Many of the loans were taken out before the financial crisis, when they were cheaper than a public works loan from the Treasury
PATRICK SEMANSKY/AP

Councils owe £8bn for 'lose-lose bet' loans

George Greenwood

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Councils are shelling out millions a year to repay or exit a long-term loan once described as a lose-lose bet.

They owe banks £8 billion for lender option borrower option (LOBO) loans, freedom of information disclosures show.

Local authorities still owe banks £8 billion of these lender option borrower option loans, freedom of information disclosures show.

The loans have been criticised for offering taxpayers poor value for money, as councils have to pay higher interest rates than borrowing directly from the Treasury, and can be stung with large exit payments if they try to refinance.

Many of the loans were taken out before the financial crisis, when interest rates were higher and they were often slightly cheaper than a public works loan from the Treasury.

However, the LOBO loans included an embedded financial product, whereby after a low “teaser” rate period, banks could increase the interest rates on the loan at set decision points.

Councils could then either accept their higher rate or pay back the loan. However, if banks chose not to exercise this option and increase the interest on the loans, councils would often have to make significant exit payments if they wanted to refinance.

After the crisis caused interest rates to collapse, banks had little incentive to use their option, while councils have been left paying up to 10 percentage points more interest than on a public works loan. Some have been left unable to refinance as the high exit payments make this uneconomic.

Arlingclose, a local authority treasury management adviser, told a 2015 select committee inquiry into LOBOs that their terms meant it was a case of “heads the lender wins and tails the borrower loses. Only if the coin lands on its edge every time, and [interest] rates remain broadly flat for decades, does the local authority win.”

Some UK banks have since amended the terms of these loans. Barclays converted all its remaining LOBOs into ordinary long-term fixed rate loans in 2016, on the ground that it would create greater certainty for local authorities while making its loan book less complex to manage.

In 2019, Royal Bank of Scotland offered local authorities the chance to leave LOBO loans on favourable terms, which most did.

However, 95 per cent of the value of outstanding loans are held by foreign banks and financial institutions, who may feel less public pressure to amend the terms of the deals.

The figures were obtained through freedom of information requests by the local democracy campaign group Research for Action.

A spokesman for Research for Action said: "This is clearly a UK-wide issue and has been deemed problematic by financial experts, accountancy firms and concerned citizens."

A spokesman for the Local Government Association said: "LOBOs have been a legitimate financial instrument for them to use but must be viewed in the context of a council's entire debt profile and borrowing, not in isolation.

"Any evaluation of the decision-making of councils around LOBOs needs to take account of the information available when the decision was made, such as financial forecasts and risk assessments and not on the basis of hindsight. Some councils have refinanced their LOBO arrangements but this is always a local decision based on what is best for the council."