Evolution SECURITIES

Association of Retained Council Housing

The role of an independent financial advisor in potential funding decisions.

Agenda

- Financing challenges facing Local Authorities
- Case Study 1
- Case Study 2
- The role of an independent financial advisor

Financing challenges facing Local Authorities

- ***What has changed?***
  - Dismantling the HRA subsidy

- ***Creates new opportunities/imposes new challenges*** for Local Authorities.
  - Need to ***align long term borrowing costs*** with housing revenues
  - Manage a major ***one off change*** in the debt portfolio

- In a ***challenging market*** for debt
  - ***Increased cost*** in accessing the PWLB
  - Bank Funding ***less competitive***
  - Institutional/retail investors ***less flexible but hungry to lend***
  - Majority of 'long maturity' LOBOs ***now in call/reprice period***

- At a time of ***unprecedented uncertainty*** on interest rates/inflation

Decisions on borrowing in April 2012 will impact on the net revenues from Housing for years to come. Local Authorities have some difficult decisions to make ahead of the "HRA exit date"

Case Study 1

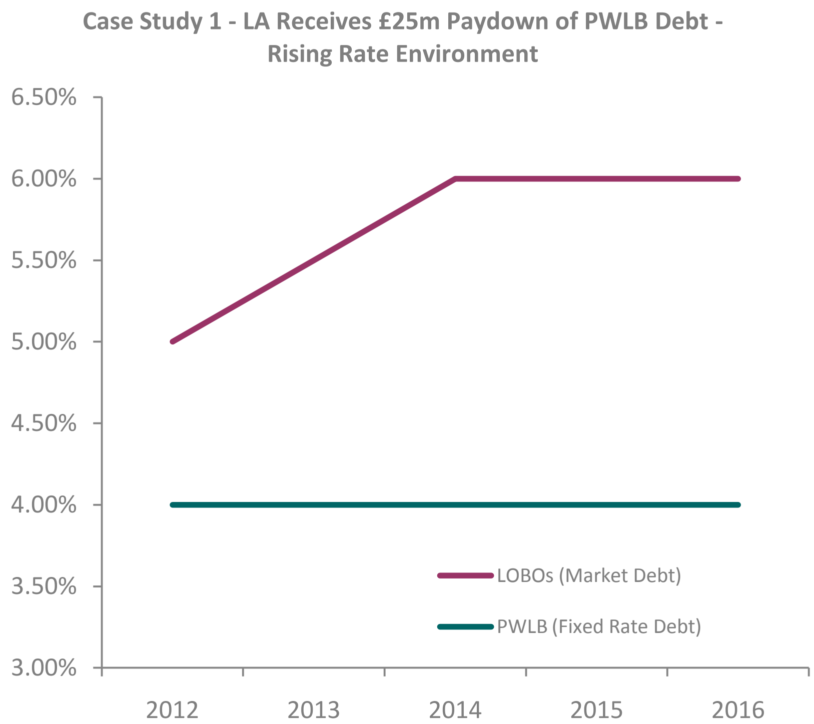
- A Local Authority will receive a payment from Government

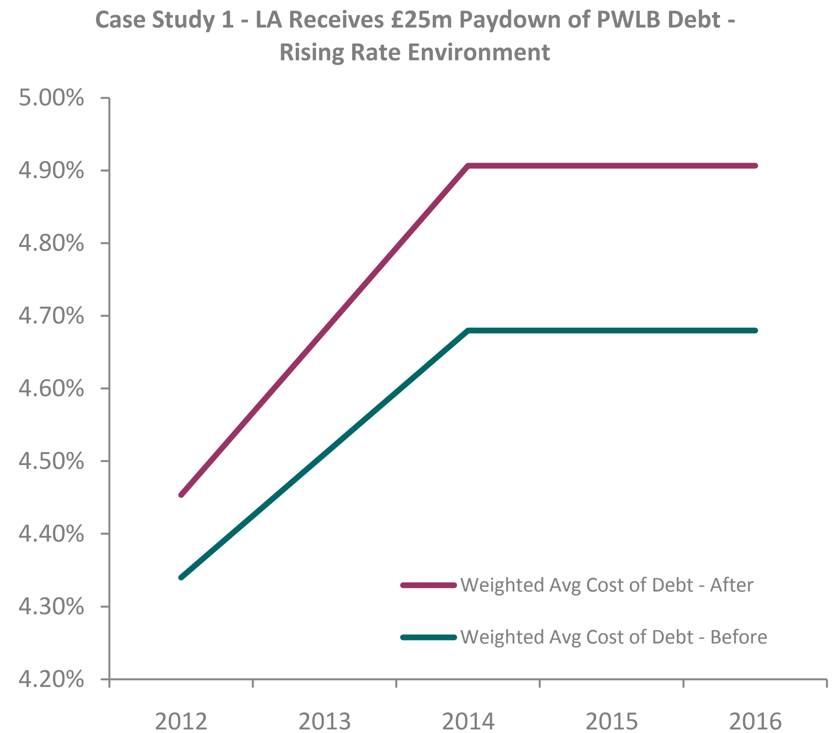
  – Case Study 1 assumes: -
    - The Local Authority initially has a debt portfolio comprised of 2/3 PWLB, 1/3 Lobos amounting to £100m of debt.
    - Will ***receive a £25m payment*** from central Government
    - The funds will be used to repay equally a % of PWLB borrowing across a range of maturities
    - Breakage costs will ultimately be met by central Government

- How does this impact the Local Authority?

  – Shifts the balance of its borrowing portfolio between fixed rate debt and debt linked to rising interest rates
    - Leaves the Local Authority ***significantly more exposed*** to rises in interest rates
    - Puts it in a position where it has the opportunity to ***refinance*** only when rates are high
    - ***Limits the benefit*** of any low interest rate (? Low inflation) environment

Case Study 1





Evolution Securities Rate Forecast

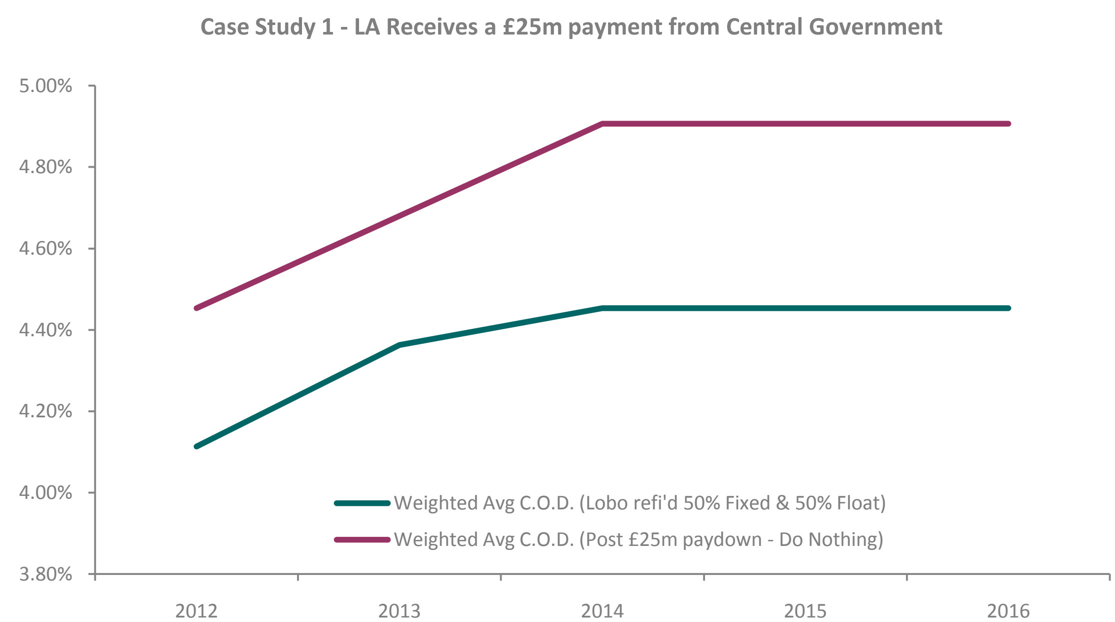
Apr-11	Q4 2012	Q4 2013	Long Term
Base Case			
6m Libor	*2.50%*	*3.60%*	*4.00%*
Gilt 30Yr	*5.30%*	*5.50%*	*5.50%*
RPI	*3.30%*	*2.80%*	*2.50%*

Apr-11	Q4 2012	Q4 2013	Long Term
Sustained Deflation			
6m Libor	*1.75%*	*2.00%*	*4.00%*
Gilt 30Yr	*4.75%*	*5.00%*	*5.50%*
RPI	*0.80%*	*1.70%*	*2.50%*

Apr-11	Q4 2012	Q4 2013	Long Term
Inflation Pick UP			
6m Libor	*5.50%*	*5.50%*	*4.00%*
Gilt 30Yr	*7.50%*	*6.75%*	*5.00%*
RPI	*6.10%*	*6.10%*	*2.50%*

Case Study 1

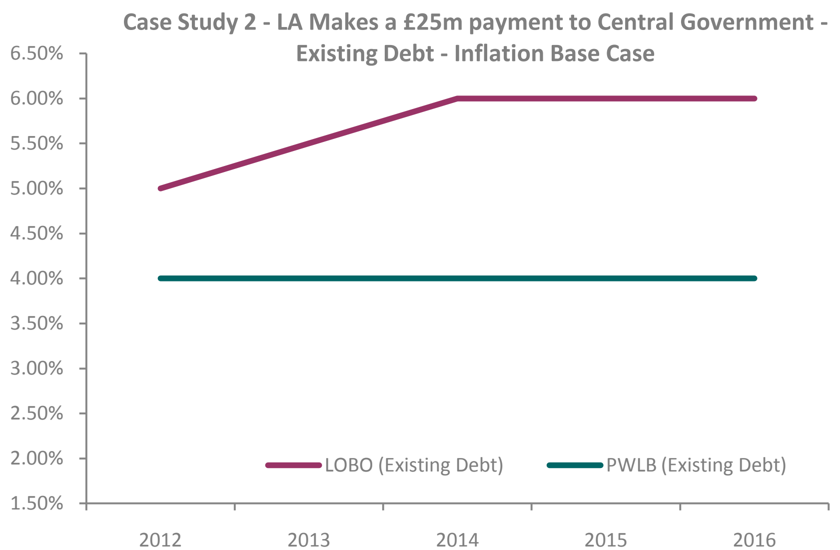
- So what would you do?
  - One option is to replace the Lobos with a mix of fixed and floating rate debt (say 50% Fixed & 50% Floating)
    - Lower optionality
    - More predictability
    - Lower overall cost



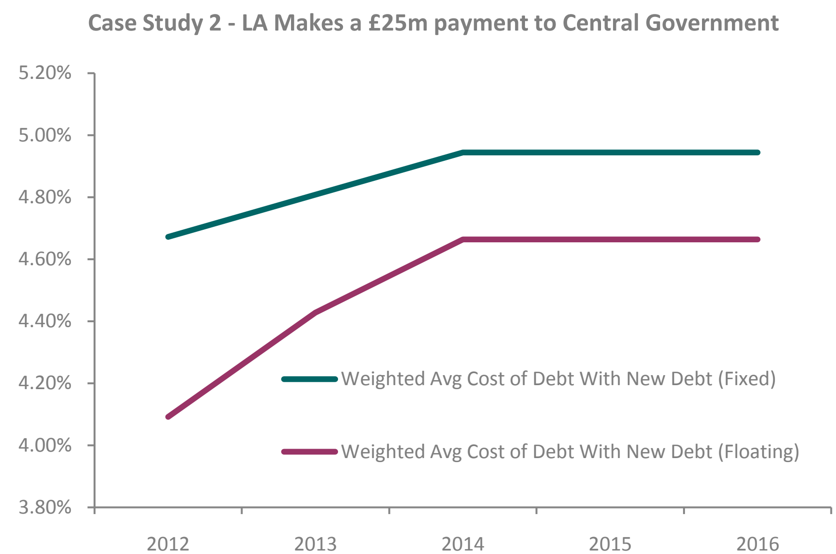
Case Study 2

- A Local Authority is required to make a payment to Government
  - Case Study 2 assumes
    - The Local Authority initially has a debt portfolio comprised of 2/3 PWLB, 1/3 Lobos amounting to £100m of debt.
    - Will be required to **make a £25m payment** to central Government
- In this instance, what issues does this create for the Local Authority?
  - What is the level of **interest rate risk** that it should take on its debt portfolio?
  - What can it actually **afford to pay**?
  - How does it **align interest costs with the growth of housing revenues**?
  - What is the **impact on the new debt**?
  - Should it therefore **borrow fixed, floating or inflation linked**?
  - Does it need the **flexibility** to move from one type of financial instrument to another?
  - What market should it use?
- How should a Local Authority address these issues?

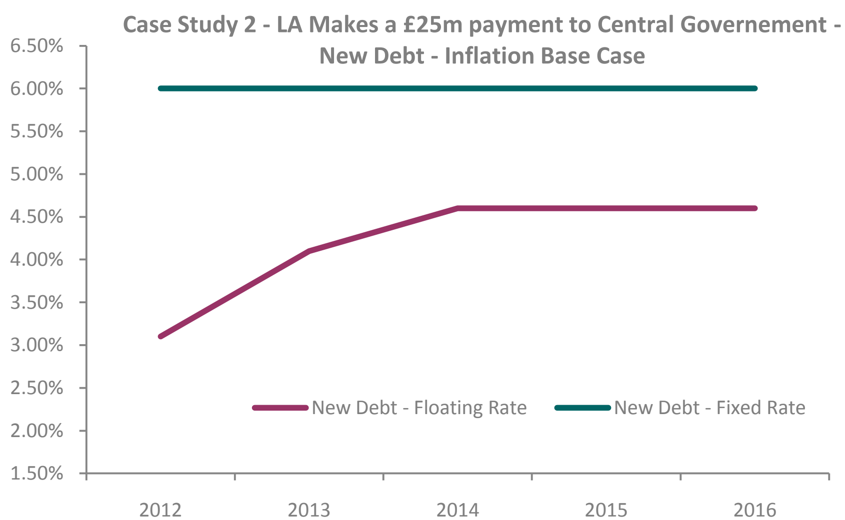
Case Study 2



Case Study 2 - LA Makes a £25m payment to Central Government - Existing Debt - Inflation Base Case
6.50%
6.00%
5.50%
5.00%
4.50%
4.00%
3.50%
3.00%
2.50%
2.00%
1.50%
LOBO (Existing Debt)
PWLB (Existing Debt)
2012
2013
2014
2015
2016



Case Study 2 - LA Makes a £25m payment to Central Government
5.20%
5.00%
4.80%
4.60%
4.40%
4.20%
4.00%
3.80%
Weighted Avg Cost of Debt With New Debt (Fixed)
Weighted Avg Cost of Debt With New Debt (Floating)
2012
2013
2014
2015
2016



Case Study 2 - LA Makes a £25m payment to Central Governement - New Debt - Inflation Base Case
6.50%
6.00%
5.50%
5.00%
4.50%
4.00%
3.50%
3.00%
2.50%
2.00%
1.50%
New Debt - Floating Rate
New Debt - Fixed Rate
2012
2013
2014
2015
2016

The role of an independent financial advisor

- What do Local Authorities need from an independent financial advisor?

  – Modelling the debt portfolio
    - Matching funding costs to revenue
    - Stress testing potential financial outcomes
    - Determining the acceptable risk matrix for the borrower

  – Advice on the mix of debt
    - Floating Rate
    - Fixed Rate
    - Inflation Linked

The role of an independent financial advisor

- What do Local Authorities need from an independent financial advisor?

  - Advice on accessing the markets
    - Bank Loans
    - Private Placements
    - Public issues
    - Retail Bonds
    - PWLB

  - Advice on Execution
    - Choosing the provider
    - Managing/negotiating the documentation
    - Executing the Deal

The role of an independent financial advisor

- In all of these things what must an advisor have?

  - Strong advisory credentials
    - Gained through advising Corporates, Financial Institutions and Government Related Entities

  - Independence
    - Unbiased views, with no special relationship with providers
    - No commission / introduction revenue sharing agreements

  - Broad experience of the various debt markets
    - A team with experience of executing transactions in a wide range of markets
    - Knowledge / experience of banking, private placements, bonds and the PWLB

The role of an independent financial advisor

- In all of these things what must an advisor have?

  – A trading platform
    - To provide up to the minute understanding of demand in the market
    - To validate the pricing received from Banks/underwriters

  – Strong relationships with the providers
    - To cross check the feedback from arrangers

  – The capacity to execute
    - If arrangers are unable to perform

Evolution SECURITIES
100 Wood Street
London EC2V 7AN
Tel: 44 (0)20 7071 4300
Fax: 44 (0)20 7071 4457
Email: EvoCredit@evosecurities.com