Report to	Cabinet	**Item**
	11 October 2017	10
Report of	Chief finance officer (Section 151 Officer)	
Subject	Municipal Bonds Agency borrowing framework agreement	

Purpose

To seek approval for the council to enter into the borrowing framework agreement prepared by the UK Municipal Bonds Agency.

Recommendation

To approve the council's entry into the UK Municipal Bonds Agency (UK MBA) framework agreement and its accompanying schedules including the joint and several guarantee.

Corporate and service priorities

The report helps to meet the corporate priority value for money services.

Financial implications

If the council takes borrowing via the UK MBA there will be savings in interest paid when compared with borrowing taken via the Public Works Loan Board (PWLB) and the money markets. These are anticipated to be 0.2 per cent when compared with the PWLB borrowing rates. This would equate to a saving of £20,000 per annum in borrowing costs on a £10m loan.

Ward/s: All wards

Cabinet member: Councillor Kendrick, resources

Contact officers

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Background documents

None

Report

Background

Cabinet was presented with the report ‘Potential investment in the UK Municipal bonds Agency’ on 10 September 2014. This report outlined the set-up of the UK MBA by the Local Government Association (LGA), its rationale for setting up the UK MBA and its request for investment (in the form of share capital) by local authorities to cover the initial launch and operation of the UK MBA. Cabinet approved the investment of up to £100,000 to fund the mobilisation and implementation phases. The council has, to date, invested £50,000 with the UK MBA.

The council is now at the stage of needing to enter into a Framework Agreement if it wants to access funding from the UK MBA. The agreement includes an accession document confirming that the council has the necessary approvals to sign the agreement and a joint and several guarantee to those lending money to the UK MBA in respect of the borrowing of all other local authorities from the UK MBA.

The Framework Agreement details how the UK MBA expects to interact with the local authority borrowers, including detailing how the joint and several guarantee and contribution arrangement will work and documenting the loan standard terms and conditions.

Framework agreement and the joint and several guarantee

The Framework Agreement in summary comprises:

- The Framework Agreement itself, which is primarily designed to prevent a call on the joint and several guarantee and lays out how the UK MBA will interact with local authorities.
- Schedule 1: Form of Authority Accession Deed, which local authorities sign to commit them to the Framework Agreement.
- Schedule 2: Form of Guarantee, which is the joint and several guarantee.
- Schedule 3: Loan Standard Terms, which is the loan agreement that covers any borrowing by an authority.
- Schedule 4: Form of Loan Confirmation, which supplements the Loan Standard Terms and confirms details of a loan such as principal, maturity, interest rate etc. It is signed by the UK MBA and a borrower.

By having a framework agreement in place with all authorities that want to borrow from the UK MBA it will be able to;

- issue bonds without having to prepare a full prospectus for each bond issue, thus reducing costs and complexity.
- list the financial instruments on the UK stock exchange
- reduce costs and attract potential investors by not having to have a separate credit rating and assessment of participating authorities for every tranche of financing.

The nature of the framework agreement means, that in practice, having it in place with all participating authorities that all borrowers are collectively and individually guaranteeing the debt of each and every borrower jointly and severally. However the risk of default by a local authority is very low. This has never happened to date. However, with Councils receiving less funding and needing to take on more risks and become commercial, the risk may now increase.

There is a statutory and prudential framework in place, under which local authorities operate, which is extremely strong and designed to prevent such a thing.

Also local authorities have access to the PWLB as lender of last resort and therefore can refinance any borrowings from the UK MBA by the PWLB if it cannot repay its debt to the UK MBA by other means.

Historically, the government has intervened when a local authority has found itself in difficulty or the government has deemed a local authority to be incapable of managing itself effectively.

Legal advice and opinion

Legal advice and opinion has been sought by a small group of authorities. This was procured independently of the UK MBA. The group commissioned Allen & Overy, a law firm specialising in financial transactions, to advise on the Framework Agreement. Allen & Overy engaged Jonathan Swift QC to provide senior counsel's opinion.

His main conclusions were:

- local authorities do have the power, in principle, to enter into the arrangement envisaged by the Framework Agreement; and
- whilst it would, in principle, be lawful for a reasonably financially robust local authority to enter into the commitments entailed in the Framework Agreement, the final assessment of whether or not it would be reasonable use of the in principle power must be made taking into account the specific financial position of each local authority, whether it is financially robust and the balance of the advantages and disadvantages of doing so.

The council has the power to enter into the Framework Agreement under Section 1 of the Localism Act 2011 – the general power of competence. Borrowing under the Framework Agreement will be under Section 1 of the Local Government Act 2003 – the power to borrow.

Borrowing through the UK MBA

The UK MBA will only lend to UK local authorities who can give a joint and several guarantee.

The UK MBA would prefer all borrowers to become shareholders. This ensures a strong alignment of interest between borrowers and shareholders, and is viewed positively by ratings agencies and the capital markets. This authority is a shareholder and will accordingly benefit from being charged a lower interest rate than if it were not a shareholder.

There is a transparent pricing structure for borrowing via the UK MBA. It will charge local authorities the interest the agency pays to obtain the funds it on-lends, plus any transaction costs up to a maximum of 0.5 per cent of the amount borrowed, plus a margin to cover its costs. This margin is currently set at:

- 0.10 per cent for shareholders; and
- 0.15 per cent for non-shareholders.

Transactions costs include the agency's credit rating agency fees, bank syndicate fees and legal costs. The council has the option to amortise these over the life of the loan or to expense them.

The agency will act as an intermediary, borrowing the money and on-lending it to local authorities on a matched basis to deliver cheaper capital finance to local authorities through periodic bond issues, as an aggregator for loans from other bodies such as the European Investment Bank, and facilitating longer term inter-authority lending via the Agency. Once the first bond issue has taken place local authorities will be able to borrow from the agency in a similar way as it does from the PWLB, although it may take a slightly longer time to go through the whole process than it currently does with the PWLB.

If a local authority wishes to repay a loan early the agency will pass on the cost of early repayment by a local authority (usually referred to as prepayment in financial services) to that local authority. However, the Agency will not profit from the transaction and will assist any local authority seeking early repayment to find the cheapest solution.

Risks and Advantages

As entering into the Framework Agreement and borrowing via the UK MBA is different in nature to borrowing from the Public Works Loan Board there are different risks associated with this.

There are inherent risks associated with the proposed structure, not least the joint and several nature of the guarantee. These are:

- the council's guarantee may be called independently of any other guarantee and for the full amount owing by the UK MBA under the financing document that is covered by the guarantee (and, therefore, such participating local authority is potentially liable to pay out amounts to the MBA that exceed the amounts borrowed).
- even though the council can terminate its guarantee, it will continue to guarantee the "Guaranteed Liabilities" entered into by the UK MBA before the termination date. The effect of this is that the Council's liability under its Guarantee may potentially continue in existence for many years after termination.

However, the risks associated with the joint and several guarantee are mitigated by the contribution arrangements. The Framework Agreement is such that the council's exposure, from a practical perspective, is proportional to the amount borrowed by the Council as a proportion of all non-defaulting loans made by the UK MBA.

The risk of a default by a local authority is very it low. Therefore the likelihood of having to contribute to a default is also very low. However, in changing times and Councils receiving less money and being advised to become more commercial, as referred to above this may increase.

There is a risk that the UK MBA does not observe its obligations under the Framework Agreement, but the council is entitled to expect that the UK MBA will do so. The LGA and local authorities control the UK MBA via their shareholdings so could intervene if the UK MBA did not abide by the Framework Agreement.

The prime advantage is the prospect of lower borrowing costs and the possibility to obtain types of loans that are not available from the PWLB. This is important as it is likely that the Council's need to borrow will increase in the immediate future. Borrowing will be required to both fund regeneration and housing schemes managed internally or to lend to council owned companies and Joint Ventures who will undertake the development. Borrowing will also be required to fund the commercial property acquisition programme – which is an important part of the Council's strategy to create new income streams to support the funding of core council services.

Therefore the potential advantage of achieving lower interest rates on Council borrowing more than offsets the low risk that a local authority defaults and the UK MBA is unable to recover the debts owed to it in order to repay the Council any contributions it is required to make.

The Framework Agreement only comes into effect if the council borrows from the UK MBA. If the council does not borrow, there is no risk to it arising from the contribution arrangements or joint and several guarantee. The council is not obligated to borrow via the UK MBA and even if it chooses to legally commit to borrowing via a bond issue, it will not be required to take a loan that is not cheaper than the PWLB, so the bond will not be issued. Therefore, the financial risk of the UK MBA either failing to deliver a saving or the council not borrowing having signed the Framework Agreement is eliminated.

Integrated impact assessment

The IIA should assess **the impact of the recommendation** being made by the report
Detailed guidance to help with completing the assessment can be found here. Delete this row after completion

Report author to complete	
Committee:	Cabinet
Committee date:	11 October 2017
Director / Head of service	Karen Watling
Report subject:	Approval to enter into the Municpal Bonds Agency Framework Agreement
Date assessed:	28 September 2017
Description:	The authority can take borrowing from the Municipal Bonds Agency at a lower interest rate level than offered by the PWLB. however in order to do this it must enter into a framework agreement which would mean that is would be jointly and severally liable to repay the debt of any defaulting authority. this report outlines this and the risks and advantages of doing so.

	Impact			
Economic (please add an ‘x’ as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Finance (value for money)	☐	☒	☐	
Other departments and services e.g. office facilities, customer contact	☒	☐	☐	
ICT services	☒	☐	☐	
Economic development	☒	☐	☐	
Financial inclusion	☒	☐	☐	
Social (please add an ‘x’ as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Safeguarding children and adults	☒	☐	☐	
S17 crime and disorder act 1998	☒	☐	☐	
Human Rights Act 1998	☒	☐	☐	
Health and well being	☒	☐	☐	

	Impact			
Equality and diversity (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Relations between groups (cohesion)	☒	☐	☐	
Eliminating discrimination & harassment	☒	☐	☐	
Advancing equality of opportunity	☒	☐	☐	
Environmental (please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Transportation	☒	☐	☐	
Natural and built environment	☒	☐	☐	
Waste minimisation & resource use	☒	☐	☐	
Pollution	☒	☐	☐	
Sustainable procurement	☒	☐	☐	
Energy and climate change	☒	☐	☐	
(Please add an 'x' as appropriate)	**Neutral**	**Positive**	**Negative**	**Comments**
Risk management	☐	☐	☒	

Recommendations from impact assessment
Positive
Negative
The use of the UK MBA to obtain external funding widens the options open to the authority and should result in savings in borrowing costs. In order to do this the council is required to enter into a framework agreement and a joint and several guarantee. However there are risks associated with this because of the joint and several arrangement. If an authority defaults on its debt repayments then all authorities who have borrowed from the MBA will be liable for debt and the liability will continue for as long as the loans remain outstanding even if the authority has already repaid all of its debt. The risks are considered to be low and there are actions that can be taken to cover the debt by the defaulting authority before needing to call upon other authorities to cover the debt.
Neutral
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Issues