BLACKPOOL COUNCIL

REPORT

of the

DIRECTOR OF RESOURCES

to the

EXECUTIVE

on

12 September 2016

Approval for the Council to Borrow from the UK Municipal Bonds Agency

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1. Introduction

1.1 This report seeks approval for the Council to enter into an arrangement with the UK Municipal Bonds Agency (the "Agency"). The Agency requires that local authorities borrowing from it enter into its Framework Agreement.

1.2 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.

2. Background

2.1 The purpose of the Agency is to deliver 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. The Agency is wholly owned by 56 local authorities and the Local Government Association (LGA). The Council is a shareholder in the Agency with an investment of £10,000.

2.2 The Council has limited sources of capital finance available to it with the main source of long-term borrowing being the Public Works Loan Board (PWLB). The cost of borrowing 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 provider of long-term loans to the PWLB.

3. Framework Agreement and Guarantee

3.1 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 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".

3.2 The Council has the power to enter into the Framework Agreement under Section 1 (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.

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

3.4 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.

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

3.6 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 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 Public Works Loan Board is available to all local authorities as lender of last resort provided that the borrowing from the Public Works Loan Board 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.

3.7 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 covers a limited default on a principal repayment by a local authority; the provisions of the Framework Agreement will be used if these facilities are exhausted. Blackpool had unearmarked reserves of £5.6m million as at 31 March 2016 and in the unlikely event of a call for contributions under the Framework Agreement or payment under joint and several guarantee, has access to Public Works Loan Board funds at 48 hours' notice if required (this is a similar arrangement to the one that exists between the Council and Lancashire Pension Fund).

3.8 The risks associated with the joint and several guarantees 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.

3.9 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.

3.10 Section 13 of the Local Government Act 2003 secures all debts of a local authority on its revenues and therefore it is highly 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.

3.11 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 are unable to recover sums owed to them.

3.12 In return for accepting this risk the Council will receive access to more diverse and cheaper sources of capital finance via the Agency. On balance the financial advantages outweigh the financial disadvantages.

3.13 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 contribution arrangements or joint and several guarantee.

4. Client Base and Loan Pricing

4.1 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.

4.2 The Agency 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. Accordingly the Agency will charge a higher interest rate to borrowers that are not shareholders, albeit one which still remains competitive.

4.3 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:

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

4.4 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.

4.5 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 account for them in-year.

4.6 The Agency will not require local authorities to borrow at a rate that is higher than the Public Works Loan Board, 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 institutions such as the European Investment Bank.

5. Recommendations

1. To approve the Council's entry into the Framework Agreement and its accompanying schedules including the joint and several guarantee.

2. To delegate authority to the Director of Resources as Statutory Finance Officer and the Director of Governance and Partnerships as Monitoring Officer to sign those documents, as appropriate, on behalf of the Council.

3. To grant the Director of Resources delegated authority to agree amendments to the Framework Agreement as appropriate.

MR S THOMPSON
DIRECTOR OF RESOURCES