RETAIL CHARITY BONDS

MARKET UPDATE

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Borrowers can expect lower interest rates on Retail Charity Bonds post-Brexit

Mark Glowrey of JCRA explains how for charities considering a retail bond issue, there is now an opportunity to borrow at exceptionally low rates, tapping into strong investor demand at interest rates well under 4%.

One unexpected result of the EU referendum has been the further drop in interest rates, both short-term and long-term. The Bank of England moved swiftly to drop the base rate by a quarter of a point to a new low of 0.25%. Longer-dated funding rates followed suit, encouraged by the Bank's quantitative easing (QE) process. Ten-year gilts (Government bonds), which stood on a yield of over 1.4% pre-referendum, have increased sharply in price over the summer with the benchmark standing on a yield of 0.72% at the time of writing.

Investors are now expecting lower returns on their investments, which is good news for borrowers.

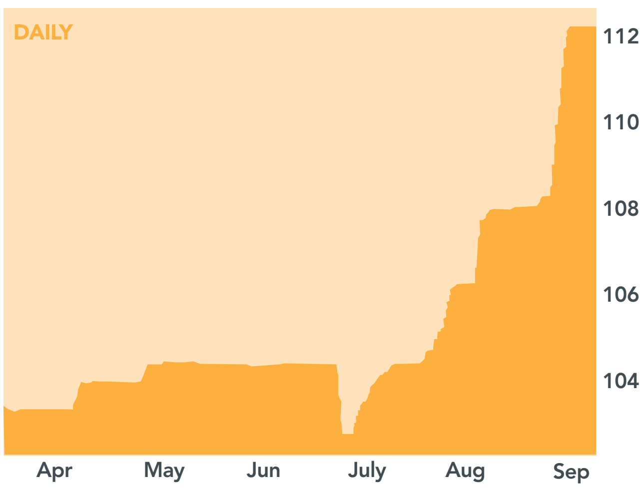
The QE programme also included plans to buy £10 billion of Sterling corporate bonds. Whilst this programme is restricted to the more liquid investment grade issuers, the additional demand has lifted prices across the sterling corporate bond market in general.

The effect of all this is that investors are now expecting lower returns on their investments, which is good news for new borrowers.

So what does this mean for the expected interest rate on future Retail Charity Bond issues? To date, three bonds have been issued for Golden Lane Housing, Hightown Housing Association and Charities Aid Foundation. All three bonds met with strong demand from investors at launch, with the issues oversubscribed and books closing ahead of schedule. Initially trading was fairly subdued with prices rising to a small premium over the issue price on limited turnover.

However, there has been a notable change since Brexit. As yields have fallen in the gilt market, the trading prices on these Retail Charity Bonds have risen sharply. For instance, GLH's 4.375% 2021 bond had been trading in the secondary market between 102 – 104 prior to the vote, but saw a sharp rally over August, with the last price at the time of writing at 112.25.

Golden Lane (MENCAP) 4.375% July 2021 4.375% 29 July 2021 (Price Chart) 112.25 n/c 7 Sep 2016



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At that price, the yield to redemption equates to 1.75%. In other words, investors are currently willing to invest in GLH for what would equate to a rate of return of 1.75% if they held the bonds until they are redeemed (repaid).

The other two bonds have also seen strong performance, and whilst QE is undoubtedly a factor, strong demand from the growing SRI (socially responsible investment) fund management sector has also helped take yields on those bonds down to around 3%.

The prices that investors are willing to pay in the secondary market for these existing bonds provides a guide for the interest rates that new bond issuers could expect to pay. For charity borrowers considering a retail bond issue, this means there is now an opportunity to borrow at exceptionally low rates, tapping into this investor demand at interest rates well under 4%.

Mark Glowrey is a Director at JC Rathbone Associates and part of a team that manages the distribution of Retail Charity Bonds.

Like all bonds listed on London Stock Exchange, each retail charity bond can be bought and sold in what's called a secondary market. The price that the bonds are traded for reflects the demand from buyers and the return they are willing to accept on their investment. Prices are shown as the cost for each 100 units of bonds, so a price of 105 means you would pay £105 to buy each £100 of bonds.

Since the borrower pays a fixed amount of interest per 100 units and will repay the original value of the bonds to bondholders on maturity, the result is that the higher the price of the bonds, the lower the yield you would get on your investment. For example, if the bonds pay 4% and you buy them in the secondary market at 105, you would get £4 on every £105 you invest, and get £100 back at the end of the term.

To find out more about Retail Charity Bonds, please contact Daniel Carrico on 07710 091899 or email daniel.carrico@allia.org.uk

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