



DAO(GEN)2/00

22 February 2000

Dear Accounting Officer,

## **GOVERNMENT LENDING FOR PERIODS IN EXCESS OF 25 YEARS**

### ***Purpose of this DAO***

To inform Government Departments of a change to National Loans Fund (NLF) lending policy. The change also affects Voted loans.

### ***Information***

With effect from today the NLF will no longer advance loans for periods in excess of 25 years. Uncertainty over the cost at which the Government could borrow at the longest maturities exposes the NLF to risk of loss. Section 5 of the National Loans Act 1968 requires that interest rates be "at least sufficient to prevent a loss".

The NLF is at risk of losses with lending at long maturities in two respects:

- i) there are no gilts in issue beyond 30 years maturity, so we have no hard information on our likely borrowing costs beyond 30 years. With the current downward sloping yield curve we have assumed that the rate applicable to a 30 year loan is appropriate for longer maturities. With long yields at their current low levels that is a very strong assumption;
- ii) 30 year gilt yields are depressed because we are not borrowing much when demand for gilts is strong. We are particularly vulnerable to error in estimating yields at the end of the yield curve as there are no further points through which to interpolate. In addition, any error in estimating our cost of borrowing for 30 years will be factored up on longer loans.

Accordingly we have decided that it would be imprudent to lend for periods of more than 25 years.

Existing loans will be unaffected by this change. The Treasury will continue to set a rate for the purposes of discounting should borrowers require to repay early existing loans.

***Action***

Departments should draw this to the attention of their sponsor bodies to whom they advance NLF or Voted loans.

***Enquiries***

Information on the general policy is available from Roy Westwater in our Debt and Reserves Management (DRM) team (020 7270 4613). Questions on lending arrangements or specific loans should be directed towards Departments' usual contact in EFA.

*Yours sincerely,*

*Jamie Mortimer*

**JAMIE MORTIMER**