

# Midlands Engine Green Bond

PFM Financial Advisors LLC

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# Agenda

- ◆ **Introductions**
- ◆ **Midlands Engine Green Bond**
- ◆ **Lessons from Abroad**
- ◆ **Green Finance Fund**
- ◆ **Green Finance Lending Programme**
- ◆ **Proof of Concept and Long Term Structure**
- ◆ **A Transformational Opportunity**

# Introductions

# The Midlands Engine - Partnering for Prosperity

- The Midlands Engine Partnership is a pan-regional body that works to complement the activity of the region's businesses, public sector and world-leading universities
- Partners include 65 local authorities, 20 universities, NHS trusts, the private sector and third sector
- The Midlands is the largest regional economy outside London and home to 11 million people - the region's economy is the size of Denmark
- The Partnership has a particular focus on:
  - Advanced Manufacturing
  - Green Growth
  - Food and Agri-tech
  - Health and Life Sciences
  - Inward Investment and Exports
  - Building Infrastructure for Growth

# The UK Municipal Bonds Agency

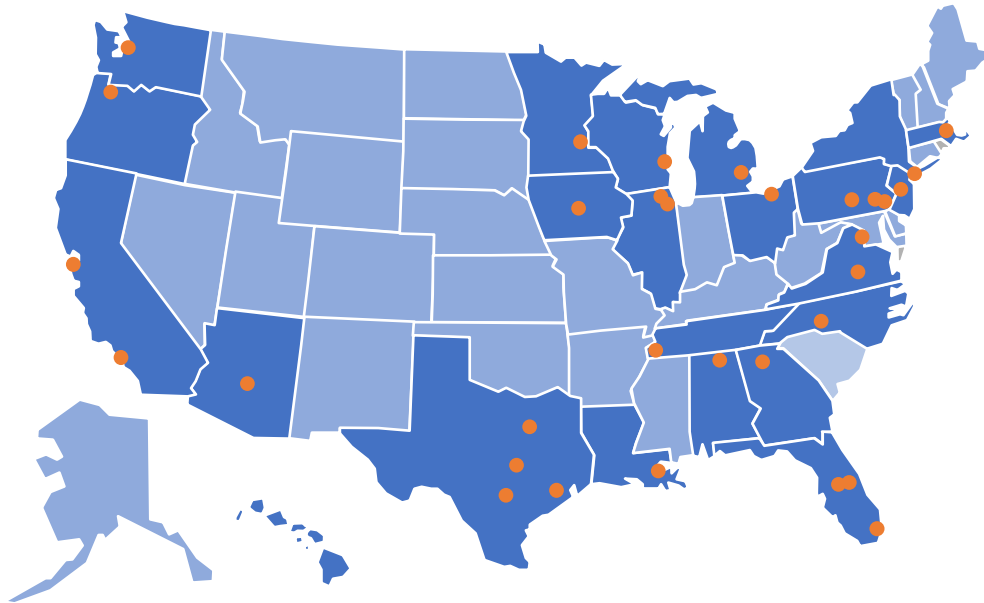
- Established in the public interest to:
  - Tailor products, such as ESG, to suit local authorities' needs
  - Secure long-term investment from insurers and pension funds
  - Generate economies of scale
  - Reduce dependency on the PWLB
  - Exercise greater scrutiny over excessive and risky borrowing by councils
  - Deliver savings
- The UKMBA is owned by local government for local government

# PFM Financial Advisors

## International Resources, Local Service

Has 32 locations, over 300 employees and is approaching 50 years of providing independent advice and market leadership across the United States including advising on over **\$71 billion of local government bonds** in 2023.

Leveraging all of those resources, PFM provides local, focussed advice from our **London Branch** to local government in the UK



# The Midlands Green Bond

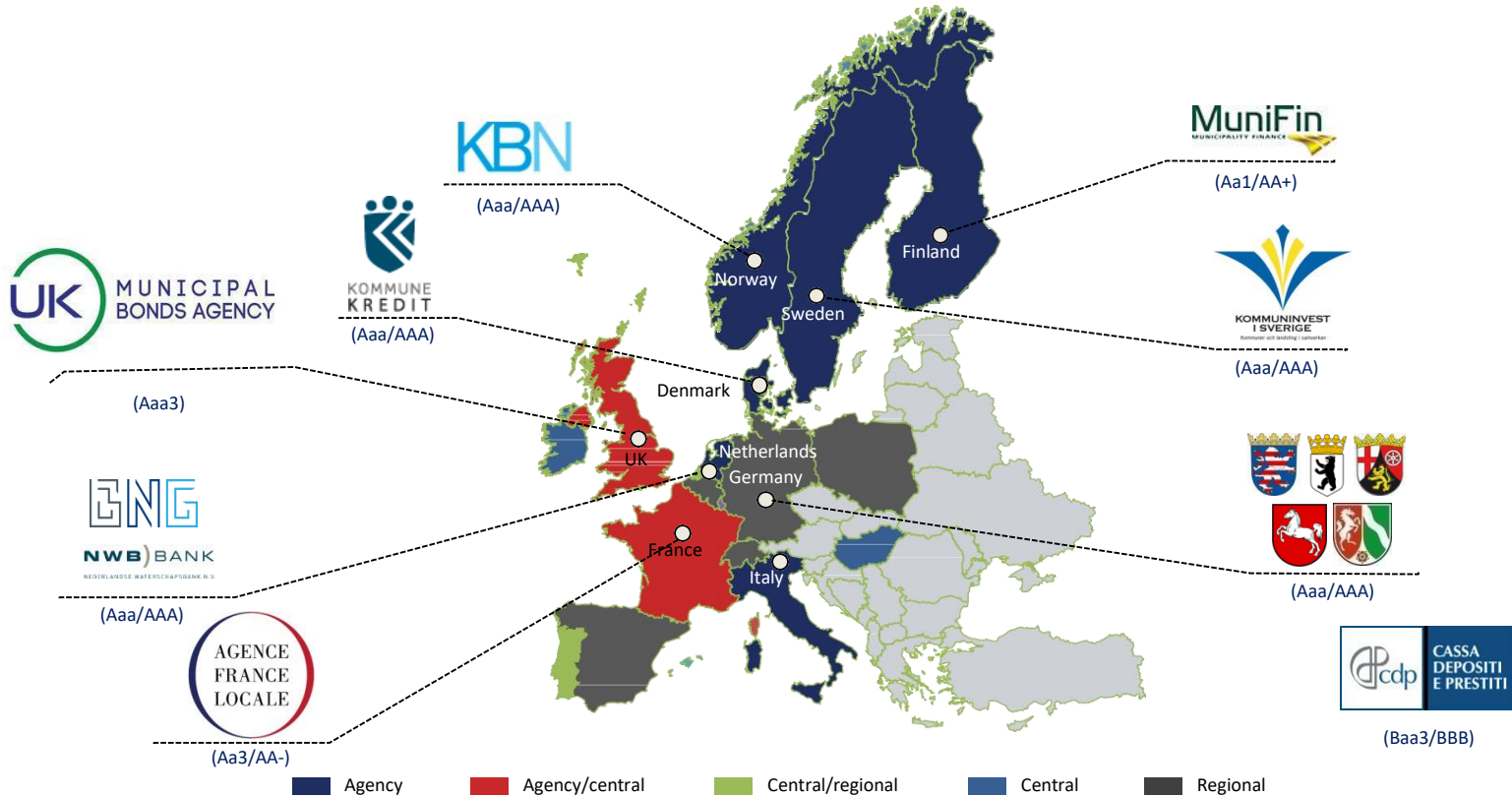
# Genesis

- The Partnership is seeking to leverage its scale to secure investments from pension funds and insurers in green bonds that fund capital expenditure.
- Supports the Partnership's *Ten Point Plan for Green Growth*:
  - Tenth point covered green finance and “new models of green finance”
  - Enables investment to help unlock green growth
  - Investment opportunities include green energy, housing, decarbonisation of industry, energy efficiency, public transport etc.
- Initial focus on public sector real estate and business lending
- Climate transition requires vast amounts of capital expenditure



# Lessons from Abroad

# Municipal Funding Systems in Europe

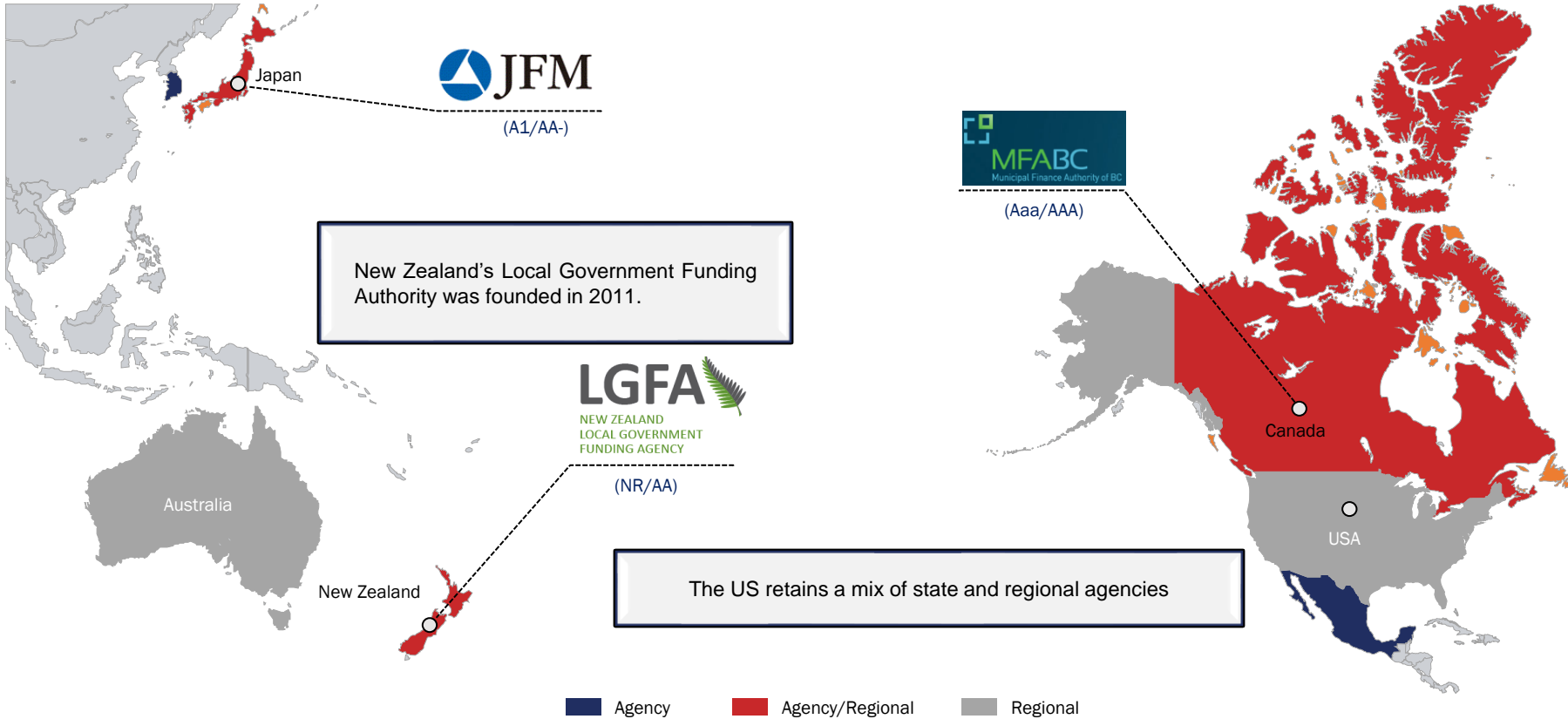


In Europe, Finland produced the first municipal funding authority, MuniFin in 1889....

...Throughout the 20th century different systems developed across Europe reflecting the ranging legal and financial frameworks of sovereign states...

...The agency funding model was gradually adopted throughout Scandinavia and the Netherlands, and more recently in Italy, France and the UK

# Municipal Funding Systems Globally



Canada has a hybrid system: since 1970 The Municipal Funding Authority of British Columbia has been an agent for its constituents; elsewhere regions and localities independently access capital markets.

New Zealand's LGFA acts on behalf of participating local authorities and is their primary source of funding.

Japan also has an agency, Japan Finance Organisation for Municipalities (JFM). Its market share is much smaller and like Canada funds local authorities alongside a regional system.

# Lessons From Germany - NRW

- NRW Bank is the state development bank for North Rhine-Westphalia
- Region includes the industrial heartland of Germany - The Ruhr
- It focuses on:
  - Economic Development - SMEs, equity and debt, start-ups, restructuring
  - Social Housing
  - Infrastructure
  - Municipalities and local authorities
  - Economic development and regeneration
  - Climate change projects
  - Education and universities
- Is financing economic development and regeneration in a region subject to significant industrial decline

# Lessons from the US – California IBank

- US municipal bond market is currently worth \$4 trillion
- California Infrastructure and Economic Development Bank (Ibank) has contributed \$54 billion of infrastructure and economic development activity that promoted a healthy climate for jobs, contributing to a strong economy
- It focuses on:
  - Municipalities and local authorities
  - Expanding access to venture capital
  - Infrastructure
  - Small business loans
  - Economic development and regeneration
  - Climate change projects

# Application to Midlands

- No-one can cut their way to economic growth and regeneration
- Local authority and public sector budget challenges are real and, in many cases, very severe - demand needs to be reduced
- Without investment to drive growth, develop the region and improve public services, the only outcome is stagnation and decline
- Growth and productivity is key
- Region will benefit from very significant capital investment in infrastructure, public services, housing, higher education and private businesses
- Only way to move forwards is to take control and make things happen
- Municipal bonds are a key tool to fund capital investment, infrastructure, regeneration and economic development

# Key Proposals

- Establishment of:
  - Green Finance Fund (GFF) to lend to local authorities and, in time, the wider public sector
  - Green Finance Lending Programme (GFLP) to lend to businesses
- Both programmes will be subject to a pilot
- Longer term, establishment of a mutual to provide oversight on behalf of the Partnership
- Operations will be outsourced
- Longer term, expand the lending programme beyond initial green focus

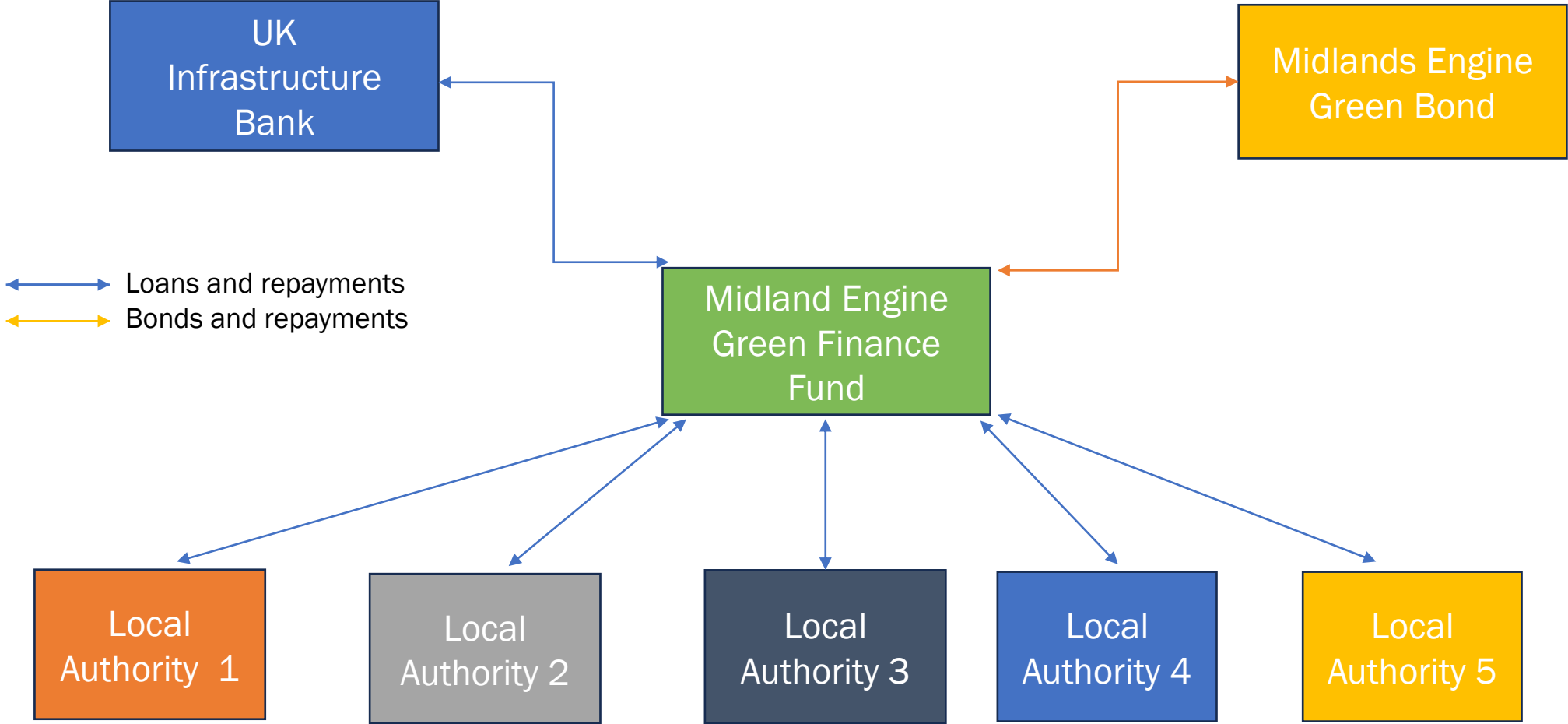
# Green Finance Fund – Local Authority and Public Sector Lending



# Midlands Engine Green Finance Fund

- Green Finance Fund (GFF) will provide funding to the public sector for green projects at rates below the PWLB
- How will this be achieved?
  - Initially, funding will be sought from the Government / UKIB (40%) and bond markets (60%)
  - This allows loans made by the GFF to be below the PWLB Certainty Rate - 0.16% below PWLB rates before costs
  - Five-year eligibility window for projects: 3 year look back; 2 year look forward
  - We believe the UKIB will not finance the GFF if PWLB provides the other 60% of funding - UKIB's remit is to be additive

# Green Finance Fund - Structure



# Economics

- Interest rate will be blended:
  - Treats all parties fairly
  - Ensures transparency for all parties
- If the UKIB supports the GFF, the blended interest rate saves 0.16% over the PWLB before costs:\*

Loan Maturity (Years)	PWLB Certainty Rate	Saving Over		
		UKIB	GFF Loan	PWLB
10	4.86%	4.46%	4.70%	-0.16%
20	5.34%	4.94%	5.18%	-0.16%
30	5.38%	4.98%	5.22%	-0.16%
40	5.30%	4.90%	5.14%	-0.16%

- Longer term costs of the GFF and bond issues will be 0.02 to 0.05% per annum, decreasing as the pool increases

\* The PWLB Certainty Rate is Gilts +0.8 per cent and the UKIB loan rate is Gilts +0.4 per cent. Gilts are the bonds issued by the UK Government to fund deficit spending and investment.

# Credit Quality and Investor Perception

- Moody's has never experienced a default by any investment grade sub-sovereign borrower, which includes local authorities, in an advanced economy:

	Average Cohort Size	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Aaa	25	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Aa	46	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
<b>A</b>	<b>27</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.00%</b>
Baa	10	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Ba	18	0.68%	1.10%	1.37%	1.57%	1.57%	1.57%	1.57%	1.57%	1.57%	1.57%
B	9	3.42%	11.26%	20.33%	28.97%	34.56%	36.84%	40.44%	43.47%	49.75%	57.46%
Caa-C	5	15.64%	17.91%	17.91%	20.79%	30.35%	54.37%	73.53%	86.23%	87.45%	87.45%
<b>Investment Grade</b>	108	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
<b>Speculative Grade</b>	26	3.34%	6.225	9.17%	12.31%	15.30%	18.21%	21.74%	24.60%	27.51%	31.52%
<b>All</b>	127	0.47%	0.84%	1.19%	1.53%	1.83%	2.09%	2.39%	2.60%	2.79%	3.00%

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- No municipal bond agency in an advanced economy has experienced a default
- TfL's bond prices reflect investors' realisation TfL will not and can not go bankrupt

# Bond Pricing

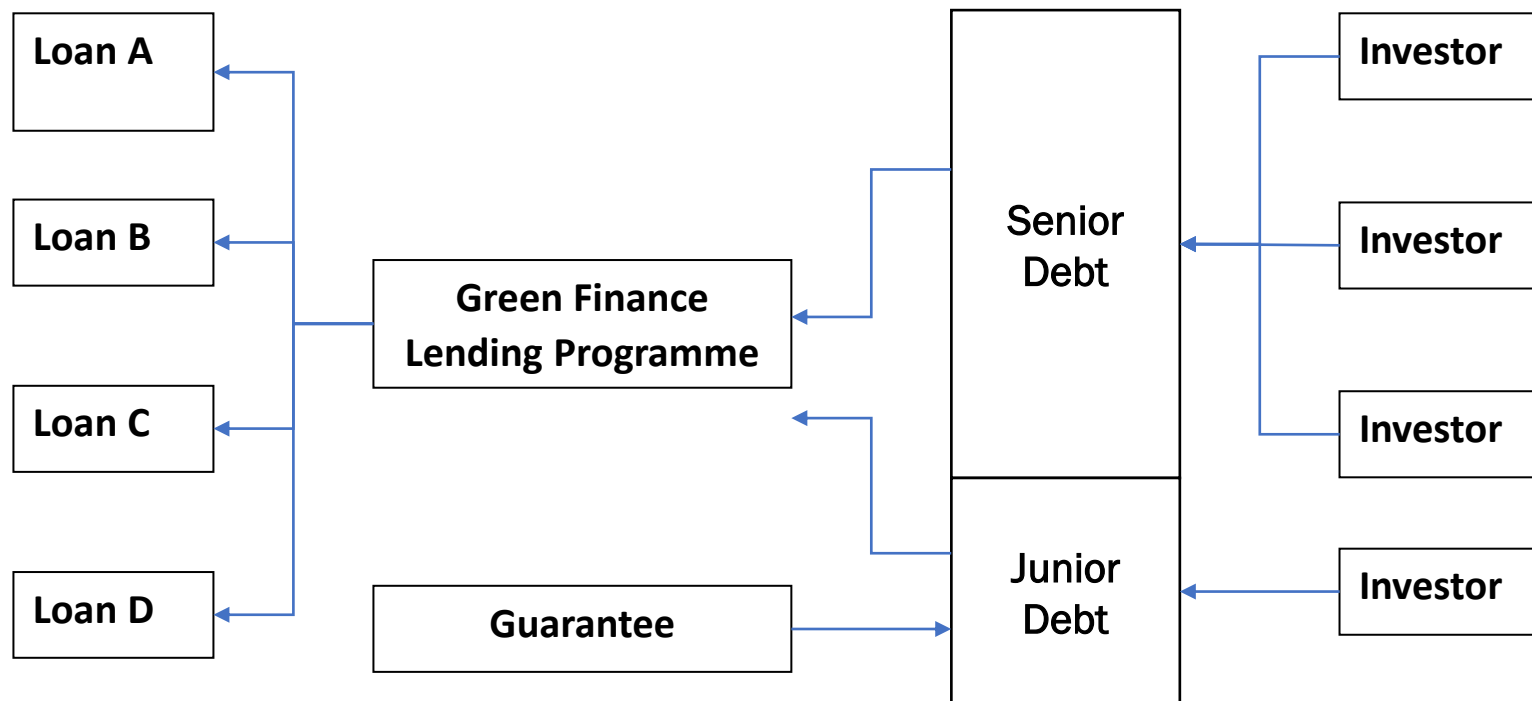
- The pricing of municipal bonds depends on four factors:
  - Benchmark sized issues =>£250 million
  - Liquidity - the more bonds issued over different maturities and the more they trade, the better
  - Credit quality of the borrower
  - Investor perception
- Four municipal bonds trade comfortably below the PWLB Certainty Rate:
  - UKMBA / Lancashire 2025 FRN: 0.07% below
  - TFL 2042, 2045 and 2064 bonds: 0.14%, 0.2% and 0.36% below
- UKMBA / Lancashire 2060 bonds and GLA's bonds rarely, if ever trade

# Green Finance Lending Programme – Business Lending

# Green Finance Lending Programme

- Businesses are finding it difficult to borrow for green capital investment:
  - Maturity on offer from banks is too short
  - Even small businesses are often required to undertake disproportionate and costly “green audits” to access what funds there are
- The Programme will seek guarantees and funding from HM treasury, the UKIB and other sources:
  - HM Treasury, either directly or through one of its bodies such as UKIB, will be asked to guarantee 10-20% of the funding needed by the programme; other guarantors exist
  - The bond markets will be used to fund all lending
  - The LGPS may be the ideal purchaser of the HM Treasury-backed debt

# GFLP Structure:



- A guarantee covering 10-20% of the loan fund is provided by the UK Government or an entity such as the UKIB, or overseas public bank
- This “junior debt” would ordinarily be retained by the fund or its sponsors, reducing lending capacity and increasing costs
- Investors purchase both the senior and junior debt; the LGPS may be the ideal purchaser of the junior debt



# How Would the Business Programme Work?

- Initial lending will most likely target mid-sized manufacturing businesses:
  - These businesses face limited access to finance
  - At 15.4%, advanced manufacturing is the second largest economic sector in the Midlands by GVA
  - A key driver of exports and inward investment
  - Often need long maturity loans to make green investment viable
- Credit criteria and credit processes will be put into place

# Proof of Concept and Long Term Structure

# Governance

- Thematic Board short-term
- Long-term, board of directors for Midlands Green Bond
- The Midlands Green Bond would:
  - Approve the GFF and GFLP's green lending framework i.e. the types of projects it will fund, and the monitoring and reporting of the use of proceeds
  - Agree the public sector and quasi-public sector entities that may access the GFF
  - Agree which businesses may access the GFLP
  - Agree the credit process and credit criteria which determines who can borrow

# Short Term Proof of Concept

## ➤ Pilot the Green Finance Fund:

- Midlands Engine Partnership seeks support from the UKIB
- Use the UK Municipal Bonds Agency to save time and reduce costs
- Loan agreements reflecting the above prepared for signing by local authority borrowers and bonds marketed as Midlands Engine Green Finance Fund

➤ For best pricing, initial GFF pool must total £416.67 million - £250 million public bond and £166.67 million UKIB funding

# Long Term Structure

- If the proof of concept for the GFF is successful and GFLP viable:
  - Establish a mutual to manage the Midlands Engine Green Bond
  - Set-up the necessary infrastructure to issue bonds, raise other finance
  - Transition governance to the mutual
  - Bonds issued via a special purpose vehicle
  - Operations delivered by third parties

# A Transformational Opportunity

# A Transformational Opportunity

- This **should** be one of the most exciting and ambitious programmes in the UK
- The Midlands Green Bond could make a very significant contribution to economic growth, job creation, service provision and regeneration across the Midlands
- It will deliver substantial environmental benefits
- Lending and outcomes should not be limited to initial use cases:
  - Financing vehicle can fund green projects beyond the initial targets
  - Can be used to deliver other funding i.e. non-green expenditure such as long-term business loans, general local authority borrowing, wider university and NHS funding
  - Can help deliver regeneration and economic development in disadvantaged areas
  - Can raise and provide different types of finance to businesses to grow the economy and improve productivity

Questions?