the existence of investors who are willing to accept longer terms and even less returns *“few basis points”*, as long as the bonds are green *(Sweden LA)*.

The expectation for England is that the financial market will have an increase in need and demand for a GaS investment. Despite the strong suggestions that the market would still have high demand on products that offers the highest returns, there will always be investors who are keen to invest in GaS bonds, due to corporate strategy and embedded social responsibility *(Intermediary 2)*. One example is the European Investment Bank who is increasingly interested in social, affordable, and green housing projects *(HA4)*. Therefore, MBs featuring GaS aspects would represent a more attractive option for investors, as opposed to normal, non GaS, municipal bonds *(Intermediaries 1, HA2, HA4, Urban Economic Advisor).* In England, Sir Merrick Cockell, UKMBA Chairman posted on LinkedIn that there is strong evidence that investors are seeking quality *“near-sovereign”* bonds, including verifiable green bonds ([Cockell, 2020](#_ENREF_62)).

This appetite is predicted to continue, even in the case of GaS bonds offering investors lower returns, provided that they are still commercially and financially attractive *(Intermediary 2, Urban Economic Advisor)*. A PFM representative explained that both Kommuninvest and other LAs in Sweden, have undertaken numerous GaS bond issuances which reflects the strong market demand for them. The UKMBA would still be able to present GaS bonds as part of its portfolio, as in addition to positive press reports, many investors and individual are making *“regular calls”* directly to the Agency looking for GaS bonds. Even a small-scale community bond with *“with relatively attractive rates of interest would still work”* as it is a *“win/win”* situation for the LA and community *(PFM)*. However, a THFC representative stated that investors, although attracted to GaS bonds, also seek higher returns. Therefore, a combination of both is required. Please see Green and Social Bonds Investors, page 70.

#### 8.2.2 Green and Social Bond Issuers

English LA history is full of examples where GaS bonds have been used, but on a limited scale *(MHCLG, LA 2, Urban Economic Advisor, PFM)*. Due to the high demand and strength of the trend, which is expected to grow further, most Las are achieving better pricing on their issued GaS bonds (*Sweden LA)*. More potential savings on the GaS bonds are associated with credit assessment. Although credit rating is mainly about the issuer's ability to repay the debt, when it comes to the public sector, the social impact is also taken into consideration in CRAs methodology *“what you are raising the bond for and why you are taking on debt and how you spend it might have an impact on social outcomes”*. There is a separate assessment for green bonds that CRA opine on the bonds’ greenness level and the use proceeds *(CRA).*

##### Motive

The recent MHCLG guidance for LAs has incentivised them to be greener and have more of a social conscience in their investments. The general message is for LAs to explain those investments to their public, especially if they look like a *“bad investments”* financially, by demonstrating their social and/or environmental benefits and emphasising that these investments are not *“just purely for profit”* *(MHCLG)*.

The limited use of social impact bonds may be due to the lack of motivation for LAs, as they were always able to borrow from PWLB very cheaply anyway; therefore, they have not had to seek alternative funding sources. LAs might also fear that their GaS bonds would be perceived as being to enable them to achieve cheaper funding, and not as part of their genuine responsibilities “*payment by result and another contract rather than a genuine social impact bond” (LA 2)*. This view was supported by a GLA Strategic Advisor, who stated that this is core to LA function, and therefore the motive behind GaS should never be solely to drive costs down, as it should be part of their current role *(GLA Strategic Advisor).*

LAs purpose is already socially driven, and therefore it is widely expected GaS bonds to be perceived even more positively by the sector and investors *(LA 2, HA1)*. This view was echoed by a representative from Kommuninvest who argued that LAs are already carrying out activities that are socially and environmentally positive. Therefore, they are rightly positioned in the middle of the transition to sustainability that is taking place worldwide. This is further proven as most of GaS bonds issuers belong to the public sector *(Kommuninvest).*

In the UK, the existing applications of social impact bonds and social investment bonds are extremely complicated, leaving LAs with a risk of securing the potential savings. Despite the limited impact and current use of GaS bonds, there is still great potential to use social bonds for social policy and broader economic goals *(Core Cities Group).* A representative from PFM echoed the same by arguing that GaS bonds has the full potential to be implemented in wide range of projects. Therefore, there is no reason why LAs cannot undertaken GaS bonds in an aggerated manner to *“fill the blanks”*, which is a common practice in the US *(PFM)*, especially as those *“blanks”* are not being covered currently by any product offered by the PWLB *(MHCLG)*. Please see Green and Social Bond Issuers page 71.

##### Reporting

Despite all the positivity around GaS bonds, they are not problem free. Many stakeholders suggested that, despite the savings potential, a key problem lies in the high level of post-issuance workload and administration *(Sweden LA, Urban Economic Advisor, MHCLG, UKMBA, PFM)*. The issuer is normally liable to continue publishing *“investor letters”* every year, showing the projects the funds are being spent on and what the environmental or social benefits of investments are. This formulates part of the investor commitment, and evidences their investments environmental impact *(Sweden LA, Urban economic advisor)*. This leads to the necessity of different stakeholders involved agreeing on a mechanism and method of monitoring and evaluating the impact and outcomes both socially and environmentally *(Urban economic advisor, MHCLG, UKMBA, PFM).*

A representative from UKMBA demonstrated the difference between issuing social bonds and green bonds. It would always be possible for UKMBA to issue good social impact bonds, as social impact is already embedded in the Agency’s mission. However, green bonds demand Tracking of the *“physical pound movement”* from investors all the way through to Councils, to ensure the very same pound would be spent on the green project. This requires the *“correct checks”* to be in place to ensure that the money raised by UKMBA is going to be invested in green projects with green impacts, which may prove to be difficult *(UKMBA).* An example of this is as follows:

*“It is a bit like the electricity. If you talk about green electricity; you’re buying green electricity from a supplier, but in reality, the electricity is going into your building which is basically straight good old-fashioned brown electricity, because the green electricity comes through the same pipe as all the dirty electricity. So, that is sort of the same issue where it has been bond from an older trail perspective, just actually ensuring that the money that you borrow in a green fashion is used in the green fashion and you can’t” (UKMBA).*

This view was echoed by housing experts who explained that using GaS bonds as an innovative instrument is quite costly for issuers, and very complex to administer. Therefore, post issuance, an issuer needs to invest in evaluating and recording the impact of those bonds according to each investor requirement (HA4). The challenge is not in applying a green or social bond framework to an entity, but rather in proving those impacts to each investor *(HA1).*

# 8.3 Summary

This chapter, in line with the fourth level of Healey (1992) framework, has covered important aspects of the development of the bond market in England as related to the formal and informal rules and ideas prevailing in the market, and effects different stakeholder actions and strategies.

This chapter explained how Local authority strategy and behaviour towards bonds was not determined only by rational decisions and other players behaviours, such as PWLB, but also are subject to the wider social world, either implicitly or explicitly. LA decisions and attitude towards bonds were constrained by the informal political and social environment contexts that had a fundamental impact on how the bond market is developed and accessed by LAs in England. Such factors were related to LA knowledge and understanding of bonds and the bond market, the long reliance on the PWLB as an easy and quick source of funding, the quality and specialism of in-house expertise, and leadership ambition and risk tolerance.

In addition, the prevailing culture in both English society and LA, means that there is less inclination to work collaboratively and collectively on issuing bonds, and consequently on the role of the UKMBA. The UKMBA function is also challenged by structural difficulties related to the economic and credit gap between different LAs in England, the impact of Brexit, Scottish Referendum, and the difficulties in mixing different LA debt across the UK.

Bond programs that carry green and social features are expected to succeed in England, due to the strong indications of an existing demand, as well as anticipations of the growth in that demand. GaS bonds have a great potential to be undertaken by English LAs to assist them delivering on their roles and responsibilities. Furthermore, featured bonds such as GaS can enhance LA credit rating and allow them to access debt at lower costs, due to the high investor demand. Nevertheless, such bonds often require extra resources post issuance for the reporting and monitoring of the *‘greenness’* of the funded project outputs.

The next chapter builds on the; description of bond market development, the analysis of the key players and their interactions in Chapters 5 and 6, the analysis of the bond market barriers in Chapter 7, and the analysis of the formal and informal rules that inhibit the bond markets stakeholders and players in this chapter. Therefore, the next chapter will summarise the thesis by identifying the significant features of municipal bond market development in England, and provide some implications of such features on the overall development of the English municipal bonds market. The following chapter will identify the theoretical contribution of the application of the historical institutionalism theory and the proposed framework on the bond market in England.

# Chapter 9. Conclusions and implications

# 9.1 Introduction

There has been a growing interest in how finance has changed practices and orientations in LAs, and there has been a noticeable growth in financialisation literature. Financialisation played an important part of the meta-context of this thesis and feeds into the way the study was approached. However, this thesis takes a different approach, by attempting to address the impact GFC had on Local Authority finance, evident in the changes in central government spending, lender behaviour, and financial market practices. In England, local authorities have suffered drastic cuts in central government grants and subsidies as part of strong austerity measures. Furthermore, banks had to change their lending terms to LAs as they were unwilling to expose themselves to LAs long-term risk, meaning less attractive financial products available in the market. Although PWLB remained the main accessible lender to LAs in England, concerns grew about its products suitability, its role as a central government tool, and the risks associated with overreliance on it as a lender.

Municipal bonds are tools that have been employed in different countries and in various governmental contexts. If developed soundly, the MB market can offer an efficient and tailored funding solution that fits with LA needs and projects. On the other hand, sceptics about MBs argue that MB market development varied drastically in its success to deliver the desirable outcomes, and in some scenarios, failed to stand up to expectations. Therefore, this thesis represents a micro-study that is seeking further understanding of MB market stakeholder roles, and social relations within the institutional context of LAs in England. The increased applications of financial instruments such as municipal bonds in the public sector is seen as a *“financialisation”* phenomena; a reflection of the growing role of the financial market motives, and its dominance in public sector. Hence although this thesis has arisen as a result of the financialisation phenomena, is not designed to contribute to financialisation literature and discussions. Instead, this thesis aims to address the uncertainties associated with MB applications, by seeking further understanding as to whether MBs could be used more widely in different governmental contexts in England.

This aim is achieved by answering to a number of objectives:

* Mapping the available different MB’s models in different governmental contexts,
* Developing an understanding of the features, characteristics, advantages and disadvantages of bond applications, and the way each has been developed and shaped,
* Evaluating what works well and works less well in cases where there has been a successful MB process introduced.
* Establishing an understanding of the barriers faced in different MB models, how they act as blocks in the MB market, and identify the way forward to overcome these barriers, and
* Explore the implications for different stakeholders who may be involved in future application of MBs.

This thesis applied the Historical Institutional Theory to understand the use and applications of MBs in England. The use of HI theory helped in understanding LAs as entities who follow certain rules, while at the same time aiming to maximise their benefits. It allowed the assessment of LAs as bodies that are embedded in various social, economic, and political relationships that are in most cases forced upon them ([Bell, 2002](#_ENREF_24)). Furthermore, the application of HI theory helped in seeking further understanding of LA choices in issuing bonds or otherwise, along with the reasons behind such decision ([Steinmo et al., 2008](#_ENREF_280)).

The theoretical position of this thesis has been used to develop an analytical framework which views social and institutional interaction between a complex array of stakeholders at different levels. The framework applied in this thesis was developed by [Healey (1992)](#_ENREF_116), and it consists of a four level model that allowed in-depth understanding of MBs within their urban and political economy, also while considering the social relationships that govern the actors involved. The first level addressed the main activities and relationships that affects the progress and outcomes of bond market development. The second level covered the analysis of the key actors and stakeholders and their roles in the development of the bond market. The third level carried out an in-depth assessment of the municipal bond application barriers and discusses the means to overcome those barriers in the English bond market, along with MBs advantages and disadvantages. The fourth level shows an analysis of social relations, including the formal and informal rules and ideas that affect the development of the municipal bond market and constitute the strategies and interests of the bond market actors. In addition, the fourth level evaluated the different stakeholder orientations towards featured bonds, such as green and social bonds.

Both the theoretical position and the analytical framework served well to allow the required examination of MBs. Firstly, it allowed actors behaviour to be analysed, by considering historical development of events in the market rather than predictions of the future. It helped to see the value of path dependency of different actors and how that affected, and still affects, their strategies and actions. Secondly, it allowed the work to draw parallels, where possible, between the Swedish bond market, the English housing bond market and English municipal bond market. Furthermore, cross-LA analysis in England was completed, which allowed further understanding for the variance of their actions in the bond market. Thirdly, the thesis approach lent itself well in defining the different barriers faced by issuers in the bond market, and an evaluation of the ways and methods in which such barriers can be overcome, or at least mitigated. This helped in unveiling the role that can be played by different stakeholders, eg market makers, aggregators and banks, to assist in overcoming market barriers. Fourthly, the assessment of LAs in England was carried out in a way that considers the social, political, and economical contexts in which they are governed and affected by in their decision making process and its outcomes.

The case studies were carefully considered, and they allowed in-depth analysis of the MB market in England by cross-checking the evidence gathered from other governmental contexts. Along with the English LAs, the other two case studies were the Swedish MB market and the housing sector bond market in England. While the former allowed the drawing on international lessons from the Swedish LA sector, the analysis of the housing sector bond market allowed further understanding of the context of bonds within England. This strengthened the thesis analysis by building on the similarities and differences between LAs in England and Sweden as well as between LAs and HAs in England.

Data was collected from industry documents and in-depth semi structured interviews with elite members from different stakeholder groups; part of the MB market, or those who have an influence on the application and development of the bond market in England and Sweden. A total of 24 elite interviews were completed in the period between January 2018 and March 2019, and included six groups of classifications:

1. Five interviewees from the LA sector,
2. Three interviewees who work close to LAs,
3. Two interviewees from central government bodies MHCLG and PWLB,
4. Six interviewees from the housing sector in England,
5. Three market makers interviewees, including one from credit rating agencies, and
6. Five interviewees from aggregator agencies from Sweden, UKMBA and the housing sector in England.

The thesis, by maintaining alliance with the conceptual framework in its design and conduct, helped to increase the case study design quality and strengthened the findings of this research. The data collected from all interviewees was then thematically analysed, guided by the four levels of the analytical framework. Perceptions collated from different stakeholder groups, and the available documentation, were then cross analysed using triangulation methods which helped to explore the key barriers faced in the bond market, and the ways to overcome those barriers.

This chapter provides a conclusion to the study and has four sections. The next section seeks to summarise the key findings by providing a brief overview of the answers to the key research questions. The second section considers the implications of policy and practice for stakeholders. It seeks to reflect on the specific findings and offer lessons at a general level for different stakeholder groups. The third section reflects on the theoretical approach adopted and considers the theoretical contribution of this thesis. The fourth section goes further to discusses the thesis limitations.

# 9.2 The main features of the municipal bond market in England

The exploration of municipal bond market development in England, along with evidence from both international applications and housing association applications, revealed key features of this market. Those features can be summarised as:

1. The impact of austerity on LA financial positions and so on bond applications,
2. Bond market actors and the role they play,
3. The advantages and disadvantages associated with MBs,
4. The main barriers faced by LAs in England and ways to overcome those barriers, and
5. The role of formal and informal ideas, rules, and norms in the bond market.

## 9.2.1 Austerity and bonds in England

Local authorities financial position in England has been heavily impacted by austerity measures. Along with the limited taxing powers, their position was affected by the reductions of central government grants and the reduction in the level of freedom attached to those grants. Furthermore, human resources and in-house expertise were affected adversely, leaving LAs with less capability to act. The financial position was further affected by the increased usage of LA reserves under the growing pressure to continue their service delivery tasks. All of that increased the need for LAs to borrow to fund the delivery of their projects.

Municipal bonds are generally underused in England. Most LAs are reluctant to use bonds as they require a considerable amount of preparational work and upfront costs as compared to the PWLB. In addition, the credit rating and market monitoring might not suite every local authority. Some of the smaller LAs would not be attracted to the idea of obtaining a credit rating and would lack the benchmark size required for bonds anyway. This is evident by the fact that all previous bond issued by LAs in England were carried out by those sizable authorities who achieved a very good credit rating.

## 9.2.2 Bond Market Actors

1. Banks and the central government were seen as most powerful players on the issuers side. Banks, in addition to their role in facilitating issuance and provide access to investors, offer issuers market insights needed for a successful bond program. As they are permanently in the market, banks provide issuers with investor preferences and demands which enhances the issuers certainty.

Similarly, central government has a direct and indirect impact on the final credit rating granted to LAs. Central-local relationship, the freedom allowed to LAs, and the possibility of central government intervention to rescue a risky LA are all factors that affects the final credit rating granted to LAs. Furthermore, the credit strength enjoyed by central government indirectly affects LA credit rating, as CRAs would never give LAs a better credit rating than one given to central government. Therefore, LAs credit rating is linked to the overall credit quality of the state.

1. Investors are affected by the bond issuer profile and what it can offer in its risks and returns. Large pension funds are the main players on the investor side. They are in continuous need of safe investments that guarantees gradual increase in the returns. Therefore, bonds issued by LAs are expected to be met by a good demand from investors.

The UKMBA, once active, it is expected to appeal more widely, as it can match investor demand. In addition to that UKMBA, as an aggregator, would be able to provide investors with more confidence due to its cross-guarantee framework whereby pooled LAs guarantee each other. Although credit rating would still be the main driver behind investor demand and pricing, the *“popularity”* of a LA is expected to play a significant role. Therefore, there might be cases where a lesser known LA would pay more returns to investors compared to more well known LAs, even if their credit rating is similar.

1. After the GFC, banks were forced to reduce their long-term financial exposure to LA, and were unable to offer the stability and certainty previously offered to their borrowers. LOBO loans though witnessed some popularity, have been heavily criticised as overengineered and complex, working in a way that benefited banks and not the Local Authority.
2. The unique existence of the PWLB in England presented one of the strongest reasons why a very limited number of LAs have sought bond issuance so far. PWLB, as a central government tool, offers LAs easy, cheap, and quick access to borrowing. Therefore, English LAs have relied increasingly on PWBL as the main lender to the sector. Unlike other countries, by having access to funding from PWLB, LAs in England have never been under the pressure to seek bonds or take greater risks in their borrowing arrangements. However, the Treasury uses PWLB as a mean of controlling LA borrowing, which often results in higher costs when the Treasury is aiming to reduce LA borrowing. The problem lies in the fact that PWLB works as a ‘one size fits all’. Therefore, the change in PWLB pricing aiming to control overborrowing or decrease risk taken by certain LAs will affect all LAs in England and not only the risky ones.

The argument that PWLB leaves no gap in the market to be filled by bonds is not very strong. Despite PWLB’s features, it lacks the flexibility needed by LAs, which can be offered by bonds. Due to Local Authority borrowing needs to fund long-term projects, they often require a funding tool that allows delayed repayments until the project starts generating income. Furthermore, LAs would prefer a product that would allow inflation-linked repayments, whereby the cost of the debt grows in line with the project income. Both features are offered by bonds and not by PWLB products.

Despite the convenience of PWLB, developing a bond market in England will empower LAs with more options, should the PWLB stop or reduce its lending by increasing its costs. Nonetheless, the development of a bond market should not aim to replace the PWLB. The expectation for PWLB is for it to remain as the biggest lender to LAs, but bonds can fill the gaps left by PWLB and introduce healthy competition.

Considering the unique existence of the PWLB in England, and the previous limitations of its products and it being a policy enforcement tool, LAs’ over-reliance on PWLB limits their ability to act when needed. The PWLB had previously changed its position from a lender of last resort to a lender of first resort and there is nothing to stop it reversing the change. Should the treasury want to limit LA borrowing or should any change in the central government approach take place, LAs would run the risk of not having any alternative lender to fund their projects. This scenario has happened before even with the existence of PWLB when banks (post GFC) were not willing to be exposed to the risk of long-term lending to LA leaving the latter with unfair and risky alternatives such as LOBO loans. Therefore, developing a sound and functioning MB market would benefit LA by allowing them to diversify their borrowing portfolio and limit the current risk of over-reliance on the PWLB as a result.

1. UKMBA: Most LAs in England would have around £50m debt needs annually, far from the attractive £250m benchmark size. An aggregator such as UKMBA is essential for smaller LAs who wish to access the bond market. An aggregator is beneficial for both individual LAs as well as the sector in general, as it can offer LAs access to bonds at a lower cost, compared to single lane route, and achieve better discipline compared to PWLB.

UKMBA should be able to provide better funding stability by educating the sector and showcasing LA strengths. Essentially, UKMBA is expected to garner substantial interest from the banking sector, who would be keen to reduce its long-term lending to the sector, and at the same time keen to facilitate LA access to the bond market. With such interest from banks, the UKMBA should carry out an honest assessment with each LA and explain where and how bonds could work. As LAs in England are in need of political support and an enhancement of public image, UKMBA has a role in explaining to LAs the implications associated with carrying out the credit assessment.

LAs in England suffer from lack of expertise and required capacity to engage with the bond market. This is a result of austerity measures that hugely affected their in-house resourcing. In addition to that, the long reliance on PWLB as an easy source of finance meant that LAs did not even need such capacity. UKMBA, by having all resources and expertise needed in place, would be able to take most of the work from LAs, and allow them to access bonds, thus diversifying their debt portfolios.

Tailored funding is another feature of bonds that UKMBA can provide to LAs. Although UKMBA should be able to provide funding that fits with borrowers terms and needs, in some cases individual LAs need to consider not only their needs, but also those of others in the pool. Furthermore, the UKMBA ability to pool bonds may be limited by the differences between the four countries, regions, and even between LAs where there are considerable disparities. Such mixing might result in mixed risks from an investor perspective, leading to less efficiency.

The joint and several guarantee scheme caused major concerns to individual LAs who were unable to commit. Not all LAs were comfortable with the unlimited responsibility posed by the scheme, especially given that many risky LAs were already UKMBA members or shareholders. As the joint and several guarantee scheme caused further delays to the UKMBA start, it had to be replaced by a proportionate-guarantee scheme, which was easier for LAs to accept. Nevertheless, the original scheme aimed to reduce borrowing costs by achieving stronger credit for the UKMBA. Therefore, it is not yet clear as to how much of an impact the new scheme would have on both credit and costs.

Even for large LAs who do not lack debt size, credit quality, or in-house expertise, UKMBA might still prove to be useful. As well as the fact that not all LAs would be able to issue regularly without a considerable time gap, LAs would also struggle to maintain their engagement with the financial market. For those LAs with similar credit rating to UKMBA, the latter can achieve better pricing in some cases due to the economies of scale. Those two reasons justified why Lancashire County Council undertook a single bond issuance via UKMBA.

The challenge is for UKMBA in achieving a debt cost that is cheaper or close to PWLB costs whereby the latter fluctuates subject to Treasury policy. Therefore, even if the UKMBA managed to lend to LAs at a cheaper price than PWLB, if the Treasury wants to limit such access to UKMBA, they can reduce PWLB costs making bonds an unviable option. But before such considerations, UKMBA’s delayed start risks sending the wrong message to LAs, especially while PWLB is so prominent in the market.

1. Despite the acknowledgement that it takes a long time until an aggregator launches, UKMBA should be more proactive in its approach. The lack of communication with LAs is a major issue, as it seems many lack a clear view “I *don’t know what they are doing!”* *(Core Cities Group)* *“what are they doing? Why are they doing it? I don’t understand” (HA5*). Even UKMBA itself seemed to be underinformed about LAs needs, until UKMBA asked them in late 2019 about their perspective. This later resulted in major changes in the UKMBA approach, and possibly boosted the UKMBA first issuance in 2020.
2. Although this is not a housing research project, the study nevertheless reveals some lessons that could benefit the housing sector. Apart from those of large size, smaller English HAs struggled to access the bond market due to issues related to in-house expertise and capacity as well as the ability to issue bonds in a benchmark size efficiently. To overcome that, smaller HAs had to merge with other HAs to formulate bigger entities, pool their expertise, and be able to create a benchmark size bond. The use of the aggregator model applied nationally and internationally is found to have the potential to ease the pressure on the smaller HAs. Services offered by bond aggregators provides HAs with the legal, and administrative expertise, reduces paperwork, and allow them access to the bond market with smaller bond shares when aggregating different HAs needs to reach a benchmark size issuance.

## 9.2.3 Municipal Bonds Advantages and Disadvantages

English LAs exposure to a bond market would enhance their discipline, accountability, and governance similar to private entities. The result should give them the ability to borrow at better terms, and therefore enhance their funding efficiency. This is not limited to the debt costs but is extended to cover the risk associated with such costs. While banks undertake long-term lending, subject to periodic reviewal of the interest rate, bonds are designed to last for longer time, which allows LAs more certainty and better risk management.

Although LA debt in England is part of the national debt records, there is a distinct possibility for a change, considering the similar reclassification that took place with housing sector debt. The change works in favour of both central and local governments in terms of debt costs. Should such change happen in the future, PWLB’s debt would be disadvantaged. LAs would then benefit from an active bond market rather than being left with uncertainties.

Bonds are certainly perceived to be a more complicated and time-consuming funding tool by most LAs in England. This might well be because they remain untested, due to the existence of PWLB. Nevertheless, the evidence from English HAs, as well as Swedish LAs, shows that bonds are simple financial tools once been understood by borrowers *“So, a bond, it’s a simple instrument” (HA4)*.

Another disadvantage is associated with bonds costs. This is both the reoccurring upfront cost each time a LA seeks bonds, as well as the post issuance costs to maintain the bond program.

The two disadvantages were found to be linked, and the existence of UKMBA would help to minimise their impact. UKMBA, by carrying most of the workload, should be able to simplify the process, reduce the timeframe, and reduce fixed costs associated with bonds.

Market dependency is not an advantageous feature of bonds. As a bond market is usually dominated by a small number of large investors, the demand and costs are, to a certain extent, controlled by those investors. The Sterling market is much smaller than Euro or Dollar market. Sterling investors are more powerful, leaving LAs with unsure about the actual demand, timing, or costs. Such impact can be mitigated by the UKMBA who would be able to widen the bond investor base by seeking international investors.

# 9.3 Implications for Stakeholders

The following section draws on the thesis findings to explain the implications for bond market stakeholders, and the lessons that can be learnt to overcome market barriers. This section will focus on the main barriers suggested by the literature and propose tools that would assist practitioners to overcome said barriers.

### a) Transparency

LAs in England provide a wealth of information that is available publicly. Such existing levels of information are thought to be healthy and adequate should a LA wish to issue bonds. It is notable that the general demands for more transparency for the purpose of scrutiny might not be necessarily needed by bond market players.

Both CRAs and investors require specific types of information that may not necessarily exist in the form needed, but such information will ultimately be the result of LA engagement with the capital market and arguably boost the existing levels of transparency.

When it comes to bonds, a unified code of practice would be useful to guarantee consistency in information supplied, using a standardized information channel. Instead of a mere increase of information supply by LAs, an organised code that would guarantee simple, quick, and useful access to information would be preferable.

Ideally, the role of UKMBA would be to take some of the burden of transparency to the public from Local Authorities, and also to increase transparency within the pool. In the first instance, UKMBA would organise, present, and communicate data in a roadmap to investors in a way that makes a LA investable. Secondly, UKMBA should aim to increase the level of transparency provided by each LA in the pool to each other, as well as to the UKMBA. This is of great importance considering that both UKMBA and each LA in the pool are guaranteeing, via the joint and several guarantee or proportionate guarantee scheme, to pay the debt (or part) should any LA default on repayments.

### b) Certainty

Bonds timescales are considerably longer than any other sources of debt, ie funds provided by PWLB and banks, meaning certainty levels associated with bonds are considerably lower. Such uncertainty is not related to investor demand but is more about what price such demand exists. Municipal bond pricing is affected by many variables, such as the number of investors and their appetite, central government gilt costs, and the timing of issue. Therefore, demand certainty is factored in to the competitive offering each issue provides.

More risk lies in the fact that the final pricing on the day of issuance may not present a very good value for money. But as most of the upfront costs have already taken place, it may be hard for an issuer to pull out on the day.

One way to reduce such uncertainty is by reducing the timeframe for any bond issuance. The UKMBA, unlike a single LA, by being permanently in the market would be able to offer more certainty regarding timing, as it requires reduced documentation and a standard procedure. Certainty can be increased by maintaining a close relationship with market makers, intermediaries, and banks. Such relationships would need to be long lasting and based on honesty and fairness. Similar to UKMBA, market makers are constantly in the market and closer to investors. Thus, they will be able to provide information about investors demand and market pricing.

Linking bonds to the right project will result in better demand certainty. Investors, although looking for safe and profitable investments, will consider the project on which the money will be spent. While infrastructure and housing projects are well perceived by investors, commercial investment is not. Therefore, the demand and pricing would vary considerably in line with the project funded. Both UKMBA and LAs would have to ensure that they communicate planned funding projects to investors, while ensuring that they educate them about the sector strengths.

### c) Credit Rating

Credit rating is a time consuming and costly process, but at the same time it is essential for any engagement with the financial market. The LA sector carries very strong creditworthiness under the current debt framework, the Prudential Code, and their taxing power. With that in mind, the existence of PWLB as a last resort, and the possibility of central government intervention, both add to the sector creditworthiness, making the idea of bankruptcy almost impossible.

All LAs in the UK who have sought a credit rating have achieved a good rating. However, what is unclear is whether the decision of the remaining LAs not to seek a credit rating is motivated by their disinterest in bonds or by an actual lack of creditworthiness.

It is a fact that investors require credit rating to be in place before investing. But the credit rating result is not the only factor driving demand. In England, not much quality debt, such as MBs, exists. Investors are aware of the sector strengths, therefore, their demand on such bonds is expected to be high, sometimes overriding credit rating considerations.

The existence of UKMBA and its AA3 rating means that LAs in England can access bonds at a cost close to sovereign debt, even if their own credit rating is lower than that.

While credit rating is a must, a number of concerns prevails about its credibility and validity. Unlike other countries, such as Sweden or the USA, the English bond market has not been active enough to allow CRAs the engagement needed to understand the sector; their lack of understanding plays a negative role in the bond market. Along with the different levels of understanding between various CRAs, the way in which information is interpreted varies, which leads to a variety of different outcomes. This puts LAs under more pressure to be rated by different CRAs simultaneously. Such practice is unjustifiable as it adds costs without any real understanding of what impact would have on investor attitude.

### d) Costs

The cost associated with any funding source is the strongest factor to consider when a Local Authority evaluates different funding products. Any bond program has to present a potential for achieving good value for money as compared to other sources, mainly the PWLB. The pricing of PWLB, despite the fluctuations, would always be used as a reference point for any bond costs.

While PWLB offers almost a daily interest rates, bond costs are uncertain until the deal is completed. All previous bond issues in England were either cheaper or equal to PWLB rates *“either beaten or equalled the 80 basis points over the gilt that PWLB does”* *(UKMBA).* Nevertheless, a bond program cost is not simply the returns offered to investors. Unlike PWLB, any single-lane bond program consumes a considerable upfront cost associated with obtaining the credit rating and the legal work involved. Even when accessing bonds via UKMBA, each LA has to pay either a membership fees or a premium on price if not already a shareholder at UKMBA.

A cheaper funding source does not automatically mean that it represents a more efficient source. For LAs in England, efficiency can be achieved by matching each project to the right source of funding. Considering the flexibilities offered by bonds, such as tailored terms, matching assets with liabilities, the long-term fixed costs, payment holidays, and being inflation linked, bonds are highly advantageous in their efficiency.

The UKMBA has a role in reducing the costs associated with bonds, but mostly for small LAs who lack the benchmark size. Despite the expectations of an expensive start, gradually UKMBA should be able to provide LAs with cheaper borrowing as it builds its market presence and gets to know its investors.

The lack of MBs in England means that investors might be underinformed about all sector strengths. Therefore, UKMBA has a role in educating investors and boosting their confidence. By doing so, UKMBA will create a floor price not only for its bond programs but also for other single lane programs.

Swapped issuance is one of the methods that can drive the cost of bonds down. It entails issuing bonds in foreign currencies whereby the demand will be higher, and hedging the debt back immediately to the local currency. This would not only help in overcoming any national currency limitations but also essential for introducing competition to national investors.

In the Sterling case, investors are already very limited in their number, and the practices demonstrated in the housing sector, i.e as investors control the demand, they have an influence on price. MBs would only add to the supply side, seeking international investments via swapped issuance might prove to be essential.

Nonetheless, the impact of swapped issuances on efficiency is questionable, as both issuers and investors would bear extra currency risks. Although issuers can eliminate such risk by hedging, investors would require their risk to be reflected in the returns. This might limit the overall efficiency of such a swap. Therefore, banks can mediate the risk by swapping the bonds at their end, so investors are not exposed to currency risks.

Swapped issuances are not available for LAs in England as they are prohibited from issuing debt in any foreign currency without Treasury consent, however, the UKMBA is not. Therefore UKMBA, who has the expertise needed and the market presence, would overcome the risk and legal difficulties associated with swapped issuance, and grant LAs the needed access to international investors.

### Liquidity

Both primary and secondary market liquidity levels are unclear when it comes to the MBs in England. Primary market liquidity assessment requires an active market, and it is determined by investor demand. While bonds should represent an attractive risk-return equation to big investors such as pension funds, LAs who lack the expertise might struggle to present their bonds as an attractive option. Such liquidity grows with rapid and regular issuance. UKMBA, with the potential of issuing rapidly and regularly, would create an active market where its investor pool incorporates international investors.

Although it is important to have a good secondary market liquidity level, investor practices play against that. Most bond investors are large pension funds who practice a *“buy and hold”* approach. With the fact that investor income from bonds trending upwards over time, they do not intend to sell their bonds unless they have experienced some financial difficulties, which may be rare.

The lack of issuance contributes further to such illiquidity. Bonds are usually utilised by LAs to fund an asset that is designed to be long lasting. Therefore, the possibility of reissuance is not high for any single LA. This is evident by the fact that most LAs in England who have issued bonds previously have not issued since.

To enhance secondary market liquidity levels, there has to be more issuance in the market. But even then, SML levels might still be low. Therefore, the role of market makers, banks, and aggregators is essential. As they are engaged with the market continuously, they would be able to supply both issuers and investors with the secondary market information needed for any secondary market transaction. With the increased information supply, more clarity is provided for secondary market buyers and sellers which would ultimately help to increase the SML levels.

### Formal and informal rules, ideas, and norms of the MB Stakeholders

This research has revealed some ideas and assumptions that reside in the bond market and exist amongst different stakeholder groups. Such ideas are significant in their contribution to the lack of MBs issued in England.

* **Local authorities**

Due to the existence of PWLB, most LAs in England did not have to engage with the financial markets or speak its language at all. Their knowledge of bonds, as opposed to the housing sector, is primarily filled with expectations around bonds being difficult, complicated, and expensive borrowing tools. Therefore, UKMBA has a great role to play in educating the sector and simplifying the overall process.

Along with the variance in English LA size, resources, and problems, the in-house expertise and the quality of such expertise varies considerably. Most small LAs would lack such expertise, not only due to the austerity measures but also due to fact that they have not needed this expertise previously. The existence of UKMBA means that this should not be a barrier for small LAs from accessing bonds, as UKMBA would undertake most of this workload, having all the required expertise.

Even when they have in-house expertise, structural difficulties contribute to the difficulty Local Authorities have in undertaking a bonds issuance. While senior management would struggle to convince politicians to agree on taking the risk to issue bonds, others would fear that a successful bond program could signal the ability of LAs to maintain financial autonomy, leading to further reduction in the central government grants.

* **Investors**

The role of LAs in England as service providers and tax collectors might make them less exciting from an investor perspective. Investors do not wish to invest in entities they do not understand, and such lack of understanding is found in the LAs sector in England. It is a multi-layered structured sector, and the responsibilities of each layer are not very clear. Therefore, its vital for the LA sector to communicate with its public and investors a clear boundary of responsibilities and simplify its structural complexities.

UKMBA can play a role in marketing LAs, and the sector, in a way that makes them understood by investors. Nevertheless, both English LAs and UKMBA would face another structural problem when pooling finance, should the pool contain LAs from any of the other three countries in the UK. Such practice is not expected to sit well with investors, as the risk level from each country would differ greatly. Therefore, to achieve the best possible efficiency via UKMBA, it is in the best interest the members of each pooled issuance to be close to each other in terms of their risk profile, and therefore their credit rating. Furthermore, those within a pooled issuance should belong to the same country, ie England, Scotland, Wales, or Northern Ireland. Any mix of authorities that includes LAs from the different countries within the UK would result in less favourable, pricing due to the mixed risks.

Culturally, LA structure in England, and the surrounding society in general, are believed to have an impact on the bond market. The development of an active MB market is subject to either an active single-lane issuance or aggregator, neither of which are active in England. Furthermore, LAs in England are unlike their US peers who are individualistic in their approach and oriented by the financial market, nor like Swedish LAs who are led by consensus, as shown by the role of Kommuninvest. Such factor is undermining the performance of UKMBA when trying to pool different LA bonds together.

It is essential that LAs in England avoid unfavorable outcomes of such structural problems by avoiding undertaking the costly single-lane route, so long as UKMBA is active. Also, ambitious, and powerful leaders should not use bonds as a platform to increase their personal and reputational gains or to satisfy their ego by going with the single lane route.

Despite all of that, the two most recent issues that took place in the UK happened after the creation of the UKMBA are the Aberdeen City Council and Lancashire City Council issuances. Lancashire County Council, despite having the required debt size to take a single lane route, issued its bonds using the UKMBA. Aberdeen City Council went with the single lane issuance without the UKMBA, and such decision was well justified. Firstly, UKMBA did not market its services to Scottish LAs as they do not have the general power of competence to enter the JaS guarantee. In addition to that, Aberdeen City Council had all the facilities to issue on a single lane route; the debt size to issue in a benchmark size, the in-house expertise, and the strong credit rating that would make it more efficient compared to a pooled issuance. Therefore, it is expected that similar LAs in England would follow this template by issuing bonds on a single lane route and not via the UKMBA.

# 9.3 Theoretical Contribution

Not many studies have been done about the bond market in England. Some studies addressed the importance of socio-economic factors in the development of bond market *“A credit culture should be nurtured to encourage the bank disintermediation process, which will allow a corporate bond market to develop on the foundations laid by the aforementioned government bond market development”* ([Saidi et al., 2009: p27](#_ENREF_252)). Other studies focused more on the barriers that can be faced by any countries attempting to develop a MB market. Such challenges can be the cost of developing a bond market ([Cox and Schmuecker, 2013](#_ENREF_65)), the uncertainty about those costs and derived demand ([Cox and Schmuecker, 2013](#_ENREF_65), [Aidan et al., 2014](#_ENREF_9)), the credit rating and its validity ([Black et al., 2015](#_ENREF_30), [Yinger, 2007](#_ENREF_321)), transparency and its requirements ([Dunne et al., 2006](#_ENREF_79), [Ang and Green, 2011](#_ENREF_15)), and the lack of liquidity in the secondary markets ([Ang and Green, 2011](#_ENREF_15), [USAID, 2010b](#_ENREF_299)).

Additional studies, such as [Aidan et al. (2014)](#_ENREF_9), discussed the establishment of the UK Municipal Bond Agency and its functions within the LA sector [Bibby and Sharma (2014)](#_ENREF_29) debated LAs financial position and the need for a MB market in England prior to the initiation of UKMBA, and similar work is found in the LRD Report ([LRD, 2015](#_ENREF_156)). Some studies looked at green, social, and solar bond applications ([Bridge, 2014](#_ENREF_50), [Eichler, 2016a](#_ENREF_84), [Lab, 2016](#_ENREF_143)). Others assessed bond transparency, liquidity, and efficiency in the context of the EU ([Biais et al., 2006](#_ENREF_28)).

This thesis addressed bond market development in England directly and revealed the key barriers, the significance of each barrier within the sector context, and which barriers can be overcome and how. Furthermore, this thesis presented a new view as to how bonds would work taking into account the existence PWLB as a major lender to the sector, the advent of UKMBA, all of which while looking at the social norms, ideas and rules that prevail in the sector.

The austerity measures, continuous cuts in funding, and the increased pressure on LAs in England to deliver services and infrastructure, call for greater theoretical consideration and more pioneering empirical research to provide guidance, and explore implications for the development of a municipal bonds market. The third chapter, a theoretical review on the development of bond market in the UK and internationally, provided a basic conceptual framework for the following empirical fieldwork analysis. The empirical fieldwork analysis of an in-depth evaluation for the development of municipal bond market, its barriers, and solutions from an institutional perspective, has linked the abstract theories with the real world and contributed to the understanding of the development of municipal bond market in England in the following two aspects:

1. The application of the historical institutional theory on the development of the municipal bond market in England.
2. The proposition of a framework for the English MB market analysis.

## 9.3.1 The application of the Historical Institutional theory for the development of the municipal bond market in England

According to the neoclassical approach, players decisions are made within the market framework. This view states that development activity is initiated by demand, to which the supply responds at the right time, in the right place and at the right price ([Lichfield and Darin-Drabkin, 1980](#_ENREF_150)). Thus, actors strategies, interests and actions are in line with the context set by market signals, more specifically *“the price mechanism through which supply and demand are brought into equilibrium”* ([Adams, 2012: P66](#_ENREF_8)).

Nevertheless, the findings of this research suggest different story. The main players in the municipal bond market in England are not necessarily willing to, free, or capable of, responding to market signals. Despite the increased need for borrowing, reduced governmental grants, the fall in banks’ lending, and the lack of freedom associated with PWLB, LAs in England were not always able to respond to the opportunities offered by the bond market. Instead, some non-market mechanisms weighed substantially on the development of the MB market. Such example is found in the empirical analysis where actors, as human beings, did not live in a vacuum, and so their opinions and understanding were affected by their surrounding environment, which included other people, events, and ideas. Formal rules, such as the Prudential Code, MHCLG and Treasury rules, taxing powers, and public finance regulations all played role in development and access to the MB market by LAs. Informal rules played a role in actors decision making. Those rules are found in forms ambition, pride, risk tolerance, custom, and other psychological factors. Such role is found in the actors’ sentiments regarding the financial market, and bonds specifically. Those sentiments are affected not only by market conditions, but also by psychological perspectives built on familiarity, knowledge, education background, experience, and social customs.

The research findings suggest that the development of a MB market in England is more complicated than in other countries, or even compared to the housing bond market in England. The development of the MB market in England is connected to the economic, political, and cultural characteristics of the country. Therefore, such development should be analyzed and examined within the wider social structure.

The Historical Institutional approach follows inductive methods ([Hay and Wincott, 1998](#_ENREF_114)) and provides detailed definition of actors strategic behavior ([Hall and Taylor, 1996](#_ENREF_111), [Bell, 2002](#_ENREF_24)), which allows a wider understanding of which institutions matter, and also why they matter ([Hall and Taylor, 1996](#_ENREF_111)). Furthermore HI, by explaining the institutional change as a product of actors interests and previous arrangements that evolve over time ([Jevnaker, 2015](#_ENREF_123)), helped to accommodate the complexity of the LA finance in England, which is experiencing institutional changes with the ever increasing importance of the municipal bond market.

In this research, the Historical Institutionalism approach has served well to achieve the research objectives and to identify the significant characteristics of the MB market in England, the barriers, and the ways to overcome those barriers. Both formal and informal rules imposed considerable constraints on MB market development.

Central government intervention plays a considerable role in the fate of the MB market, as shown in the Treasury use of PWLB as a policy tool. The empirical findings have also shown the impact of the social structure, previous experience, custom, and psychological factors on any LA decision-making process, which is acknowledged by the Historical Institutionalism and rejected by the neoclassical approach. The historical institutionalism theory is identified to be appropriate and applicable to reveal the complexity of the municipal bond market in England.

## 9.3.2 A proposed framework for the English MB market analysis

This research reviews the development of various MB markets internationally. As no appropriate framework can be applied directly to the analysis of the MB market in England, this research tried to take a synthesis of a variety of models to incorporate them within the context of the LAs in England, thus seeking to build up a unified bond market model specific for the sector in England.

The theoretical review and empirical fieldwork suggest that any proposed framework for the MB market in England should be able to provide a clear format where two aspects can be merged together. The first aspect is the need to include actors and stakeholders informal rules and behaviour, and how they drive forces for the interests of those actors and their interactions with the wider societal powers. The second aspect of such framework should consider identifying those barriers that affect the development of a bond market and suggest methods by which they can be overcome, within the societal context in England.

The original proposed analytical model in Chapter 3 for the development of a bond market in England is applied to the literature review structure and empirical fieldwork analysis (Chapters 5 - 8).

The exploration of the bond market development in England described in Level 1 (The Environment) completed in Chapter 5 covers the events and activities related to the MB market and the key players that affect and/or affected by the MB market. Although the development of MB market in England might carry similar underlying features to other developed countries, variations are found in the following two aspects:

* 1. The unique existence and functions of the PWLB in offering LAs a great certainty over debt accessibility and cost of that debt, in addition to the non-compliance requirements. Such existence provides a good reason for most LAs to not even consider bonds as an alternative financial tool.
  2. The variation across LAs in England such as the different sizes, wealth, accountability, debt size, and human resources means that MBs are not suitable for every local authority.

The analysis of the players, their roles, and the relationships between them in Level 2 (The Actors) completed in Chapter 6 revealed the similarities and differences in the development of the MB market in England and Sweden. It is found that the key players in the bond market are LAs, banks and intermediaries, the central government, LGA, aggregators, investors (mainly pension funds), and CRAs. One of the strongest players in the market are banks, with their multidimensional role having an interest in reducing their exposure to LAs, facilitating the bond market, acting as intermediaries, and providing market information. Investor groups hold the other significant role in the MB market. Investors in England are considerably stronger than their peers in other countries due to their large size and small number. Such investors are limited to the big pension funds, who control most of the demand and therefore control the market pricing.

Similarly, the UKMBA role as an aggregator is different in some of its functions to similar entities such as Kommuninvest. Although there are similarities, such as UKMBA aiming to lend LAs efficiently, educate them about credit rating, diversify their borrowing portfolio and supply tailored funding, its role is subject to the characteristics associated with the existence of PWLB and the risk tolerance at the local level that eventually led to the abolition of the joint and several guarantee scheme.

The complexities of the bond market development in England results from its embedded correlations between LA structure, specific political and socio-economic contexts and the unique strategies and interests of its actors. Such complexities are reflection of environmental, cultural, political, and historical backgrounds as shown by the Level 3 (The Barriers) in Chapter 7. The analysis of the economic and social variables proved to be essential, mainly in understanding the Treasury (as represented by the PWLB) and their impact both in single-lane issuances and UKMBA bond activities. The analysis of the bond market development in England revealed the key barriers faced by different stakeholder groups, and how those barriers affect their strategies and interests. The findings suggest three elements in the bond market that may overcome such market barriers.

1. Market makers presented a medium through which transparency, liquidity, and certainty barriers could be lessened.
2. UKMBA, as an aggregator body that is owned by LAs, has a great role to play in reducing the impact and overcoming all identified barriers
3. Featured bonds, specifically green and social bonds, would help both LAs and UKMBA in reducing and limiting the impact of the four barriers being transparency, efficiency, credit rating, and certainty.

The social context analysis was undertaken in Chapter 8 (Formal and Informal Rules and Ideas) and looked at the role of culture, psychology, habits and personal motivations on actors decisions and actions in the bond market. Additionally, the role of existing human resources in LAs, their risk tolerance and ambitions should be considered when assessing the potential long-term development of the bond market in England.

Thus, based on the theoretical principles of the Historical Institutionalism approach in the third chapter, following the proposed analytical model, and taking into account the analysis of the case study in Chapters 5 - 8, the original model suggested in Chapter 3 is further developed into a new set-up. This new set-up focusses on the actor and structure dualism from a Historical Institutionalism point of view, where the new model utilises the strengths of the original model. This allows better understanding of the requirements of bond market development, with some substantial issues related specifically to England, stressing the situational and contextual considerations as emphasised by many previous researchers.

This framework applicable for set-ups whereby bond market development is strongly affected by social, political, economic, and environmental factors. The fundamentals of any applicable model of the bond market in England should enable in-depth analysis of the context through which actors strategies are shaped and influenced, and has a clear structure that can be followed easily to analyse actors strategies and interactions. Therefore, it is essential to have different frameworks with similar set-ups that are applicable to the analysis of the bond market in England. This is found in the following framework:

Figure 12 Proposed Analytical Framework for MB market development in England

**Inputs**

Project

Ambition

Debt

Expertise

**Outputs**

Freedom

Suitability

Project- Delivery

Scrutiny

Monitoring

Level 1: The Environment

Austerity, central government grant, human resources, service delivery, reserves, financial position, debt size.

Level 2: The Actors

Local Authority

Multi-dimensional relationship

Certainty

Liquidity

Costs

Credit rating

Transparency

Level 3: The Barriers

Aggregator

UKMBA

Social / Green Bonds

Market makers/

Banks

Level 4: Formal and informal rules and ideas

Understanding, Risk tolerance, structure, culture, GaS bonds

# 9.4 Research Limitations

This research is limited in several important aspects; the limitation in the time available for this research, the availability of the data, and the analytical skills of the researcher and the challenges of following a qualitative approach.

1. The first barrier was the scarcity of previous research and data available specifically about the bond market in England. In addition to that, very little is found on the relationship between the institutional environment and the different stakeholders in the bond market context in England. The lack of activities in the bond market itself contributed to the inadequate secondary data sources that are mostly found embedded in other consultancy style reports, or industrial presses, and not as academic research. Therefore, the researcher had to spend considerable time analysing such data and questioning its reliability and suitability for PhD research. As data analysis involved finding, coding, and categorizing data, [Yin (2011)](#_ENREF_319) stated that the researcher must determine which data is relevant and better in describing the phenomena. The analysis of the data itself required the researcher judgment in utilizing it in a form of individual participants or using cross-section analysis, and whether to use software or ‘hand’ methods to do that.
2. The analysis and findings of this research relied heavily on the data collected via interviews, and the empirical fieldwork was carried between January 2018 till March 2019. This period was associated with a lot of uncertainties for LAs with regard to Brexit, the associated political changes, and its impact on LA funding arrangements. This was followed in 2020 by the Covid-19 pandemic, which left lot of uncertainties and put all LAs under more pressure to deliver on social services. Therefore, interviewees responses might have reflected the influences that Brexit had on their perceptions, based on their experience, which could challenge the reliability of the research and the researcher’s analytical ability. This required the researcher to be very careful with the analysis to avoid such bias, and had to validate the evidence from interviews with other research resources to assure their validity and reliability.
3. The last limitation results from the use of qualitative approach in this research. This approach is fitting with enquiries that requires researcher flexibility and allows open ended questions to further understand the phenomena by allowing interviewees to use their own words while expressing their opinion ([Yin, 2011](#_ENREF_319)). Nevertheless, this approach might bring biased results ([Wallqvist and Axelsson, 2013](#_ENREF_307)) and raise ethical issues such as ignoring some selected set of data. ([Yin, 2011](#_ENREF_319)). The employment of the qualitative approach in this research challenged the analytical skills of the researcher with the requirements of being always neutral, provide a reliable and honest representation of the data, and avoid being affected by early evidence. The researcher therefore waited until all interviews were completed before doing any analysis.

Despite the above limitations that represented obstacles for the researcher, the researcher answered the research issues and investigated the development of the bond market in England using triangulations between different stakeholder groups during rapid changes in the political, social, and economical environment. The research findings can provide reference for both academics concerned with the bond market in England, as well as practitioners who are part of similar projects. Nevertheless, due to researcher limitations as a PhD student, as well as the research limitations listed above, there might still be misinterpretation and inappropriate presentation in this research, and any criticisms are welcomed.

Covid-19 may bring some systemic changes due to its impact on the financial markets and public sector funding more generally. For future studies, the impact of the Covid-19 pandemic needs to be examined in terms of its impact on local authority funding, as well as municipal bonds specifically. As the pandemic occurred after the completion of the data collection, and as its consequences are still unfolding, further research is needed to understand its impact on central government funding arrangements for LAs, and the impact of such changes on the bond market in England. This is essential considering the economic impact the pandemic has had, which is, so far, greater than the GFC’s.

What is the impact of the increasingly indebted state on local authorities’ finance? Would a further cut in grants result in encouraging local authorities to use bonds? What would be the PWLB response to the crisis, and in which direction would its products and lending terms go? How would the bond market and market makers (including UKMBA) respond to the crisis? All of these are questions that needs answers both in the short and long term.

Furthermore, the data collected comes from specific sectors, specific case studies at specific point of time. More case study work is needed in the future to analyse different sectors, countries, in different contexts and at time periods. There is scope to undertake more research on the bond market and the ability to collect more empirical data through a larger research project.

The thesis found some informal rules and ideas that resides in the LA sector. Such informal elements include confidence, ambition, and collective approach. In the future, a more in-depth analysis in relation to those informal elements is needed to specifically identify which relationships are most dysfunctional in the bond market.

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*With a spread of 100bps above comparable Gilt rate and savings of 73bps on yesterday's equivalent PWLB rate, the issue delivered significant savings for Lancashire.*

*On the evidence of tight pricing on both issues with strong investor appetite, financially sound local government has no reason to borrow at much higher rates in complicated structures.*

*UKMBA continues to work on bringing forward pooled issues*

*including verifiable Green Bonds.*: LinkedIn.

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1. **Satisficing** is a decision-making strategy that aims for a satisfactory or adequate result, rather than the optimal solution. This is because aiming for the optimal solution may necessitate needless expenditure of time, energy and resources. [↑](#footnote-ref-2)
2. *Arbitrage is defined as “the simultaneous purchase and sale of the same, or essentially similar, security in two different markets for advantageously different prices SHLEIFER, A. & VISHNY, R. W. 1997. The limits of arbitrage. The Journal of finance, 52****,*** *35-55.* [↑](#footnote-ref-3)