

Appendix 2 - UK Municipal Bonds Agency's Framework Agreement, And Joint And Several Guarantee

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1. PURPOSE OF REPORT

- 1.1 This report seeks approval for the Council to enter into the borrowing documents prepared by the UK Municipal Bonds Agency (UKMBA) (the "Agency").
- 1.2 The Agency requires that local authorities borrowing from it enter into its Framework Agreement. 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 Agency in respect of the borrowing of all other local authorities from the Agency. Entering into the Framework Agreement enables the Council to access funding from the Agency as and when required.
- 1.3 This report sets out the background to the Agency, key facets of the Framework Agreement and the advantages and disadvantages of entering into the Agreement, including an assessment of the risk that the Council will be called upon under the guarantee. It seeks approval for the Council to enter into the Framework Agreement.

2. EXECUTIVE SUMMARY

- 2.1 The purpose of the Agency is to deliver an alternative source of strategic capital finance for local authorities. It is designed to be cheaper than PWLB, and to reduce the heavy reliance that many Councils place on PWLB borrowing, and so reduce risk. It will do so via periodic bond issues, as an aggregator for financing from other institutions and by facilitating greater inter-authority lending. The Agency is wholly owned by 56 local authorities and the Local Government Association ("LGA").
- 2.2 The Council has limited sources of capital finance available to it. The margin charged by the PWLB rose significantly in 2010 and therefore the LGA explored and then, with the support of a number of local authorities, established the Agency as an alternative to the PWLB.
- 2.3 Councils have traditionally used PWLB for borrowing. However, the terms of PWLB borrowing can be changed by Government, and at present there are limited alternatives available at the scale and interest rate that Councils need. The UKMBA is designed to fill this gap by providing a strategic alternative to PWLB, that is cheaper, and will spread risk.
- 2.4 The Agency's Framework Agreement sets out the arrangements for borrowing from the Agency and incorporates a joint and several guarantee that requires all local authorities borrowing from the Agency to guarantee the money owed by the Agency to those who have lent it money to fund its loans. The

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Framework Agreement incorporates a mechanism to prevent a call under the guarantee by requiring borrowers to lend the Agency money to cover a default by another local authority, referred to as "contributions".

- 2.5 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.
- 2.6 Acting on behalf of prospective borrowers, a small group of authorities appointed lawyers, Allen & Overy, to review and advise upon the documentation. Allen & Overy instructed counsel to obtain senior opinion on vires and reasonableness. The advice and opinion resulted in a small number of changes to the Agency's documentation.
- 2.7 Counsel raised three key considerations that a local authority must take into account when taking a decision to enter into the Framework Agreement:
- Its specific financial position;
 - Whether or not the council is "reasonably financially robust" i.e. the council it can meet the potential demands that the Framework Agreement places upon it; and
 - Whether it is to the authority's advantage to enter into the Framework Agreement taking into account the advantages and disadvantages of doing so.
- 2.8 Taken together, these three considerations help address a key requirement of the Wednesbury principles that the Council exercises its powers in a reasonable manner.
- 2.9 The Council has a need to borrow of **£116.5m** over the next three years comprising **£75.4m** of borrowing to fund capital expenditure and **£41.2m** of refinancing including internal borrowing. Use of the Agency will save the Council interest costs; otherwise the Council will use alternative sources of borrowing. Every 0.01 per cent interest saved is worth £100 per £1m. The savings may be significant as the Agency's bond pricing improves and as other institutions provide financing to the Agency.
- 2.10 Over time, the Agency's business case suggested that the savings delivered by the Agency would be 0.2 per cent (£2k per £1m).
- 2.11 UK local authorities are heavily supervised and subject to tight statutory control that significantly reduces the probability that a local authority will default on its financial obligations. Furthermore, the Agency will undertake

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credit assessments of local authorities and limit its exposure to authorities to reduce credit risk. In the event that a local authority needs to refinance its borrowings from the Agency, the PWLB is available to all local authorities as lender of last resort provided that the borrowing from the PWLB is not unlawful. No UK local authority has ever defaulted on one of its primary debt obligations. Taken together, the risk of a default is judged to be low and thus the risk of entering into the Framework Agreement and guarantee is deemed to be low.

- 2.12 If a local authority does default, the Agency has liquidity facilities available to it so that it can meet the interest payments due on a bond and cover a limited default on a principal repayment by a local authority; the provisions of the Framework Agreement will be used only if these facilities are exhausted. The Council has adequate reserves of £6m and in the unlikely event of a call for contributions under the Framework Agreement or payment under joint and several guarantee, has access to PWLB funds at 48 hours' notice if required.
- 2.13 The risks associated with the joint and several guarantee are mitigated by the contribution arrangements. Therefore, from a practical perspective, the real risk to the Council is the requirement to make contributions in the event of a default by another borrower and this exposure is proportional because it is calculated by reference to the amount borrowed by the Council as a proportion of all non-defaulting loans made by the Agency. If the Council has no borrowings via the Agency, it will not be called upon under the Framework Agreement.
- 2.14 In the unlikely event that the guarantee is called upon, it is also unlikely that bond holders or other providers of finance to the Agency will pursue a single Council for payment because the best outcome for lenders is likely to be achieved by pursuing all the guarantors because this maximises the potential revenues available to repay them.
- 2.15 Section 13 of the Local Government Act secures all debts of a local authority on its revenues and therefore it is extremely likely that the Agency will be able to recover amounts owed to it by a defaulting authority. In turn, this will enable the Agency to repay sums lent to it under the Framework Agreement or paid out by the Council under the guarantee.
- 2.16 The risk that the Council suffers a loss under the Framework Agreement and the joint and several guarantee is therefore a combination of the low risk of a default by a local authority and the low risk that if a local authority does default, local authorities cannot recover sums owed to them.
- 2.17 In return for accepting this low level risk, the Council will receive access to more diverse and cheaper sources of capital finance via the Agency.

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- 2.18 Although the Agency intends that the Framework Agreement is permanent, there may be a need to either amend the Framework Agreement or if the Council wishes, set aside provisions for a period of time without amending the contributions arrangements or joint and several guarantee.

3. RECOMMENDATIONS

- 3.1 The Council is recommended to:
- a) Approve the Council's entry into the Framework Agreement and its accompanying schedules including the joint and several guarantee;
 - b) Delegate authority to the Director of Finance as Section 151 Officer and Interim Director of Law as Monitoring Officer to sign those documents, as appropriate, on behalf of the Council;
 - c) Grant the Section 151 Officer delegated authority to agree amendments to the Framework Agreement as appropriate.

4. THE UK MUNICIPAL BONDS AGENCY

Establishment:

- 4.1 The establishment of the UK Municipal Bonds Agency was led by the LGA following the announcement in the 2010 Autumn Statement that PWLB rates would increase from 0.15 per cent over Gilts to 1 per cent over Gilts, greatly increasing the cost of new borrowing and refinancing. This followed the introduction of punitive early repayment penalties by the PWLB in 2007, which have prevented local authorities from restructuring their loan portfolios to reduce costs while interest rates are low. Although the Government subsequently introduced the "certainty rate", which effectively reduced the PWLB's margin to 0.8 per cent over Gilts in return for the limited disclosure of an authority's borrowing plans, the LGA found that rate remained higher than a bonds agency should be able to achieve.
- 4.2 This recent history of PWLB arrangements exposes the fact that Council are at risk of Government changing the rules. At present there are few strategic alternatives to PWLB available, and Councils rely on it very heavily. Councils would never risk investing the majority of their cash balances with one institution, but are taking a very similar risk on sources of borrowing.
- 4.3 The LGA also noted that it was easy for UK investors such as pension funds to provide capital to overseas local authorities through the London capital markets, but not so to UK local authorities.

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- 4.4 The LGA published a revised business case in March 2014 that set out how a bonds agency would issue bonds on behalf of local authorities in an efficient and cost effective manner and at lower rates than the PWLB. It identified that the regulatory environment meant that the PWLB had a de facto monopoly on providing simple loans to local authorities:
- For regulatory purposes a bank must set aside capital when lending to local authorities – unlike when lending to the Government – and therefore it is difficult for banks to compete with the PWLB on rates and make money other than by offering structured lending products.
 - Bond investor's value liquidity and benchmark sized issues (£250 million), which makes it difficult for most local authorities to access the bond markets, particularly as one-off bond issues can be costly.
 - International agencies, such as the EIB, would typically lend only for large projects or invest in liquid benchmark sized bond programmes, typically around £200 million plus, thereby excluding most local authorities.
- 4.5 The LGA's revised business case was published in March 2014 and the company established in June 2014. 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 institutions, and facilitating longer term inter-authority lending via the Agency.
- 4.6 The LGA and 56 local government shareholders representing 65 principal local authorities and 1 combined authority have invested over £6 million in the Agency

Client Base:

- 4.7 The Agency will only lend to UK local authorities who can give a joint and several guarantee. This is currently limited to 353 principal English local authorities that have the general power of competence under section 1(1) of the Localism Act 2011. The Department for Communities and Local Government specifically intended that local authorities should be able to give guarantees using the power in its regulatory impact assessment.
- 4.8 The ability to give joint and several guarantees may in due course be extended to other local authorities e.g. combined, Welsh or Scottish authorities. In the event that this occurs, those authorities will be eligible to borrow from the Agency.
- 4.9 The Agency would prefer all borrowers to become shareholders. This ensures a strong alignment of interest between borrowers and shareholders,

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and is viewed positively by ratings agencies and the capital markets. Accordingly, the Agency will charge a higher interest rate to borrowers that are not shareholders, albeit one which remains competitive.

Loan Pricing:

- 4.10 The Agency will operate a transparent pricing structure. 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 an annualised 0.1%, for shareholders, to cover the ongoing costs of the agency. Non-shareholders may be charged at a higher rate of 0.15% annualised, to encourage their participation as shareholders.
- 4.11 The Agency may adjust these margins for new borrowing transactions at its discretion, but will not increase them. It is expected that these margins will reduce once the Agency is profitable.
- 4.12 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.
- 4.13 The Agency will not require local authorities to borrow at a rate that is higher than the PWLB, thus when borrowing via the Agency the Council should always achieve a saving. Over time, the rates offered by the Agency are likely to improve as its bonds programme develops and it is able to borrow from international institutions such as the EIB.

Early Repayment (Prepayment):

- 4.14 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.
- 4.15 Prepayment rights will track through between the loans to local authorities and the Agency's financing. For bond issues, voluntary prepayment is calculated in a similar way to the PWLB's early redemption penalties, although one option available to local authorities will be to buy back part of the bond.

Governance:

- 4.16 The Agency is a public limited company and as such is directed by its Board.
- 4.17 In addition, the Board will have the following 2 sub- committees, chaired by independent non-executives:

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- Risk, Compliance and Audit Committee; and
- Nomination and Remuneration Committee.

4.18 In addition, the Agency will establish a Local Authority Advisory Board, comprising local authority finance officers, to facilitate two-way communication between the Agency and its borrowers. (S151 officers from the initial group of borrowers will make up the inaugural Local Authority Advisory Board and will determine the detailed terms of reference in consultation with the Board of the UKMBA, including ongoing member selection process.)

Credit Process:

4.19 Prior to approving any loans, the Agency will carry out a credit assessment of each potential borrower.

4.20 The Agency has developed a proprietary credit scoring model based on similar methodologies to the main credit rating agencies. In order to access funding from the Agency, a local authority will need to be able to achieve a "single A" credit rating on a standalone basis; rating agencies typically "notch up" a local authority to account for implied Government support.

4.21 The model is based on Moody's, one of the main three global credit ratings agencies. It has been reviewed independently by Ernst & Young to validate its robustness and fitness for purpose. The model looks at both quantitative, e.g. the financial performance of the council, the existing level of borrowing, how much flexibility does the council have in generating revenues and qualitative factors, e.g. is the council heavily dependent upon revenues from a single business or industry, has the council had governance, audit or other performance related issues.

4.22 The Agency will assess the council informally, upon an expression of interest, and advise if there are likely to be any credit related problems in advance of any formal request for borrowing

4.23 In addition to credit scoring, the UKMBA will ensure appropriate diversification of its lending portfolio, through the contractual concentration limits agreed in the Framework Agreement.

5 THE FRAMEWORK AGREEMENT AND THE JOINT AND SEVERAL GUARANTEE

Content of the Framework Agreement:

5.12 The Framework Agreement comprises:

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- The Framework Agreement itself, which is primarily designed to prevent a call on the joint and several guarantee and lays out how the Agency will interact with local authorities.
- Schedule 1: *Form of Authority Accession Deed*, which local authorities sign to commit themselves 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 and etc. It is signed by the Agency and a borrower.

Need for the Joint and Several Guarantee:

- 5.2 The LGA's revised business case highlighted the need for borrowing authorities to sign a joint and several guarantee:
- The joint and several guarantee allows the Agency to issue bonds without having to prepare a full prospectus for each bond issue, pursuant EU's "Prospective Directive", thereby reducing costs and complexity.¹
 - The UK Listing Authority's "listing rules" that govern whether financial instruments can be listed on a UK stock exchange would not permit bonds issued by an agency to be listed on the London Stock Exchange for some years without a joint and several guarantee, meaning the bonds would need to be listed elsewhere such as the Channel Islands or Luxembourg.
 - If, instead of a joint and several guarantee, investors were investing in individual stand-alone bond issues, every bond would require a separate credit rating. Investors would have to assess the participating authorities in each bond, which would materially impact an agency's ability to reduce costs and deter a number of potential investors and lenders from lending money to the agency. The joint and several guarantee draws on the strength of the local government sector and is simple for investors to understand.

Nature of the Joint and Several Guarantee:

- 5.3 The joint and several guarantee is a schedule to the Framework Agreement and is direct, unconditional, irrevocable and not separately administered:

¹ Article 1(2)(d) of Directive 2003/71/EC

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"2.1.1 guarantees to each Beneficiary each and every obligation and liability the Company may now or hereafter have to such Beneficiary (whether solely or jointly with one or more persons and whether as principal or as surety or in some other capacity) in respect of the Guaranteed Liabilities and promises to pay to each Beneficiary from time to time on demand the unpaid balance of every sum (of principal, interest or otherwise) now or hereafter owing, due or payable (following the expiry of any grace period provided for) by the Company to any such Beneficiary in respect of any such Guaranteed Liability; and

2.1.2 agrees as a primary obligation to indemnify each Beneficiary from time to time on demand from and against any loss incurred by such Beneficiary as a result of any such Guaranteed Liability being or becoming void, voidable, unenforceable or ineffective as against the Company for any reason whatsoever, whether or not known to such Beneficiary, the amount of such loss being the amount which such Beneficiary would otherwise have been entitled to recover from the Company."

- 5.4 In practice this means that all borrowers are collectively and individually guaranteeing the lenders to the Agency against a default by a local authority.
- 5.5 The Council can withdraw from the joint and several guarantee by giving notice and repaying its loans to the Agency. However, the irrevocable nature of the guarantee means that the Council will continue to guarantee the Agency's borrowings at the date of withdrawal until those borrowings mature. This prevents moral hazard i.e. a local authority borrowing from the Agency to achieve a cheaper borrowing rate, but walking away from the obligations. Withdrawal does mean that the Council will not be guaranteeing future borrowing by the Agency.

Preventing a Call on the Guarantee:

- 5.6 The Framework Agreement significantly the risk of a possible call on the joint and several guarantee by minimising the risk of default by a local authority, limiting the possible impact of a default and containing a default before the Agency's ability to make payments is threatened.
- 5.7 The Framework Agreement imposes obligations on the Agency that are designed to reduce the possibility of default by a borrower:
- The Agency must credit assess each borrower and exclude those that do not achieve at least the equivalent of a strong investment grade rating equivalent to an "A" rating from the established credit rating agencies such as Moody's.

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- “Concentration limits” ensure that the Agency will maintain a diverse loan book over time that limits the proportion of the Agency’s loan book that can be lent to a single or small group of authorities.
 - Credit lines are available to the Agency that it must utilise in the event of a local authority missing a payment or defaulting, before it has recourse to other borrowers.
- 5.8 The Framework Agreement establishes a “contributions” mechanism that requires borrowers to lend the Agency funds to cover its obligations in the event of a default by a local authority. In practice, this default is likely to be on a periodic interest payment due on the bond, and so will be of limited size. There will be time to work with the defaulting authority to correct the position before further default occurs.
- 5.9 The contributions to cover default are calculated in proportion to an authority’s share of the performing loan book, limiting each Council’s exposure. The loans are interest bearing and will be repaid once the Agency has recovered the sums owed to it by the defaulting authority, which it is required to do by the Framework Agreement. If the Council has no outstanding borrowings via the Agency, it will not be called upon to make contributions under the Framework Agreement.
- 5.10 In practice, this means that if the Agency had £275m, which paid 3% interest, in outstanding debt, split evenly between 11 councils, and a single council defaulted on an interest payment. Each of the other participating councils would be asked to contribute 10% of the defaulted interest payment to ensure that the investor was paid on time. That would equal £75 thousand each. (The UKMBA has a credit facility in place, which may also be used to cover this default.)
- 5.11 The defaulting council would then be pursued through the courts for full repayment plus interest costs. Upon resolution of Council’s default, it is expected that contributions would be returned with interest.
- 5.12 The payment schedules set out in the Framework Agreement are designed to ensure timely payments by local authorities so that error or late payment by a borrower does not risk a call for contributions or under the guarantee.
- 5.13 The Framework Agreement prevents a Council from taking action against a defaulting authority so that a single authority cannot jeopardise the structure of the Agency and / or act against the interests of other borrowers.

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Accounting for the Guarantee:

- 5.14 The Agency commissioned accounting advice from Grant Thornton setting out the local authority accounting requirements for borrowing via the Agency including the joint and several guarantee.
- 5.15 Although the Council is unable to rely on this advice and must procure additional advice if it is uncertain regarding the accounting requirements, Grant Thornton's advice does not raise any concerns at this time. For example, if the Council judges the risk of a call under the joint and several guarantee to be zero, the accounting requirements of entering into the Framework Agreement are minimal and mostly confined to disclosures in the event that the Council borrows from the Agency.

6 RISK OF DEFAULT BY AN AUTHORITY

- 6.1 The risk of a default by a local authority is deemed to be very low: no principal local authority has ever defaulted on a loan. The National Audit Office in its *Financial Sustainability of Local Authorities* report of November 2014 observed:

"A legal framework at the core of the local government accountability system effectively prevents local authorities becoming insolvent. Local authorities cannot borrow to finance revenue expenditure or run deficits."

- 6.2 The statutory and prudential framework under which local authorities operate is extremely strong and designed to prevent local authorities from over-reaching themselves and becoming insolvent. Key aspects of the framework include:
- Local authorities are prevented from borrowing to fund services by the Local Government Finance Act 1992, which sets out how budgets and the Council Tax must be calculated, particularly Section 31A, 32 and 42A of the Act. These provisions require a budget to be balanced on a cash basis without the use of borrowing.
 - Local authorities must comply with the prudential framework established by Part 1 of the Local Government Act 2003 and related regulations, including the Prudential Code for Capital Finance in Local Authorities published by CIPFA.
 - Section 151 Officers have varied powers and responsibilities that result in prudent financial management. For example, if an authority cannot pay its bills at it falls due, he or she must submit a Section 114 report to the Executive / Council, which must be acted upon. A Section 151 officer must also report on the adequacy of reserves and robustness of budget

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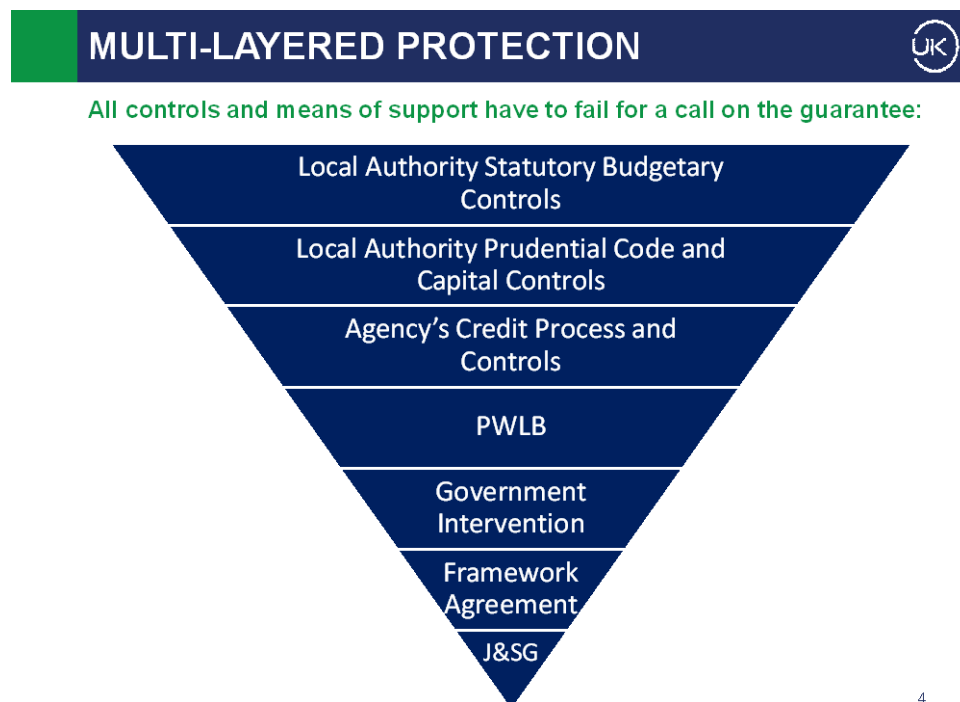
estimate under Section 25 of the Local Government Act 2003 and action be taken by the Council to remedy an adverse report.

- A local authority must make a Minimum Revenue Provision ("MRP") repay debt under the local authorities (*Capital Finance and Accounting*) (*England*) Regulations 2003, issued by the Secretary of State under Sections 21 of the Local Government Act 2003 (as amended). This means that a local authority sets aside cash via its revenue budget, sufficient to ensure it can repay its debt. So the repayment of the bond on maturity is covered.
- 6.3 The Agency's credit assessments, risk management processes and the concentration limits should reduce the possibility that a local authority borrowing from the Agency is likely to default.
- 6.4 Local authorities have access to the PWLB as lender of last resort and therefore can refinance any borrowings from the Agency by the PWLB if it cannot repay its debt to the Agency by other means.
- 6.5 Historically, the Government has intervened when a local authority finds itself in difficult or the Government deems a local authority to be incapable of managing itself effectively.
- 6.6 For the Council to be called upon to make contributions under the Framework Agreement, let alone be called upon under the joint and several guarantee, all the above controls and protections must fail. This has been summarised by the Agency in its presentations as set out in figure 1 below:

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7 RISK OF NOT RECOVERING CONTRIBUTIONS OR PAYMENTS UNDER THE JOINT AND SEVERAL GUARANTEE

7.1 The Local Government Act 2003 provides several key protections to lenders that greatly reduce the possibility that the Agency and therefore the Council would be unable to recover sums owed to it if it is required to make a contribution or pay out under the joint and several guarantee:

- Section 6 provides that a lender is not required to ensure that a local authority has the power to borrow and is not “prejudiced” in the absence of such a power. This prevents a local authority claiming an act was “ultra vires” to side step its obligations.
- Section 13 provides that all debts rank pari passu i.e. have equal status under the law and thus a creditor cannot be disadvantaged by later subordination of that debt by a local authority.
- Section 13 also secures all debts of an authority on its revenues, which is the strongest possible security for a loan as the bulk of a local authority's revenues are either raised under statutory powers or allocated by the Government.

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- Section 13 also provides for a receiver to be appointed by the High Court on application if principal and / or interest greater than £10,000 is outstanding for 60 days.

7.2 The Framework Agreement requires that the Agency must pursue any defaulting authority to the extent that if it does not do so promptly, borrowers can force it to do so. Furthermore, the Framework Agreement provides for a strict application of the proceeds of any debt recovered by the Agency from a defaulting authority.

8. LEGAL ADVICE AND OPINION

8.1 A small group of authorities commissioned Allen & Overy, a law firm, a specialist in financial transactions, to advise on the Framework Agreement. Allen & Overy engaged Jonathan Swift QC to provide senior counsel's opinion on, amongst other things, whether:

- Entry into the Framework agreement, execution of the Guarantee, entry into borrowing transactions under the Framework Agreement and the provision of contribution loans would all be within the general power of competence under the Localism Act 2011; and
- A local authority that decides to enter into the Framework Agreement and the Guarantee on the basis of the Document Package would be acting in accordance with the requirement of Wednesbury reasonableness.

8.2 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.

8.3 Wider considerations, such as establishing the independence of the sector, whether they have merit or not, should not have a bearing on the Council's assessment of the advantages and disadvantages of entering into the Framework Agreement.

8.4 Jonathan Swift QC's opinion was procured independently of the Agency.

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- 8.5 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.

9. RISKS AND DISADVANTAGES OF ENTERING INTO THE FRAMEWORK AGREEMENT

- 9.1 Exposure to the contribution arrangements and the joint and several guarantee means that entering into the Framework Agreement and borrowing via the Agency is different in nature to borrowing from the Public Works Loan Board, under a bilateral loan facility or through a bond issue in the capital markets.
- 9.2 There are inherent risks associated with the proposed structure, not least the joint and several nature of the guarantee. These are:
- The risk that the Council's guarantee may be called independently of any other Guarantee and for the full amount owing by the Agency 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 UKMBA that exceed the amounts borrowed).
 - Even if the Council has terminated its Guarantee, it will continue to guarantee the "Guaranteed Liabilities" entered into by the Agency 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.
- 9.3 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 the requirement to make contributions in the event of a default by another borrower and this exposure is proportional because it is calculated by reference to the amount borrowed by the Council as a proportion of all non-defaulting loans made by the Agency.
- 9.4 The risk of a default by a local authority is low as set out in section 6 of this report. The ability of the Agency to recover sums owed to it in the event of a default is set out in section 7 of this report.
- 9.5 There is a risk that the Agency does not observe its obligations under the Framework Agreement, but the Council is entitled to expect that the Agency will operate in accordance with its obligations under the Framework Agreement when considering whether or not to enter into the Framework Agreement. The LGA and local authorities control the Agency via their

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shareholdings so could intervene if the Agency did not abide by the Framework Agreement.

9.6 The prime advantages to the Council are:

The prospect of lower borrowing costs and the possibility to obtain types of loans that are not available from the PWLB. Cheaper capital finance will reduce pressure on the Council's finances. This advantage more than offsets the low risk that a local authority defaults and the Agency is unable to recover the debts owed to it in order to repay the Council any contributions it is required to make.

Reducing risk by creating a new strategic source of finance that is not so readily exposed to changes in government policy

9.7 The Framework Agreement only comes into effect if the Council does borrow from the Agency. If the Council does not borrow, there is no risk to the Council arising from the contribution arrangements or joint and several guarantee. The Council is not obligated to borrow via the Agency 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 to the Council of the Agency either failing to deliver a saving or the Council not borrowing having signed the Framework Agreement is eliminated.