Classification: Public
Key Decision: No

Gravesham Borough Council

Report to: Council

Date: 11 October 2016

Reporting officer: Director (Corporate Services)

Subject: Municipal Bonds Agency

Purpose and summary of report:

To provide Members with an update of the Local Government Association's Municipal Bonds Agency and seek approval for the Council to adopt the Agency's corresponding Framework Agreement.

This report sets out the background to the Municipal Bonds Agency, key facets of the Framework Agreement and outlines the risks of the joint and several guarantee.

Recommendations:

1. The Council is recommended to approve the Council's entry into the Framework Agreement and its accompanying schedules (including the joint and several guarantee).

1. Introduction and Background

1.1 The primary source of borrowing for UK local authorities has historically been the Public Works Loan Board (PWLB) since there has been very little alternative to the comparatively low borrowing rates it has offered.

1.2 In June 2014, the Local Government Association (LGA) therefore established the UK Municipal Bonds Agency (MBA) with the primary objective of delivering cheaper capital finance to local authorities. It will do so via periodic bond issues as an aggregator for financing from institutions such as the European Investment Bank (EIB) and by facilitating greater inter-authority lending.

1.3 In its business case for the MBA, the LGA assessed that in stable market conditions a council borrowing £100m over 20 years from the MBA would save as much as £4.7m when compared to a loan from the PWLB.

1.4 The LGA estimated that a budget of £1m was required to set up the Agency and, once this 'mobilisation' phase was complete, a further £8m - £10m of operating capital will be required to cover launch and early operating costs and provide a buffer against risks.

1.5 The MBA is wholly owned by 56 local authorities and the LGA who together have invested over £6 million in the Agency. The Council is a shareholder in the MBA having made an investment of £20,000 in February 2015.

1.6 The Council is not seeking to borrow funds from the MBA at this present time; it is only seeking authority to agree and sign up to its Framework Agreement. Any future decision to borrowing from the Agency would be the subject of a further report.

2. The Framework Agreement

2.1 The Framework Agreement as set out in Appendix 2 comprises :

- The Framework Agreement itself which is primarily designed to prevent a call on the joint and several guarantee and lays out how the MBA 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, etc. This is signed by the Agency and the borrower.

2.2 The MBA'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 MBA to guarantee the money owed by the Agency to those who have lent it funds to finance its loans. The Framework Agreement incorporates a mechanism to prevent a call under the guarantee by requiring borrowers to lend the MBA the funds of any default by another local authority referred to as "contributions".

2.3 By adopting the Framework at this time, the Council is agreeing only to the terms and conditions detailed above that will enable it to obtain funding from the MBA should it wish to pursue this as an option in the future. Access to one of the cheapest sources of finance on the market will provide the Council with scope to reduce the costs of borrowing and therefore its impact on Council Tax. The MBA's business case suggests that savings delivered by the Agency (when compared to the PWLB) would be in the region of 0.2%.

2.4 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.

2.5 Acting on behalf of prospective borrowers, a small group of authorities appointed lawyers, Allen & Overy, to review and advise upon the documentation of the MBA. 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.

2.6 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 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.

2.7 Taken together, these three considerations help address a key requirement of the Wednesbury principles that the Council exercises its powers in a reasonable manner.

2.8 The MBA would prefer all borrowers to become shareholders. This ensures a strong alignment of interest between borrowers and shareholders and is also viewed positively by ratings agencies and the capital markets. Accordingly the MBA will charge a higher rate of interest to borrowers that are not shareholders (charging these borrowers a margin of 0.15% compared to a margin of 0.1% to those borrowers who are shareholders).

2.9 UK local authorities are subject to tight statutory control that significantly reduces the probability that a local authority will default on its financial obligations. Furthermore the MBA will undertake credit assessments of local authorities to assess 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 lawful. No principal UK local authority has ever defaulted on one of its primary debt obligations and the risk of a default is judged to be low. The National Audit Office in its Financial Sustainability of Local Authorities report of November 2014 observed that "*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*".

2.10 The MBA will only lend to UK local authorities who can give a joint and several guarantee. This is currently limited to the 353 principal English local authorities that have the general power of competence under section 1(1) of the Localism Act 2011.

3. Joint and Several Guarantee

3.1 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 to the EUs “Prospective Directive”, thereby reducing costs and complexity.

- 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 listed on the London Stock Exchange without a joint and several guarantee, meaning the bonds would need to be listed elsewhere such as the Channel Islands.

- If, instead of a joint and several guarantee, investors had recourse to challenge the MBA’s on-lending arrangements, every tranche of financing would require a separate credit rating and require investors to assess participating authorities which would materially impact the MBA’s ability to reduce costs and potentially deter a number of investors and lenders from lending money to the MBA.

3.2 Should a local authority default, the MBA has liquidity facilities available to it enabling it to 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 called upon if these facilities are exhausted. In the unlikely event of a call for contributions under the Framework Agreement or payment under the joint and several guarantee, the Council has access to PWLB funds at 48 hours’ notice if required. The joint and several guarantee is a schedule to the Framework Agreement and is direct, unconditional and irrevocable.

3.3 The risks associated with the joint and several guarantee are mitigated by the contribution arrangements. In essence, 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 since 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 with the MBA, it will not be called upon under the Framework Agreement.

3.4 In the unlikely event that the guarantee is called upon, it is also unlikely that bond-holders or other providers of finance to the MBA will pursue a single Council for payment because the best outcome for lenders is likely to be achieved by pursuing all the guarantors since this maximises the potential revenues available to repay them.

3.5 Section 13 of the Local Government Act secures all debts of a local authority on its revenues and therefore it is highly likely that the MBA 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. Although the MBA 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 contribution arrangements or joint and several guarantee. In return for accepting this risk, the Council will receive access to more diverse and cheaper sources of capital finance via the MBA.

4. Other Considerations

4.1 Early Repayment (Prepayment) – The MBA will pass on the cost of early repayment by a local authority (usually referred to as prepayment in financial services) to that local authority. The MBA will not however profit from the transaction and will assist any local authority seeking early repayment to find the cheapest solution. 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.

4.2 Governance – The MBA is a public limited company and as such is directed by its Board. The Board will have the following 3 sub-committees:

- Risk, Compliance and Audit Committee ;
- Nomination and Remuneration Committee ; and
- a Local Authority Advisory Board comprising local authority finance officers to facilitate two-way communication between the MBA and its borrowers.

4.3 Credit Process - Prior to approving any loans, the MBA will carry out a credit assessment of each potential borrower. It has developed a proprietary credit scoring model based on similar methodologies to the main credit rating agencies. In order to access funding from the MBA, a local authority will need to achieve a "single A" credit rating on a standalone basis (whereas rating agencies typically take implied Government support into consideration).

4.4 Internal Assessment - The Council's Legal Services Division have reviewed the Framework Agreement and assessed there were no issues contained within the Agreement that should give the Council any cause for concern.

5. Background Papers

Appendix 2 – The UK Municipal Bond Agency's Local Authority Financing Framework Agreement.

Anyone wishing to inspect background papers should, in the first place, be directed to Committee & Electoral Services who will make the necessary arrangements.

IMPLICATIONS	**APPENDIX 1**
Legal	Under Section 151 of the Local Government Act 1972, the Section 151 Officer has statutory duties in relation to the financial administration and stewardship of the authority, including securing effective arrangements for treasury management. Taking an active part in the establishment of the Agency does not commit the Council to borrowing but would give early access to cheaper borrowing if required.
Finance and Value for Money	The MBA should assist with the Council’s aim to become more financially self-sufficient by bringing competition to the market and offering the Council a potential cheaprt source of capital funding.
Risk Assessment	The benefits of the MBA and signing up to its Framework Agreement are judged to outweigh the risks. It frees local authorities from the uncertainty of unpredictable Government adjustments of PWLB interest rates and the significantly higher repayment burden any increase would imply.
Equality Impact Assessment	**Screening for Equality Impacts**
	Question
	a. Does the decision being made or recommended through this paper have potential to cause adverse impact or discriminate against different groups in the community? If yes, please explain answer. No
	b. Does the decision being made or recommended through this paper make a positive contribution to promoting equality? If yes, please explain answer. No
	In submitting this report, the Chief Officer doing so is confirming that they have given due regard to the equality impacts of the decision being considered, as noted in the table above
Corporate Plan	Strategic Objective 4 – Sound and self-sufficient council
Crime and Disorder	N/A
Digital and website implications	N/A
Safeguarding children and vulnerable	**N/A**

adults	