

**UK MUNICIPAL BONDS AGENCY PLC**

**DOCUMENTS PACKAGE FOR LOCAL AUTHORITIES**

**21 DECEMBER, 2015**

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# **DOCUMENT ONE**

## **EXECUTIVE SUMMARY** **(prepared by Allen & Overy)**

**UK MUNICIPAL BONDS AGENCY PLC: EXECUTIVE SUMMARY**  
**(PREPARED BY ALLEN & OVERY)**

**1. Introduction**

- 1.1 We have been appointed by Birmingham City Council, Reading Borough Council and Southwark Borough Council (the **Councils**), who are acting as an informal working group on behalf of English local authorities (each, an **LA**), in relation to a Local Authority Financing Framework Agreement (the **Framework Agreement**) which is proposed to be entered into by UK Municipal Bonds Agency PLC (**UK MBA**) and each LA wishing to borrow from UK MBA. We have agreed to provide advice to LAs as to the matters, and to the extent, set out in this Executive Summary and the Follow-up Memorandum referred to below (the **Advice**). The scope of the Advice is limited to those matters: however, we are able to provide further advice to any LA on the documents or transactions referred to therein, which can be arranged separately and to which separate fee arrangements will apply.
- 1.2 Nothing in the Documents Package (as defined below) should be construed as a recommendation by us or any of the Councils to enter into the Framework Agreement. Each LA must form its own assessment as to the merits of entering into the Framework Agreement after taking into account the contents of the Documents Package as a whole, as well as any other factors which that LA deems relevant to its own circumstances.
- 1.3 We have reviewed and commented on six separate drafts of the Framework Agreement (dated 10 April, 2015, 2 September, 2015, 9 September, 2015, 16 September, 2015, 14 December, 2015 and 18 December 2015) prepared by Clifford Chance (acting for UK MBA) We have also provided comments on the Introduction to the UK Municipal Bonds Agency referred to below, which was prepared by UK MBA (and which includes, as an appendix, a layperson's guide to the Framework Agreement). We also prepared the Instructions to Counsel for the purpose of obtaining the Counsel's Opinion referred to below.
- 1.4 This Executive Summary forms part of a package of documents (as seen and initialled by us for identification, the **Documents Package**) which has been prepared jointly by us, the Councils, UK MBA and Clifford Chance to help LAs with their internal approval processes. This Executive Summary is intended to be a summary only and, for the purposes of any LA deciding whether it would be prudent for it to enter into the transactions envisaged by the Framework Agreement, it should be read in conjunction with the rest of the Documents Package. The other documents in the Documents Package are:
- (a) Document 2: Introduction to the UK Municipal Bonds Agency – this provides an overview of UK MBA, its background, its objectives, its operating model and its governance. It also

contains, as an appendix, a "*Guide to the Framework Agreement*", which is intended as a detailed, but layperson accessible, guide to the Framework Agreement. Please note that the "*Guide to the Framework Agreement*" is only intended to be a summary, intended for ease of accessibility to, and not a substitute for, the Framework Agreement and precedence should always be given to the Framework Agreement.

- (b) Document 3: Framework Agreement – final draft dated 14 December, 2015. Please note that it is for each LA to satisfy itself as to whether the execution version of the Framework Agreement that it is being asked to sign is in the same form as the final draft Framework Agreement attached as Document 3.
- (c) Document 4: Follow-up Memorandum – this provides details of the history of our review of the Framework Agreement and outlines the risks originally identified therein, our and Counsel's suggested amendments, the extent to which these risks have been addressed in the final Framework Agreement and, in our opinion, any residual risks that remain for LAs to consider before entering into the Framework Agreement. We also briefly address (i) how the Framework Agreement caters for the concept of a "combined authority" consisting of two or more LAs (pursuant to an order of the Secretary of State pursuant to section 103 of the Local Democracy, Economic Development and Construction Act 2009) and (ii) any further mitigation arising for the benefit of LAs by operation of law (i.e. outside of the Framework Agreement).
- (d) Document 5: Counsel's Opinion – Jonathan Swift QC was asked to provide an opinion as to whether (among other things) (x) entry into the Framework Agreement, execution of the Guarantee (as defined below), entry into borrowing transactions under the Framework Agreement and the provision of contribution loans (if required) would (subject to compliance with *Wednesbury* reasonableness requirements) all be within the general power of competence under the Localism Act; and (y) an LA that decides to enter into the Framework Agreement and the Guarantee on the basis of the Documents Package (assuming that it has properly read and understood its contents and duly evaluated the risks identified, and has followed all appropriate procedural requirements) would be acting in accordance with the requirements of *Wednesbury* reasonableness. His main conclusions are that: (a) LAs do have the power, in principle, to enter into the arrangements envisaged by the Framework Agreement; and (b) whilst it would, in principle, be lawful for a reasonably financially robust LA to enter into the commitments entailed in the Framework Agreement, the final assessment of whether or not it would be a reasonable use of the in principle power must be made taking into account the specific financial position of each LA. Jonathan Swift QC's opinion was procured independently of UK MBA for the benefit of the Councils as an

informal working group on behalf of LAs as a whole. The Instructions to Counsel are also attached for information. Please note that the Instructions to Counsel make reference to an earlier draft of the Framework Agreement; however, having reviewed the version of the Framework Agreement attached as Document 3, Jonathan Swift QC's final opinion relates to that version.

- (e) Document 6: Accounting advice – this report from Grant Thornton (the **Accounting Report**) details the accounting requirements for LAs in relation to the Guarantees and the Loans (as defined below). It sets out the key requirements and options/methodologies available under the Code of Practice for Local Authority Accounting in the UK in preparing statutory financial statements. Please note that, as expressly stated in the Accounting Report at paragraph 2.12, the Accounting Report is provided to LAs for information purposes only and that Grant Thornton will not accept or assume responsibility to any LA for its contents.
- (f) Document 7: Standard confirmation of LA's authority to borrow from UK MBA and execute a Guarantee – this is a template, prepared by UK MBA, of the form of confirmation it will expect to receive from each LA entering into the Framework Agreement.

1.5 It should be noted that, other than in relation to the Framework Agreement, Counsel's Opinion as to *Wednesbury* reasonableness (as described at 1.4(d) above) was based upon working drafts of the documentation constituting the Documents Package (with Counsel giving his Opinion on the proviso that there would be no material change to the final form of these documents). As mentioned above, we (Allen & Overy) have seen and initialled for identification a final form Documents Package, and we are of the view that none of the changes to the documents therein since the drafts of those documents provided to Counsel are material for the purposes of Counsel's analysis as to the requirements of *Wednesbury* reasonableness. For the avoidance of doubt, Counsel's Opinion was based on the final version of the Framework Agreement contained at Document 3 in the Documents Package.

## 2. **Proposed structure**

2.1 LAs that wish to borrow from UK MBA will (subject to the relevant LA acceding to the Framework Agreement and fulfilling the requirements and CPs in relation thereto) guarantee, on a joint and several basis, UK MBA's payment obligations under all its borrowings from bilateral lenders and all the bonds issued by it in the capital markets (the **Guarantees**). In relation to each LA that enters into the Framework Agreement and executes a Guarantee (a **Participating LA**), the obligations of such Participating LA will only become effective when it first agrees to borrow funds from UK MBA. UK MBA will lend the proceeds of each bilateral borrowing facility and bond issue to one or more of the

Participating LAs (the **Loans**). It is intended that, for each individual Loan, there will be some form of advance commitment or conditionality on the part of the relevant Participating LA to enter into the Loan subject to agreed parameters as to, among others, interest rates and utilisation dates. Such mechanics are intended to allow UK MBA to canvas investor appetite for a bond issue (or other bilateral lending) with certainty as to financial commitments from Participating LAs. Further details on these commitment and conditionality arrangements will be available from UK MBA.

- 2.2 The terms of the Loans will require that each payment of interest or principal by a Participating LA to UK MBA be made a specific number of days prior to the corresponding payment being due from UK MBA under its bilateral borrowing facility or bond issue.
- 2.3 If a Participating LA defaults in making one of these payments to UK MBA, UK MBA may require each other Participating LA that is a party to the Framework Agreement to put UK MBA in funds to cover the shortfall (the **contribution arrangements**). The amount payable by each Participating LA under the contribution arrangements will be the proportion of the shortfall equal to that Participating LA's borrowings as a proportion of the borrowings of all non-defaulting Participating LAs from UK MBA (and therefore any Participating LA with no outstanding borrowings from UK MBA at such time will not be liable to make a contribution loan under the contribution arrangements - but will potentially still be liable to make payments under its Guarantee if (inter alia) UK MBA fails to exercise the contribution arrangements or the contribution arrangements fail to produce the relevant amount of money for UK MBA, as described further below).
- 2.4 The rationale for the structure is that: (i) the existence of the joint and several Guarantees is intended to enable UK MBA to provide LAs with finance on cheaper terms than they would otherwise be able to access; and (ii) the contribution arrangements, and UK MBA's own credit assessment processes, are intended to forestall any need for those Guarantees to be called, and to ensure that if a Participating LA does default on its payments to UK MBA, the shortfall is spread across the remaining Participating LAs in proportion to the outstanding amount of their borrowings from UK MBA.
- 2.5 Given Participating LAs' exposure to the contribution arrangements and/or the Guarantee when borrowing from UK MBA, it is important to understand that entering into the Framework Agreement and borrowing from UK MBA is therefore very 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.

### **3. Key risks to Participating LAs**

- 3.1 We (Allen & Overy) are of the view that (other than to the extent described in the Follow-up Memorandum attached as Document 4) the risks and concerns identified by us in relation to the Framework Agreement have been satisfactorily addressed in the final Framework Agreement.
- 3.2 However, there remain inherent risks associated with the proposed structure for any LA entering into the Framework Agreement, not least the joint and several nature of the Guarantees that Participating LAs are required to provide before borrowing from UK MBA. The risk to a Participating LA is that its Guarantee may be called independently of any other Guarantee and for the full amount owing by UK MBA under any financing document which is covered by such Guarantee (and, therefore, such Participating LA is potentially liable to pay out amounts to UK MBA that vastly exceed the amounts borrowed).
- 3.3 Participating LAs should also note that, even after a Participating LA has terminated its Guarantee in accordance with clause 2.4.1 of the Framework Agreement, it will continue to guarantee the "Guaranteed Liabilities" (as defined in the Framework Agreement) entered into by UK MBA before the date of termination of the Guarantee. The effect of this is that a Participating LA's liability under its Guarantee may potentially continue in existence for many years after termination (subject to the limit contained at clause 5.3.5 of the Framework Agreement that UK MBA may not incur borrowings with a term greater than 50 years). This could be the case, for example, where the "Guaranteed Liabilities" are in respect of a bond issue with up to a 20 to 30 year maturity.
- 3.4 However, the risks associated with the Guarantees are, other than in the situation identified in paragraph 3.5 below, mitigated by the contribution arrangements mechanism (which, if operating as intended, would prevent any call on a Guarantee being made, as is the intention behind the structure). The Framework Agreement is therefore designed such that the real exposure for Participating LAs, from a practical perspective, should be under the contribution arrangements rather than the Guarantees, and that the exposure of each Participating LA (though necessarily greater than merely the amount borrowed by it) would be calculated by reference to the amount borrowed by it as a proportion of all non-defaulting Participating LA borrowings under the structure. It should be noted that, subject to the provisions relating to voluntary prepayment contained in clause 6.5 of the Loan Standard Terms, Participating LAs can prepay their Loans by giving not less than 60 days' notice to UK MBA. There is, therefore, a risk that Participating LAs can limit their liability to make a contribution (given that, once a Participating LA has reduced its borrowings from UK MBA to zero, it is not liable to make contribution loans under the contribution arrangements (although its Guarantee can still be called)). It is therefore for each Participating LA to form a view as to the risk of one or more other Participating LAs defaulting under their obligations under the Framework Agreement such that that Participating LA (i) will be liable to make a contribution loan, or (ii) will



be liable to make payments under its Guarantee (for example in the scenario identified in paragraph 3.5 below).

- 3.5 Even though Participating LAs are entitled to expect that UK MBA will operate in accordance with its obligations under the Framework Agreement, Participating LAs are nevertheless inevitably exposed to the risk that UK MBA fails to observe its obligations under the Framework Agreement. This may include failure to sustain and police robust due diligence and credit assessments on acceding LAs (therefore making it more likely that Participating LAs will need to contribute over and above their borrowings whether through the contribution arrangements or the Guarantee). It is also possible that UK MBA itself may default on its underlying bilateral borrowings from counterparties or under bond issues by not managing its cash flows in a prudent manner or that UK MBA may fail to (or be unable to) operate the contribution arrangements in a manner as envisaged in the Framework Agreement, in which case, each Participating LA is exposed to a call on its Guarantee without the protection that the contribution arrangements provide. It is therefore for each Participating LA to form a view as to the extent of these risks.
- 3.6 However, the Framework Agreement does contain provisions to mitigate the risks identified above (as to which we refer you to paragraph 11 of Counsel's Opinion). In summary, these include (without limitation) (i) the contractual obligations upon UK MBA to undertake (among other things) credit assessments of each LA, both when that LA accedes to the Framework Agreement to become a Participating LA, at any time any decision is made to lend to that Participating LA and periodically thereafter, (ii) the limit on the amount each Participating LA may borrow from time to time, (iii) the matched transaction basis on which UK MBA itself will borrow money, and (iv) the power for Participating LAs to collectively instruct UK MBA not to undertake further borrowing.

#### **4. Miscellaneous**

- 4.1 Allen & Overy, in providing the Advice, has taken instructions solely from the Councils. We accept a duty of care to LAs in relation to the Advice, but subject to the provisions of paragraph 12 of the Follow-up Memorandum. The statements made by us in this Executive Summary and the Follow-up Memorandum are in relation to the Documents Package (as initialled for identification by us) only and do not take into account any future changes to the documents constituting the Documents Package or any change of law applicable thereto and, for the avoidance of doubt, we do not accept any duty of care in relation to any such changes.
- 4.2 As mentioned earlier, Allen & Overy is able to provide further advice to any LA should it wish further clarifications or advice. This can be arranged separately and separate fee arrangements will apply.

Allen & Overy LLP

21 December, 2015

## **DOCUMENT TWO**

### **INTRODUCTION TO THE UK MUNICIPAL BONDS AGENCY ("UK MBA") (prepared by UK MBA)**

# **Introduction to the UK Municipal Bonds Agency (“UK MBA”)**

## **A guide for Local Authorities**

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## **Background to the UK MBA**

The Local Government Association ("**LGA**") established the UK MBA in June 2014 with the primary objective of reducing UK local authority financing costs, through becoming the most efficient and cost effective provider of finance.

The UK MBA currently has 56 local authority shareholders, along with the LGA, which was the founder shareholder.

The UK MBA will borrow money from a variety of third parties, including local authorities, and on-lend, on a matched funding basis, to UK local authorities.

In order to achieve the most competitive pricing, the UK MBA will have to be viewed as a strong counterparty and have a strong credit rating, achieved through (amongst others), the following mechanisms:

- a joint and several guarantee granted by each of the borrowing local authorities covering the full amounts owed by the UK MBA under any financing document which is covered by the guarantee;
- contribution arrangements whereby, if a local authority defaults on one of its payments to the UK MBA, the UK MBA shall require each other local authority that is party to the Framework Agreement (as defined below) to put UK MBA in funds to cover the shortfall; and
- a very conservative risk profile.

It is acknowledged that, in giving a joint and several guarantee, local authorities will be relying on the UK MBA to ensure appropriate standards of credit worthiness in relation to each of the local authorities and liquidity management.

## Why is the joint and several guarantee required?

As part of the original outline business case, significant consideration was given to putting in place a joint and several guarantee, and whether there were any alternatives, which would allow the UK MBA to fulfil its objective of reducing local authority borrowing costs.

The key reasons for requiring a joint and several guarantee to be granted by each local authority wishing to borrow from the UK MBA are as follows:

- The joint and several guarantee allows the UK MBA to issue bonds without having to prepare a prospectus, pursuant to Article 1(2)(d) of Directive 2003/71/EC (the "**Prospectus Directive**"), thereby reducing costs and complexity.
- If instead of a joint and several guarantee investors had recourse to the UK MBA's rights under on-lending arrangements, every tranche of financing which the UK MBA enters into would have to be assessed separately by investors as the underlying mix of local authorities would differ. Over time, this would materially impact the ability of the UK MBA to build a pricing advantage as the volume of third party borrowing increased and, indeed, probably deter a number of potential investors from lending money to the UK MBA.
- If instead of a joint and several guarantee investors had recourse to the UK MBA's rights under on-lending arrangements each bond may be assessed and rated differently by the credit ratings agencies. In addition, ratings agencies would have to review each local authority which was borrowing from the UK MBA.

## The UK MBA's Client Base

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

This client base is currently limited to 353 principal English local authorities, which have the general power of competence pursuant to section 1(1) of the Localism Act 2011 (the "**General Power of Competence**") including the power to give a joint and several guarantee, and which satisfy the terms of the Framework Agreement (as defined below) in relation to accession of local authorities.

The ability to give joint and several guarantees may in due course be extended to other local authorities, e.g. combined authorities or Scottish or Welsh authorities. In the event that this occurs, they will be eligible to borrow from the UK MBA, subject to appropriate credit checks.

The UK MBA would, in due course, like all local authority borrowers to become shareholders in the UK MBA. This ensures a stronger alignment of interests between local authority borrowers and shareholders and is viewed positively by ratings agencies and the markets. Accordingly, the UK MBA will charge a higher interest rate to local authority borrowers who are not shareholders, albeit one which remains competitive.



## **Borrowing from the UK MBA**

In order to borrow from the UK MBA, a local authority will need to enter into the Local Authority Financing Framework Agreement (the "**Framework Agreement**") with the UK MBA.

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

More details on the Framework Agreement are included in Appendix 1.

## Expected UK MBA lending timeline

The UK MBA recognises that approval processes and timelines within local authorities vary. The lead up to the initial bond issue will require a degree of coordination as local authorities who wish to borrow from the UK MBA go through these processes and the volume of demand for financing builds. The UK MBA will establish a regular conference call to facilitate that coordination. Subsequent bond issues should be easier to manage as local authorities will have approved the various documents. Nevertheless, the UK MBA will continue to take soundings from the local authority sector on desired maturities etc., in order to build demand.

To help local authorities through their internal approval process, the following documents package (a draft of which was reviewed by Counsel for the purposes of the Counsel's Opinion referred to below) will be available:

- an executive summary of the structure and the contents of the documents package, prepared by Allen & Overy, legal advisors to an informal working group of local authorities;
- this guide to the UK MBA (including a laypersons guide to the Framework Agreement as Appendix 1);
- a copy of the Framework Agreement;
- independent legal advice, by way of a memorandum from Allen & Overy on the history of their review of the Framework Agreement;
- Opinion of Jonathan Swift QC as to whether (amongst other things):
  - o entry into the Framework Agreement, execution of the joint and several guarantee, entry into borrowing transactions under the Framework Agreement and the provision of contribution loans (if required) would (subject to compliance with *Wednesbury* reasonableness requirements) all be within the General Power of Competence; and
  - o a local authority that decides to enter into the Framework Agreement and the guarantee (assuming that it has properly read and understood the contents of the relevant documentation and duly evaluated the risks identified therein, and has followed all appropriate procedural

requirements) would be acting in accordance with the requirements of *Wednesbury* reasonableness;

- accounting advice to the UK MBA, from Grant Thornton, on the accounting implications of the joint and several guarantee and borrowing from the UK MBA; and
- standard confirmation of local authorities' authority to borrow from the UK MBA and execute a joint and several guarantee.

Once a local authority has signed the required documentation, the UK MBA will carry out its credit assessments as detailed below prior to entering into any loan with a local authority. Once the UK MBA has sufficient borrowing demand built up on an informal basis from various local authorities, it will ask the relevant local authorities to sign an irrevocable commitment to borrow from the UK MBA in the form of a loan confirmation, which will be placed in escrow.

This irrevocable commitment will be limited in terms of, for example, timing and interest rates (along with any other parameters which are agreed between the UK MBA and the relevant local authority when entering into the loan confirmation), i.e. the UK MBA will not lend money to local authorities unless it can "beat" the Public Works Loan Board ("**PWLB**") rate at the time of lending. Equally, the UK MBA will not ask local authorities to sign an open-ended commitment in terms of timing. The loan confirmations will be held in escrow and only released when the conditions around timing, rates and any other stipulations are met.

We expect the majority of local authorities who wish to borrow from the UK MBA in the early stages will have received appropriate internal approvals by the end of March 2016.

The UK MBA has completed all the necessary internal steps to be able to issue a bond to fund borrowing requirements at short notice. Should a sufficient volume of local authorities approve the documentation at an earlier point in time, the UK MBA may look to shorten the timeline.

Nevertheless, the UK MBA will only issue a bond when the market conditions are appropriate, and accordingly will look for flexibility within a 2 to 4 week window, once local authorities have committed to borrowing.

## **Pricing of the UK MBA's loans**

The UK MBA operates a very transparent pricing structure.

The UK MBA will charge a margin over its underlying borrowing costs to borrowing local authorities. This margin is currently set at:

- 10 basis points for shareholders; and
- 15 basis points for non-shareholders.

The UK MBA may adjust these margins for new borrowing transactions downwards at its discretion, but will not increase them. It is expected that over time these margins will reduce.

In addition, the UK MBA will pass on any transaction costs to local authority borrowers. These costs will include: rating agency fees, bank syndication fees and legal costs. For ease, the UK MBA will round up transaction costs to the nearest basis point, but these will not exceed 50 basis points on the total amount borrowed.

## **Prepayment**

Any loans from the UK MBA will be funded by money borrowed by the UK MBA, either from the markets, institutions or local authorities.

Key terms such as prepayment rights will track through between the local authority loans and the UK MBA financing arrangements. For bond issues, voluntary prepayment is typically at “spens”, which is calculated on the basis of the net present value of all future payments calculated using the Gilt yield curve, and requires 60 days notice.

If a local authority wishes to prepay, it may be possible to find cheaper solutions, e.g. it may be cheaper to transfer the loan to another authority. The UK MBA will endeavour to assist with this.

The UK MBA will not look to make a profit on prepayment.

## **Approach to credit assessment of local authorities**

Prior to approving any loans, the UK MBA will carry out a credit review on the relevant local authority.

The UK MBA has developed proprietary credit scoring models based on similar methodologies to the main ratings agencies. In order to access funding from the UK MBA, a local authority would need to be able to achieve a single A credit rating on a stand alone basis (ratings agencies would typically “notch up” a local authority to account for implied Government support).

The UK MBA completes much of the credit analysis offsite, based on publicly available information. Any output would be discussed with the local authority's finance teams prior to finalisation.

It is expected that any non-public information, including the UK MBA's credit score, would be held confidential, on the basis of commercial sensitivity.

In addition to credit scoring, the UK MBA will ensure appropriate diversification of its lending portfolio, through the contractual concentration limits agreed in the Framework Agreement. Over time, as the UK MBA's volume of lending expands, these concentration limits may be amended through the agreement of the parties pursuant to the Framework Agreement.

## **Key elements of the Framework Agreement**

The following comments should be read in conjunction with the Framework Agreement, the terms of which shall always take precedence (including in the event of a dispute). Authorities are urged to read the Framework Agreement in its entirety.

The Framework Agreement is primarily designed to mitigate the risk of a call on the joint and several guarantee, and lays out contractually how the UK MBA will interact with local authorities.

The joint and several guarantee will be provided by local authority borrowers, in favour of the underlying providers of finance. In order to take advantage of the exemption from producing a Prospectus Directive compliant prospectus, the guarantee is required to be unconditional and irrevocable. Accordingly, from the point in time at which the guarantee is executed, a local authority is guaranteeing all financing obligations of the UK MBA. Should a local authority give notice to withdraw from the guarantee, including repaying all outstanding borrowings, it will continue to guarantee the borrowings of the UK MBA which are outstanding at that point in time.

The Framework Agreement mitigates the risk of a call on the joint and several guarantee. It does this in a number of ways:

- It requires the UK MBA to carry out certain processes, e.g. credit checks, and not to lend money to local authorities which it believes do not pass the credit assessment;
- It requires a level of diversification, which ensures that the UK MBA does not become overly concentrated in lending to a particular authority;
- It sets out timelines for payment to ensure that the UK MBA has funds in place on a timely basis, 5 working days in advance for payments of interest and 10 working days for in advance payments of principal; and
- It includes requirements for notification in the event that an authority will have difficulty in meeting its payment obligations.



In addition, the UK MBA will seek to maintain standby liquidity facilities, which are intended to be sized at an amount sufficient to avoid default on an interest payment.

In the event that an authority does not meet its obligations to the UK MBA on a timely basis, the UK MBA is required to ask authorities to make contributions to meet the shortfall in proportion to their borrowings. These contributions are made by way of loans to the UK MBA.

In the event that a contribution is made, the UK MBA is required to pursue recovery of the debt, from the defaulting authority, on a timely basis

## **Default by a local authority**

We are not aware of any default by the principal UK local authorities on any loan.

The statutory and prudential framework under which local authorities operate is amongst the strongest in the world.

Any lender to a local authority has protection, under statute, by way of a first charge on the revenues of that authority.

In addition, the reputational damage which would be suffered by a defaulting local authority would be significant.

## **On-going interaction with local authorities**

The UK MBA will revise credit assessments annually and when any new lending is extended to local authorities.

In addition, the UK MBA intends to establish a Local Authority Advisory Board, comprising finance officers, to ensure on-going two way communication between the UK MBA and representatives of the local authority borrowers.

## **UK MBA credit rating**

The UK MBA has a private credit rating, which it will make public at the appropriate time. The range of local authority borrowers/guarantors may impact this credit rating.

## **Governance of the UK MBA**

The UK MBA is a public limited company and as such is directed by its Board. In due course, it is expected that the Board will include 7 non-executives and 3 executives.

In addition, the Board will have the following 2 sub-committees, chaired by independent non-executives:

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

Details of the Board, the above Committees and their Terms of Reference will be available on the UK MBA's website, in due course.

## **Appendix 1**

### **Guide to the Framework Agreement**

**This Appendix 1 (*Guide to the Framework Agreement*) is intended to be a summary only, providing ease of accessibility to, and not a substitute for, the detail of the Framework Agreement. This summary is entirely subject to the terms of the Framework Agreement, which should be read in full and shall at all times take precedence (including in the event of a dispute).**

#### **Joint and several guarantee**

The joint and several guarantee (“the guarantee”) is irrevocable and unconditional.

The guarantee will become effective at the point in time at which the first loan confirmation between the UK MBA and the local authority is released from escrow (i.e. when the conditions applicable to the relevant loan confirmation are met). At that point in time, the local authority will be guaranteeing all existing finance obligations of the UK MBA and any future finance obligations which are entered into prior to the local authority giving notice to terminate the guarantee.

A local authority can only give notice to terminate the guarantee when it has no outstanding loans from the UK MBA. The irrevocable nature of the guarantee means that, at that point in time, it will continue to guarantee the finance obligations which are in place when notice to withdraw is given. However, it will not be guaranteeing any future financing obligations of the UK MBA.

#### **Contribution arrangements and mechanism**

In order to mitigate the risk of a call on the guarantee, contribution arrangement mechanics have been built into the Framework Agreement.

Contribution arrangements enable the UK MBA, in the event of a failure by a local authority to meet a payment obligation within the time frames set out under the Framework Agreement, to call proportional contributions from other borrowing authorities. These timeframes, which are specified in section 3.3 of the Framework Agreement, can be summarised as follows:

1. Payment of interest must be made to the UK MBA by 11am on the fifth business day preceding the due date of such amount under the loan made by the UK MBA to the relevant local authority. For payments of principal and

unless otherwise agreed between the UK MBA and the relevant local authority, it is the tenth business day.

2. If any of these payments have not been made and the UK MBA is unable to obtain sufficient funds by other means by 11am the following day in the case of interest or 2 days after the required date of payment (unless otherwise agreed between the UK MBA and the relevant local authority) in the case of principal, bearing in mind that the UK MBA is obliged to send follow up demands, the UK MBA shall (by 5pm on such day) issue a contribution notice to each non-defaulting local authority (a "**Contribution Notice**").
3. Each Contribution Notice will request each non-defaulting local authority to provide contributions calculated by reference to the proportion of the shortfall equal to its borrowings as a proportion of the borrowings of all non-defaulting local authorities from the UK MBA. Some non-defaulting local authorities' contributions will therefore be zero (where such non-defaulting local authority has no outstanding borrowings from the UK MBA).
4. Contributions must be made by 11am on the date specified in the relevant Contribution Notice which shall be at least 2 business days after the date of the Contribution Notice in the case of interest or 4 business days after the date of the Contribution Notice (unless otherwise agreed between the UK MBA and the relevant local authority) in the case of principal.
5. Should any local authority fail to pay any contribution due under a Contribution Notice, the UK MBA shall issue notices to the other non-defaulting local authorities (a "**Further Contribution Notice**"), requiring a further contribution by 11 am the following business day in the case of interest or 2 business days after the date of such Further Contribution Notice in the case of principal. The UK MBA may, however, elect not to carry out this process if it has obtained the required funds by other means.

The UK MBA may also by agreement with any non-defaulting local authorities issue notices to such local authorities requiring them to pay in aggregate an amount equal to the shortfall less the contributions that have been made (an "**Individual Authority Contribution Notice**"). As indicated at 3 above, contributions by a non-defaulting local authority are calculated by reference to the proportion of the shortfall equal to that local authority's borrowings as a proportion of the borrowings of all non-defaulting local authorities from the UK MBA. For example, if the UK MBA had £110million outstanding loans equally to 11 authorities and one defaulted on a £10million repayment, then each of the remaining 10 would be asked to make a £1million contribution.

Any contributions are in the form of loans to the UK MBA, upon which interest would be payable. The UK MBA is obliged, under the Framework Agreement, to pursue any defaulting authority on a timely basis for full repayment of any outstanding defaulted amounts, and shall use recoveries to repay local authorities which have made any payments under the guarantees or made contribution loans.

Further details of the timelines for payment of interest and principal and related timings for Contribution Notices are contained in the Framework Agreement. The UK MBA may use other liquidity facilities to cover a default, but, if it is unable to do so, Contribution Notices will be sent.

For worked examples of the contribution arrangements, see page [28] of this Appendix 1.

## **Prepayment**

Prepayment of a loan from the UK MBA to a local authority (the "**Loan**") may occur under the following circumstances:

### **Illegality Prepayment**

If, in any applicable jurisdiction, it becomes unlawful for the UK MBA to perform any of its obligations as contemplated by the loan agreement or to fund or maintain the Loan:

1. the UK MBA shall promptly notify the relevant local authority upon becoming aware of that event whereupon the facility will be immediately cancelled; and
2. the relevant local authority shall repay the Loan on the interest payment date (as specified in the relevant loan confirmation) immediately following the date on which the UK MBA has notified such local authority, or if earlier, the date specified by the UK MBA in the notice delivered to such local authority, together with interest accrued (if any).

### **Mandatory prepayment of funding arrangements**

If the UK MBA is required to prepay any funding which the UK MBA entered into in order to fund the making of the Loan, the UK MBA shall promptly notify the relevant local authority of such requirement and such local authority shall repay the Loan on the interest payment date (as specified in the relevant loan confirmation) immediately following the date on which the UK MBA has notified such local authority, or if earlier, the date specified by the UK MBA in the notice delivered to such local authority, together with interest accrued (if any).

### **Voluntary Prepayment for Tax**



If a local authority is required to pay any additional amounts pursuant to clause 9 (Tax Gross Up) of the loan standard terms, the local authority may elect to prepay the Loan in whole on any interest payment date (as specified in the relevant loan confirmation) at the prepayment amount specified in the loan confirmation on such local authority giving not less than 60 days' notice to the UK MBA (which notice shall be irrevocable and shall oblige such local authority to prepay the Loan in whole plus accrued interest (if any) to such date).

#### Change of Status

If at any time a local authority ceases to be treated as a “local authority” within the meaning of the Local Government Act 2003 and the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 or equivalent legislation due to legislative amendment (a “**Change of Status**”), the UK MBA may by notice to the local authority require it to prepay the Loan on the interest payment date (as specified in the relevant loan confirmation) immediately following the date of such notice, together with interest accrued (if any).

#### Voluntary Prepayment

Unless otherwise specified in the relevant loan confirmation, the Loan may be prepaid at the option of the relevant local authority in whole or in part on any voluntary prepayment date at the prepayment amount (both as specified in the relevant loan confirmation) on such local authority giving not less than 60 days' notice to the UK MBA, or such other period(s) as may be specified in the relevant loan confirmation (which notice shall be irrevocable and shall oblige such local authority to prepay the Loan in whole or, as the case may be, in part, as specified in such notice on the relevant voluntary prepayment date at the prepayment amount plus accrued interest (if any) to such date), provided that the Loan may not be voluntarily prepaid prior to the date falling 12 months after the utilisation date or following the date falling 12 months prior to the final repayment date (both as specified in the relevant loan confirmation).

#### No other prepayment

No local authority shall, without the prior written consent of the UK MBA, be entitled to prepay the Loan otherwise than as provided in clauses 6.1 to 6.5 of the loan standard terms.

#### **Default by a local authority**

Default by a local authority is likely to result in material reputational damage to that authority. The UK MBA is required to notify participating local authorities of the relevant default.

In addition, the Framework Agreement requires the UK MBA to promptly take action to recover any defaulted amounts, which may involve an application to the High Court.

Any costs related to pursuit of a default, including administration costs and interest on contributions, would be a cost to the defaulting local authority, which the UK MBA would pursue. The UK MBA has no authorisation, from participating authorities or shareholders, to negotiate forgiveness of either the outstanding debts or costs.

An event of default is primarily a failure by that local authority to meet a payment, when due, but will also include (amongst other things):

- the appointment of a receiver by the High Court under Section 13(5) of the Local Government Act 2013 in respect of that local authority; and
- the dissolution of that local authority, other than in the creation of a statutory successor.

In order to access borrowing from the UK MBA, local authorities will need to be able to demonstrate that those signing the guarantee and related documents have the appropriate authorisation. This protects both the UK MBA and other participating local authorities. To facilitate this, the UK MBA requires a certificate of approval to be signed by both the S151 officer and the monitoring officer, which identifies the chain of authority from the local authority to the relevant signatories and demonstrates that the local authority has appropriate approval to enter into the Framework Agreement and the relevant guarantee.

### **Concentration limits**

Concentration limits restrict the UK MBA's ability to become over-exposed to a single local authority, thus ensuring that, in the event of a default, contributions to that default will be spread amongst a wide group of local authorities. These concentration limits are detailed in section 5.2 of the Framework Agreement. It should be noted that concentration limits are tested at the point in time that a local authority borrows, i.e. if local authorities merge to become combined authorities, those limits may be breached. However, as per section 5.2 of the Framework Agreement, in the event of any reorganisation of local authorities, the UK MBA may propose amendments to the concentration limits for approval by 85% of participating authorities.

### **Matched Financing Arrangements**

The UK MBA shall only borrow funds (i) intended to be on-lent to the local authorities (and in any event amounts borrowed by the UK MBA shall at no time be more than 105% of the total outstanding loans it has made to local authorities), where the

interest rates on the on-loans will be at least equal to the rate paid by the UK MBA, or (ii) to meet payment obligations in the event of a default by any local authority.

### **Power of LAs to restrict UK MBA borrowing**

Participating local authorities may instruct the UK MBA not to enter into any further borrowing commitments, either under any finance documents or through the issuance of bonds, provided that the number of such local authorities is more than 50% of the number of all participating local authorities and the outstanding loans of such local authorities amount to more than 50% by value of the total outstanding loans. This shall not restrict the ability of the UK MBA to borrow further amounts under any finance document (including under any liquidity facility) or contribution loan to meet a payment obligation under a finance document.

This may occur, for example, if local authorities become concerned about the credit standards of the UK MBA or there is a fundamental change in the statutory or prudential framework.

### **Loan standard terms**

Loan standard terms protect both the UK MBA and the local authorities borrowing from the UK MBA. Any amendments to the standard terms must be agreed between both the UK MBA and the relevant borrowing local authority. Each loan agreement with a local authority will consist of the standard terms as supplemented by a loan confirmation specifying specific details for that particular loan.

**Increased Costs** Where the UK MBA has made a Loan to a local authority, the relevant local authority shall, within three business days of a demand by the UK MBA, pay for the account of the UK MBA the amount of any Increased Costs (as described below) incurred by the UK MBA as a result of:

- the introduction of or any change in (or in the interpretation, administration or application of) any law or regulation after the date of the loan agreement; or
- compliance with any law or regulation made after the date of the loan agreement.

Increased Costs include: (i) a reduction in the rate of return from the Loan or on the UK MBA's overall capital, (ii) an additional or increased cost, or (iii) a reduction of any amount due and payable under the loan agreement, in each case which is incurred or suffered by the UK MBA to the extent that it is attributable to the UK MBA

having entered into a commitment or funding or performing its obligations under the loan agreement.

The obligation on the relevant local authority to pay any Increased Costs does not apply to the extent that such Increased Cost is:

- attributable to a deduction or withholding for or on account of UK taxes required by law to be made by the relevant local authority; or
- attributable to the wilful breach by the UK MBA of any law or regulation.

### **Confidential information**

Much of the information which the UK MBA uses is available from public sources. Nevertheless on occasions, as part of the UK MBA's credit assessments, the UK MBA may receive information which is not available publicly.

The UK MBA shall assume that any information that it has received which is not in the public domain is the confidential information of the provider. This does not include information which is required to be disclosed to the UK MBA under section 6.2 of the Framework Agreement (see "*Information Requirements*" below, where the UK MBA may disclose the information to legitimately interested parties, at its discretion).

Similarly, the UK MBA will be providing local authorities with confidential information. For example, the UK MBA views its credit assessments, along with the underlying models, as being confidential. Any confidential information provided to an authority by the UK MBA will be identified as such.

The UK MBA needs to comply with the Market Abuse Directive in relation to the treatment of material price sensitive information. For such information, the UK MBA needs to ensure it is held confidential until it is appropriately communicated to the market. In addition to the credit assessments, such information may include details of authorities granting, or terminating, their guarantee.

### **Information Requirements**

A local authority is required to notify the UK MBA, in writing, where there are indications that such local authority's financial or operational performance may give rise to concerns over its ability to meet its obligations under any lending arrangements. In particular, the local authority shall notify the UK MBA:

- if it is unable to pay its debts as they fall due;

- of any report issued in respect of it under Section 114 of the Local Government Finance Act 1988 (or any replacement or equivalent provision);
- of any failure to 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, as amended or reissued from time to time;
- of any failure to set a balanced budget in accordance with Section 31A and Section 42A of the Local Government Finance Act 1992;
- if the chief finance officer's report on robustness of budget estimates and adequacy of reserves under section 25 of the Local Government Act 2003 states either that the estimates are not robust and/or the reserves are inadequate, and such local authority passes that budget without action to remedy those deficiencies;
- if external auditors issue a qualified audit opinion in respect of such local authority's accounts;
- if such local authority is or will be unable to publish audited accounts by the statutory deadline;
- of any Change of Status of such local authority;
- promptly upon becoming aware that any representation or statement made or deemed to be made by it in the Framework Agreement, any loan agreement or any other document delivered by or on behalf of it in relation to such documents was incorrect or misleading when made or deemed to be made;
- promptly upon becoming aware of them, the status and description of any dispute, litigation, arbitration, expert determination or administrative proceedings which are current, threatened or pending against such local authority, which is reasonably likely to be adversely determined, and which, if adversely determined either individually or taken as a whole, are reasonably likely to have a material adverse effect on the status or governance of the local authority, its assets, its operations, its condition (financial or otherwise), its prospects, or its ability to comply with the finance documents;
- promptly upon becoming aware of them, any event or circumstance which such local authority reasonably believes might have a material adverse effect on the status or governance of the local authority, its assets, its operations, its condition (financial or otherwise), its prospects, or its ability to comply with the finance documents; or
- promptly on request, such additional information as may be reasonably requested by the UK MBA from time to time,

and, in each case, the local authority shall set out in such notice reasonable details associated therewith, the effects of such an event or occurrence and any actions being undertaken to mitigate or remedy such event or occurrence.

## **Modification**

Any modification to the Framework Agreement requires an agreement between the UK MBA and (unless otherwise specifically provided in the Framework Agreement) local authorities being more than 85% of the number of all participating local authorities and where the value of outstanding loans of such local authorities is greater than 85% of the total outstanding loans, provided that no modification to the Framework Agreement which imposes additional obligations on a particular local authority will be made without the consent of that local authority.

## **Resignation of LAs and termination of guarantees**

A local authority may terminate its joint and several guarantee by giving written notice to the UK MBA. In order to terminate the joint and several guarantee, the local authority must have repaid all its outstanding loans from the UK MBA.

If a local authority terminates its joint and several guarantee, it shall no longer be eligible to borrow from the UK MBA, unless it repeats the accession process.

Upon termination, a local authority will continue to guarantee the UK MBA's borrowings which were in place at the time of termination until they are fully repaid.

## **Enforcement and application of proceeds**

The UK MBA is obliged under the Framework Agreement to pursue any defaulting authority for full recovery, using whatever means available.

In particular, the UK MBA may:

- declare such local authority's liabilities to the UK MBA to be immediately due and payable;
- sue for, commence or join any legal or arbitration proceedings against the defaulting local authority;
- exercise any rights of set off;
- exercise any rights it may have under Section 13(3) of the Local Government Act 2013; or
- apply to the High Court to have a receiver appointed under Section 13(5) of the Local Government Act 2013.

If the UK MBA does not take steps to recover any defaulted amounts within 90 days of the relevant failure to pay, the UK MBA shall take such action as is reasonably required by the majority of local authorities (where the majority in such case will be met if the number of such local authorities is more than 50% of

the number of all participating local authorities and the value of outstanding loans of such local authorities is greater than 50% of the total outstanding loans).

Any amounts recovered by the UK MBA shall be applied in the following order of priority:

- in discharging any amounts owing to the UK MBA's creditors;
- in payment to the local authorities which have made a payment under their guarantee; and
- in payment to the local authorities which have made a contribution, with prioritisation based on the basis for the contributions, i.e. Individual Authority Contribution Notice, Further Contribution Notice and Contribution Notice.

Any amounts payable to local authorities shall be pro-rata to the total amounts of contributions in the relevant category made by such local authorities.

## Worked examples

In the following worked examples assume the following:

- Minimum diversification: The UK MBA's total loan book is split between local authorities in such a manner as will meet its minimum requirements in terms of the total number of authorities and the amounts owing by any individual authority.
- Single name limit: The maximum amount which can be owed by any individual authority within a total loan book banding.

### Single bond in issue, £250:

Summary of exposures: 2 authorities owe £37.5 million (Authority A & B), 7 authorities owe £25million.

If authority A fails to pay a principal repayment, the following contributions will be required:

Authority B £6.6 million, remaining authorities £4.4million

Should Authority B fail to pay the contribution, the remaining authorities will be asked to contribute an additional £0.9million, i.e. a total contribution of £5.4

### Portfolio of loans at £1 Billion

Summary of exposures: 2 authorities owe £125 million (Authority A & B), 7 authorities owe £107million

If authority A fails to pay a principal repayment, the following contributions will be required:

Authority B £17.9 million, remaining authorities £15.3million

Should Authority B fail to pay the contribution, the remaining authorities will be asked to contribute an additional £2.6million, i.e. a total of £17.9 million

### Portfolio of loans at £2 Billion

Summary of exposures: 2 authorities owe £250 million (Authority A & B), 7 authorities owe £210million

If authority A fails to pay a principal repayment, the following contributions will be required:

Authority B £36.3million, remaining authorities £30.5million



Should Authority B fail to pay the contribution, the remaining authorities will be asked to contribute an additional £5.2million, i.e. a total of £35.7million

**Note:** These examples are illustrative. The UK MBA would expect the level of diversification, as the portfolio expands, to increase rather than effectively remain static.

**DOCUMENT THREE**

**FRAMEWORK AGREEMENT – FINAL DRAFT  
DATED 18 DECEMBER, 2015  
(prepared by Clifford Chance)**

DATED [●]

UK MUNICIPAL BONDS AGENCY PLC  
LOCAL AUTHORITIES

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LOCAL AUTHORITY FINANCING  
FRAMEWORK AGREEMENT

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**THIS AGREEMENT** is dated [•] and made between:

- (1) **UK MUNICIPAL BONDS AGENCY PLC** (the "**Company**"); and
- (2) **THE ENTITIES** named on the signing pages as Authorities (the "**Original Authorities**").

## **RECITALS**

- (A) The Company has been established to borrow funds and to lend such funds to certain UK local authorities participating in these arrangements.
- (B) The Company will establish a Medium Term Note Programme (the "**Programme**") for the issuance of notes, in connection with which it will enter into a trust deed (the "**Trust Deed**") with HSBC Corporate Trustee Company (UK) Limited (the "**Trustee**"), a dealer agreement and an issue and paying agency agreement.
- (C) The Notes may be admitted to listing on the Official List of the United Kingdom Financial Conduct Authority and to trading on the Regulated Market of the London Stock Exchange plc. Notes may also be issued on the basis that they will not be admitted to listing, trading and/or quotation by any competent authority, stock exchange and/or quotation system or that they will be admitted to listing, trading and/or quotation by such other or further competent authorities, stock exchanges and/or quotation systems as may be agreed with the Company.
- (D) Notes issued under the Programme may be issued pursuant to the terms and conditions as set out in the Trust Deed (the "**Conditions**") and a pricing supplement describing the final terms of a particular tranche of Notes.
- (E) The Company may also enter into borrowing arrangements, from time to time, with lenders and/or investors, which may include the European Investment Bank, UK local authorities and other entities.
- (F) To facilitate the issuance of Notes by the Company and borrowing from other lenders and/or investors, the Authorities have agreed to guarantee the payment of all sums expressed to be payable from time to time by the Company in respect of the Notes, the Trust Deed and certain other loan agreements or other borrowing arrangements that the Company may enter into from time to time.
- (G) This Agreement sets out the arrangements between the Company and the Authorities in respect of borrowing from the Company, the issuance of the Guarantees and contribution arrangements relating to any demands in respect of debt which has the benefit of the Guarantees.

**IT IS AGREED** as follows:

**1. DEFINITIONS AND INTERPRETATION**

**1.1 Definitions**

In this Agreement:

"**Authority**" means each Original Authority and any person which becomes a Party as an Authority in accordance with the terms of Clause 2.2 (*Accession of Authorities*).

"**Authority Contribution**" means, in relation to an Authority, the Authority Proportion relating to such Authority multiplied by the Shortfall Amount.

"**Authority Document**" means this Agreement, each Authority Accession Deed, each Guarantee, the Loan Standard Terms, each Loan Confirmation and any document under which the Company lends an Authority Loan to an Authority.

"**Authority Accession Deed**" means a deed substantially in the form set out in Schedule 1 (*Form of Authority Accession Deed*).

"**Authority Loan**" means a loan from the Company (as lender) to an Authority (as borrower), either (i) having the Loan Standard Terms, as modified and supplemented by the relevant Loan Confirmation or (ii) in such other form as may be agreed between the Company and an Authority.

"**Authority Proportion**" means, in relation to any Authority that is not a Defaulting Authority, the proportion (expressed as a percentage) borne by that Authority's Outstanding Loan Amount to the Total Performing Outstanding Loan Amount as at the date of the relevant Contribution Notice.

"**Business Day**" means a day (other than a Saturday or Sunday) on which banks are open for general business in London.

"**Cancellation Notice**" shall have the meaning given to such term in Clause 3.8.

"**Certificate of Approval**" means, in respect of each Authority, a certificate signed by each of the monitoring officer (appointed pursuant to section 5 of the Local Government and Housing Act 1992, as amended by Schedule 5 paragraph 24 of the Local Government Act 2000, or any replacement or equivalent provision) and the chief finance officer (appointed pursuant to section 151 of the Local Government Act 1972, or any replacement or equivalent provision) in respect of such Authority, confirming that:

- (a) the Authority has the necessary power to enable it to enter into this Agreement and the Guarantee, and perform its obligations thereunder;
- (b) the Authority has approved the entering into of this Agreement and the Guarantee;

- (c) all necessary authorisations have been obtained, and all appropriate and applicable decision-making procedures have been followed and completed, to enable it to enter into this Agreement and the Guarantee,

and identifying in the certificate, by way of attaching copies or by the inclusion of weblinks to specified and publically available copies, all documentation required to evidence the chain of authority from the council to the relevant signatories on behalf of such Authority, in each case in a form satisfactory to the Company (in its absolute discretion).

**"Confidential Information"** means all information relating to any Authority, the Company, this Agreement or the Finance Documents of which a Party becomes aware in its capacity as, or for the purpose of becoming, a Party or which is received by a Party in relation to, or for the purpose of becoming a Party under this Agreement from any Authority or the Company or any of their respective advisers in whatever form, and includes information given orally and any document, electronic file or any other way of representing or recording information which contains or is derived or copied from such information but excludes information that:

- (a) is required to be posted on the public website of the Company in accordance with Clause 5.6.1
- (b) is or becomes public information other than as a direct or indirect result of any breach by an Authority of Clause 9 (*Confidentiality*); or
- (c) is identified in writing at the time of delivery as non-confidential by the Party delivering the information; or
- (d) is known by the relevant Party before the date the information is disclosed to it in connection with this Agreement or is lawfully obtained by the relevant Party after that date, from a source which is, as far as such Party is aware, unconnected with any Party and which, in either case, as far as such Party is aware, has not been obtained in breach of, and is not otherwise subject to, any obligation of confidentiality.

**"Contribution Interest"** shall have the meaning given to such term in Clause 3.4.

**"Contribution Loan"** means a contribution by an Authority to the Company pursuant to Clause 3 (*Default and Contributions*) of an amount in respect of the Authority Contribution for such Authority specified in a Contribution Notice, a Further Contribution Notice or an Individual Authority Contribution Notice.

**"Contribution Notice"** shall have the meaning given to such term in Clause 3.3.3.

**"Creditor"** means:

- (a) the Trustee for itself in respect of the Trust Deed and on behalf of the Noteholders in respect of the Notes;
- (b) the European Investment Bank in respect of any EIB Loan Document;

- (c) each Liquidity Facility Provider in respect of any Liquidity Facility Agreement;
- (d) each Lending Authority; and
- (e) each lender or other provider of credit or financial accommodation to the Company pursuant to a Finance Document.

**"Defaulting Authority"** means a Failed Contribution Authority and any other Authority:

- (a) which has failed to make a payment when due under an Authority Document, which shall include any failure to pay on the relevant Funding Date (or has notified the Company that it will not make a payment when due under an Authority Document);
- (b) which has otherwise rescinded or repudiated an Authority Document;
- (c) which is dissolved or otherwise ceases to exist (other than as a result of the enactment of legislation creating a statutory successor to such Authority which becomes responsible for substantially all of the Authority's obligations, including hereunder); or
- (d) in respect of which the High Court has appointed a receiver under Section 13(5) of the Local Government Act 2003.

**"Directing Authorities"** means any group of Authorities where both (i) the number of such Authorities is more than 85 per cent. of the number of all Authorities, and (ii) the aggregate Outstanding Loan Amounts of such Authorities is greater than 85 per cent. of the Total Outstanding Loan Amount at the relevant time.

**"Effective Date"** in respect of each Authority means the date of the first agreement between such Authority and the Company pursuant to which the Company agrees (subject to the terms of that agreement) to make an Authority Loan to such Authority.

**"EIB Loan Document"** means each facility agreement entered into between the Company (as borrower) and the European Investment Bank (as lender).

**"Failed Contribution Authority"** shall have the meaning given to such term in Clause 3.3.5.

**"Finance Document"** means each of the Note Documents, the EIB Loan Documents, each Liquidity Facility Agreement and any facility, agreement or other instrument entered into by the Company for any credit or other financial accommodation and designated in the relevant facility, agreement or other instrument as a Finance Document.

**"Further Contribution Notice"** shall have the meaning given to such term in Clause 3.3.5.

**"Guarantee"** means each guarantee executed by an Authority in the form set out in Schedule 2 (*Form of Guarantee*).



**"Guaranteed Liabilities"** has the meaning given to that term in Clause 2.3.1.

**"Individual Authority Contribution Notice"** shall have the meaning given to such term in Clause 3.3.5(b).

**"Lending Authority"** means any local authority that provides a loan or other financial accommodation to the Company pursuant to a Finance Document.

**"Liabilities"** means, in relation to a party, all present and future liabilities and obligations at any time of such party, both actual and contingent and whether incurred solely or jointly or as principal or surety or in any other capacity together with any of the following matters relating to or arising in respect of those liabilities and obligations:

- (a) any refinancing, novation, deferral or extension;
- (b) any claim for breach of representation, warranty or undertaking or on an event of default or under any indemnity given under or in connection with any document or agreement evidencing or constituting any other liability or obligation falling within this definition;
- (c) any claim for damages or restitution; and
- (d) any claim as a result of any recovery by any party of a Payment on the grounds of preference or otherwise,

and any amounts which would be included in any of the above but for any discharge, non-provability, unenforceability or non-allowance of those amounts in any insolvency or other proceedings.

**"Liquidity Facility Agreement"** means each liquidity facility agreement or working capital facility agreement entered into by the Company (as borrower) and designated in the relevant facility agreement as a "Liquidity Facility Agreement", as the same may be amended from time to time.

**"Liquidity Facility Provider"** means each lender under a Liquidity Facility Agreement.

**"Loan Confirmation"** means a loan confirmation substantially in the form set out in Schedule 4 (*Loan Confirmation*), as modified with the agreement of the relevant Authority and the Company.

**"Loan Standard Terms"** means the standard terms set out in Schedule 3 (*Loan Standard Terms*).

**"Maximum Individual Authority Contribution Amount"** shall have the meaning given to such term in Clause 3.3.5(b).

**"Note"** shall have the meaning given to such term in the Trust Deed.

**"Note Documents"** means the Trust Deed and any Notes.

"**Noteholders**" shall have the meaning given to such term in the Trust Deed.

"**Outstanding Loan Amount**" means, in relation to an Authority and at any time, the aggregate principal amount outstanding (or in relation to any index-linked Authority Loan, the nominal amount outstanding) at that time under all Authority Loans between the Company and the relevant Authority.

"**Party**" means a party to this Agreement.

"**Payment**" means, in respect of any Liabilities (or any other liabilities or obligations), a payment, prepayment, repayment, redemption, defeasance or discharge of those Liabilities (or other liabilities or obligations).

"**Recoveries**" has the meaning given to that term in Clause 3.9 (*Order of Application*).

"**Shortfall Amount**" means the amount of any actual or expected payment shortfall in respect of amounts falling due under the Finance Documents (or, in the case of Clause 3.3.3(c), the amount unpaid by such Authority), calculated as follows:

- (a) for the purpose of determining the Authority Contribution of any Authority to whom a Contribution Notice is to be sent under Clause 3.3.3, calculated at the time of such determination; and
- (b) for the purpose of determining the Authority Contribution of any Authority to whom a Further Contribution Notice or an Individual Authority Contribution Notice is to be sent under Clause 3.3.5, calculated at the time of such determination after taking into account any amounts received by the Company in respect of Authority Contributions.

"**Total Outstanding Loan Amount**" means, at any time, the aggregate of each Authority's Outstanding Loan Amount at that time.

"**Total Performing Outstanding Loan Amount**" means, at any time, the Total Outstanding Loan Amount at that time, less the aggregate Outstanding Loan Amount of each Defaulting Authority.

## 1.2 Construction

1.2.1 Unless a contrary indication appears, a reference in this Agreement to:

- (a) any person shall be construed so as to include its successors in title, permitted assigns and permitted transferees to, or of, its rights and/or obligations under this Agreement;
- (b) any agreement or instrument is a reference to that agreement or instrument as amended, novated, supplemented, extended or restated in accordance with its terms;
- (c) "**indebtedness**" includes any obligation (whether incurred as principal or as surety) for the payment or repayment of money, whether present or future, actual or contingent;

- (d) a "**person**" includes any individual, firm, company, corporation, government, state or agency of a state or any association, trust, joint venture, consortium, partnership or other entity (whether or not having separate legal personality);
- (e) a "**regulation**" includes any regulation, rule, official directive, request or guideline (whether or not having the force of law) of any governmental, intergovernmental or supranational body, agency, department or of any regulatory, self-regulatory or other authority or organisation; and
- (f) a provision of law is a reference to that provision as amended or re-enacted.

1.2.2 Clause and Schedule headings are for ease of reference only.

### 1.3 **Third party rights**

1.3.1 Unless expressly provided to the contrary in this Agreement, a person who is not a Party has no right under the Contracts (Rights of Third Parties) Act 1999 to enforce or to enjoy the benefit of any term of this Agreement.

1.3.2 Notwithstanding any term of this Agreement, the consent of any person who is not a Party is not required to rescind or vary this Agreement at any time.

### 1.4 **Effectiveness**

This Agreement shall become effective in relation to an Original Authority only on and from the relevant Effective Date in respect of such Authority. For the avoidance of doubt, this Agreement will become effective as between the Company and each Original Authority in respect of which an Effective Date has occurred, notwithstanding that an Effective Date may not have occurred in respect of all Original Authorities.

## 2. **PARTICIPATING AUTHORITIES**

### 2.1 **Participation required to borrow**

2.1.1 The Company shall not, as lender, enter into any financing arrangement with a local authority or any other person unless such person is an Authority under this Agreement and has issued a Guarantee which has not been terminated.

2.1.2 Each Original Authority shall deliver to the Company on the date hereof:

- (a) a Guarantee duly executed by such Authority; and
- (b) an original Certificate of Approval.

2.1.3 The Parties acknowledge that the Company is not obliged to enter into any financing arrangement with any Authority, and it retains an absolute discretion to reject any request for finance.

- 2.1.4 The Parties acknowledge that it is the intention of the Company that all Authorities are or become shareholders of the Company, and the Company may in future (in its absolute discretion) determine that all new lending to be provided by it to Authorities will only be provided to Authorities which are shareholders of the Company, or add a premium to interest rates on all Authority Loans to Authorities which are not shareholders of the Company (where such premium is to be determined by the Company in its absolute discretion from time to time).

## 2.2 Accession of Authorities

- 2.2.1 If the Company and a local authority so agree, such local authority may accede to this Agreement by delivery to the Company of:
- (a) an Authority Accession Deed duly executed by the Company and the new Authority;
  - (b) a Guarantee duly executed by such Authority; and
  - (c) an original Certificate of Approval.

Provided all parties thereto have executed the Authority Accession Deed, on the Effective Date in respect of the relevant new Authority such new Authority shall assume the same obligations and become entitled to the same rights as if it had been an original Party as an Authority.

- 2.2.2 Each of the Parties appoints the Company to receive on its behalf each Authority Accession Deed delivered to the Company.

## 2.3 Extent of Guarantee

- 2.3.1 Upon the Effective Date of a Guarantee duly executed by an Authority, any and all present and future obligations and liabilities (whether actual or contingent and whether owed jointly or severally or in any other capacity whatsoever) of the Company to Creditors arising under each Finance Document or, in the case of the Note Documents, arising in respect of Notes issued, prior to or following the Effective Date of such Guarantee and on or prior to the date of termination of such Guarantee in accordance with 2.4.1 below (the "**Guaranteed Liabilities**") shall be guaranteed by that Authority. Any termination of a Guarantee will not affect the validity of such Guarantee in respect of Guaranteed Liabilities, but any further amounts borrowed under each existing Finance Document, any Finance Documents entered into, and any Notes issued (including any Notes issued following such termination date which are intended to be fungible with Notes issued on or prior to such date) following the date of such termination of a Guarantee in accordance with Clause 2.4.1 below shall not benefit from such Guarantee.
- 2.3.2 For the avoidance of doubt, the obligations of an Authority under a Guarantee shall not be discharged, impaired or otherwise affected by any amendment, novation, supplement, extension, (whether of maturity or otherwise) or restatement (in each case, however fundamental and of whatsoever nature) or

replacement, waiver or release of, any of the Guaranteed Liabilities including without limitation any change in the purposes for which the proceeds of the issue of any Note or other credit obtained pursuant to a Finance Document are to be applied and any extension of or any increase of the obligations of the Company under any Finance Documents on or prior to the date of termination of such Guarantee in accordance with 2.4.1 below or the addition of any new obligations for the Company under the Finance Documents.

2.3.3 Each Finance Document shall include a list of the Authorities in respect of which the liabilities under such Finance Document are Guaranteed Liabilities at the time of entry into such Finance Document.

2.3.4 Any payments made by any Authority under a Guarantee shall be subject to contribution arrangements as set out in Clause 3 (*Default and Contributions*).

## 2.4 **Resignation of an Authority**

2.4.1 No Authority may terminate its Guarantee unless:

- (a) any and all Liabilities of the relevant Authority to the Company have been fully and finally discharged to the satisfaction of the Company; and
- (b) the Company is under no further obligation to provide financial accommodation (including, without limitation, any Authority Loan) to the relevant Authority.

If an Authority notifies the Company in writing that it wishes to terminate its Guarantee, and requests that the Company confirm the above conditions to be satisfied, if such conditions are satisfied, the Company shall provide such confirmation within 10 Business Days of such request. Following such confirmation (or, if the Company fails to respond within 10 Business Days of the request), the Authority may terminate its Guarantee by notice to the Company in accordance with clause 7 (*Determination of Guarantee*) of the Guarantee. On receipt of such notice, the Company shall promptly notify each other Party that the relevant Authority has terminated its Guarantee.

2.4.2 No Authority may cease to be party to this Agreement unless:

- (a) the Guarantee from the relevant Authority has been terminated in accordance with Clause 2.4.1 above; and
- (b) the relevant Authority has no Guaranteed Liabilities in respect of its Guarantee (which shall be the case where no liabilities of the Company have the benefit of the Guarantee from the relevant Authority, as any liabilities which did so benefit from such Guarantee have been repaid or otherwise satisfied by the Company).

2.4.3 If an Authority notifies the Company in writing that it wishes to be released from its obligations under this Agreement, and requests that the Company confirm the above conditions to be satisfied, if such conditions are satisfied the Company shall confirm the same in writing within 10 Business Days of

such request, and shall promptly notify each other Party that it has accepted the resignation of that Authority. Following such confirmation (or, if the Company fails to respond within 10 Business Days of the request), the relevant Authority shall cease to be an Authority and shall have no further rights or obligations under this Agreement as an Authority.

### 3. **DEFAULT AND CONTRIBUTIONS**

#### 3.1 **Notification of default by Authority**

If an Authority becomes aware that it will be unable to make any payment when due under an Authority Document, or otherwise becomes a Defaulting Authority, it will immediately notify the Company of the same.

#### 3.2 **Notification by the Company of a Defaulting Authority**

If the Company becomes aware that an Authority is a Defaulting Authority, whether pursuant to a notice received from the Authority or otherwise, the Company shall notify the other Authorities thereof as soon as reasonably practicable thereafter, provided that whether the Authority is a Defaulting Authority due to a failure to pay (as set out in paragraph (a) of the definition of Defaulting Authority), the Company may elect not to notify the other Authorities until the date set out in Clause 3.3.3(a) below as the date on which it would be required to issue Contribution Notices if it had been unable to obtain funds as set out in such Clause.

#### 3.3 **Contribution Notices**

3.3.1 In order for the Company to ensure that it has sufficient funds available to meet any payments due under the Finance Documents, the terms of each Authority Loan shall require the relevant Authority to fund all payments due to the Company by transferring the relevant amounts to an account nominated by the Company by no later than 11 a.m. on the fifth Business Day (or, in respect of principal and unless otherwise agreed between the Company and the relevant Authority, the tenth Business Day) prior to the due date of such amount under the Authority Loan (the required date for transfer in respect of each payment being the "**Funding Date**").

3.3.2 If the Authority fails to transfer such amount by 5 p.m. London time on the Funding Date the Company shall promptly demand immediate payment from such Authority of the unpaid amount.

3.3.3 If:

- (a) at 11 a.m. on the date falling 4 Business Days (or, in respect of principal and unless otherwise agreed between the Company and the relevant Authority, 8 Business Days) prior to a day on which a payment is due under the Finance Documents, the Company has been unable to obtain sufficient funds from (i) one or more Liquidity Facility Providers under Liquidity Facility Agreement(s) or (ii) one or more Lending Authorities or lenders or other providers of financial accommodation, in each case, under Finance Document(s), in each

case to enable it to pay such amounts falling due under the Finance Documents, the Company shall; or

- (b) at any other time the Company expects to be unable to pay, or does fail to pay, any amount when due under the Finance Documents, the Company shall; or
- (c) on any date after the Funding Date on which an amount due by an Authority pursuant to Clause 3.3.1 above remains unpaid by the relevant Authority (notwithstanding that the Company has sufficient funds to enable it to make all payments of amounts due under the Finance Documents), the Company may,

notify each Authority (other than any Defaulting Authority) thereof as soon as reasonably practicable (or, in the case of paragraph (a) above, by 5 p.m. on such date). Such notice (a "**Contribution Notice**") shall specify the Shortfall Amount and shall set out the Authority Contribution required from each Authority which is not a Defaulting Authority (including specifying where, in relation to any Authority, the Authority Contribution is zero).

If the Company does so issue Contribution Notices, it may also initiate discussions with any Authority which is not a Defaulting Authority with a view to such Authority agreeing to be issued with an Individual Authority Contribution Notice pursuant to Clause 3.3.5(b).

3.3.4 Each Authority shall ensure that it pays an amount equal to its Authority Contribution to the Company no later than 11 a.m. on the date specified in the Contribution Notice, such date to be at least 2 Business Days (or, in respect of principal and unless otherwise agreed between the Company and the relevant Authority, 4 Business Days) after the date of the Contribution Notice.

3.3.5 In the event that any Authority fails to pay an amount equal to its Authority Contribution (including any further Authority Contribution pursuant to this Clause 3.3.5) by 11 a.m. on the date such amount is due under this Agreement, that Authority shall be a "**Failed Contribution Authority**" and, unless the Company elects otherwise, which it shall only be entitled to do if it has obtained other funds (from (i) one or more Liquidity Facility Providers under Liquidity Facility Agreement(s) or (ii) one or more Lending Authorities or lenders or other providers of financial accommodation, in each case, under Finance Document(s)) to enable it to meet its obligations under the Finance Documents, the Company:

- (a) shall calculate the further Authority Contribution required from each Authority which is still not a Defaulting Authority taking into account any amounts received in respect of Authority Contributions which have been made and issue a notice (a "**Further Contribution Notice**") to each such Authority, which shall set out the amount of the further Authority Contribution for such Authority (as well as the amount of any sums already paid by the relevant Authority) which amount shall be paid to the Company by such Authority by no later than 11 a.m. on the Business Day (or, in respect of principal and unless otherwise

agreed between the Company and the relevant Authority, the second Business Day) after the date of such Further Contribution Notice; and

- (b) may, by agreement with one or more Authorities which are not Defaulting Authorities, issue a notice or notices (each, an "**Individual Authority Contribution Notice**") to each such Authority which has agreed to the service of an Individual Authority Contribution Notice, requiring such Authorities to pay to the Company in aggregate an amount of up to the Shortfall Amount less the aggregate of the Authority Contributions which have been paid by the date such amounts are due under this Agreement (the "**Maximum Individual Authority Contribution Amount**"), and identifying the Maximum Individual Authority Contribution Amount for each such Authority and all such Authorities.

- 3.3.6 The issue of an Individual Authority Contribution Notice to an Authority which is not a Defaulting Authority shall oblige that Authority to pay by no later than 11 a.m. on (or, in respect of principal and unless otherwise agreed between the Company and the relevant Authority, the Business Day preceding) the day on which the amount is due under the Finance Documents, an amount equal to the lesser of (i) the Maximum Individual Authority Contribution Amount for such Authority; and (ii) the amount notified to the relevant Authority by the Company by no later than 3 p.m. on the Business Day (or, in respect of principal and unless otherwise agreed between the Company and the relevant Authority, the second Business Day) preceding the day on which the amount is due under the Finance Documents.
- 3.3.7 For the avoidance of doubt, nothing in this Clause 3.3 limits the power of the Company to borrow amounts, including from any Lending Authority or under any Liquidity Facility Agreement or by agreement with any Authority which is not a Defaulting Authority under an Individual Authority Contribution Notice, to enable it to meet its obligations under the Finance Documents.
- 3.3.8 If at any time the Company determines that there no longer is or will be a Shortfall Amount, disregarding for the purposes of such calculation any Authority Contribution, or that the Company otherwise has sufficient funds to enable it to make all payments of amounts due under the Finance Documents, it may cancel a Contribution Notice, a Further Contribution Notice or an Individual Authority Contribution Notice by sending a notice (a "**Cancellation Notice**") to each relevant Authority. The effect of a Cancellation Notice shall be that no Authority is obliged to pay any Authority Contribution pursuant to the cancelled Contribution Notice or any amounts payable under the cancelled Further Contribution Notice or Individual Authority Contribution Notice and any amounts already paid to the Company pursuant to the cancelled Contribution Notice, Further Contribution Notice or Individual Authority Contribution Notice shall be reimbursed by the Company to the relevant Authority (without interest or penalty).

#### 3.4 Contribution Loans



All amounts received by the Company from an Authority pursuant to a Contribution Notice, Further Contribution Notice or Individual Authority Contribution Notice shall be treated as Contribution Loans made by the relevant Authority to the Company, the repayment of which, and the payment of any interest thereon, shall be made in accordance with Clause 3.9 (*Order of application of proceeds*) and shall be due and payable only at the times and to the extent that the Company has funds available to make such payments in accordance with Clause 3.9 (*Order of application of proceeds*). Interest on Contribution Loans ("**Contribution Interest**") shall accrue at an interest rate equal to the higher of (i) the interest rate payable by the Defaulting Authority under the relevant Authority Loan, and (ii) the prevailing rate offered by the Public Works Loan Board (or any replacement agency) in respect of loans having the same maturity and interest basis under the relevant Authority Loan (and to the extent (ii) applies, the relevant Defaulting Authority shall be required to indemnify the Company in respect of such cost pursuant to the Loan Standard Terms). Such interest, if unpaid, will be compounded with the amount due under the relevant Contribution Loan on the date falling 6 months after the relevant Contribution Loan is made and at 6-monthly intervals thereafter, but will remain immediately due and payable subject to availability of funds to make such payments in accordance with Clause 3.9 (*Order of application of proceeds*).

### **3.5 Indemnity in respect of unpaid Authority Contributions**

3.5.1 Each Defaulting Authority which fails to pay an amount equal to its Authority Contribution as specified in a Contribution Notice or any amounts payable under a Further Contribution Notice or an Individual Authority Contribution Notice on the date such amount was due under this Agreement shall indemnify the Company, within three Business Days of demand, against any cost, loss or liability incurred by it as a result of such non-payment.

3.5.2 Any amount payable to the Company under Clause 3.5.1 above shall include the cost of utilising the Company's management time or other resources and will be calculated on the basis of such reasonable daily or hourly rates as the Company may notify to such Defaulting Authority.

### **3.6 Application of Contribution Loans**

The Company will apply all Contribution Loans towards discharging any sums owing by the Company to any Creditor as and when such amounts fall due or otherwise in accordance with Clause 3.9 (*Order of application of proceeds*).

### **3.7 Enforcement by the Company**

If an Authority becomes a Defaulting Authority, the Company will promptly exercise its rights and take action to recover all sums owing from the Defaulting Authority to the Company. Such action may include (without limitation) exercising any right to:

3.7.1 declare its Liabilities to be immediately due and payable;

3.7.2 sue for, commence or join any legal or arbitration proceedings against the Defaulting Authority to recover any Liabilities;

- 3.7.3 exercise any right of set-off;
- 3.7.4 exercise any rights it may have under Section 13(3) of the Local Government Act 2003; or
- 3.7.5 apply to the High Court to have a receiver appointed under Section 13(5) of the Local Government Act 2003.

### 3.8 **Action to recover debt through Company only**

- 3.8.1 The Authorities shall not have any independent power to take action against a Defaulting Authority. However, in the event that the Company has failed to take any steps towards recovery of amounts owing to it by a Defaulting Authority within 90 days of the relevant failure to pay by a Defaulting Authority, the Company shall take such action as the Directing Authorities may reasonably require (provided that for these purposes only, the references in the definition of Directing Authorities to 85 per cent. shall be deemed to refer to 50 per cent.).
- 3.8.2 Without prejudice to the right of an Authority to enforce the other obligations of the Company under this Agreement, each Authority agrees that, to the extent that it has made a payment in respect of its Guarantee, it will not exercise any rights it may have against the Company to require repayment or reimbursement in respect of such payment (whether by way of subrogation, indemnification or otherwise), but shall be entitled to recover such amounts in accordance with Clause 3.9 (*Order of application of proceeds*) (and shall notify the Company of the relevant amount on request), provided that such amounts are deemed to become due and payable only at the times and to the extent that the Company has funds available to make such payments in accordance with Clause 3.9 (*Order of application of proceeds*).

### 3.9 **Order of application of proceeds**

All amounts from time to time received or recovered by the Company from a Defaulting Authority or otherwise identified by the Company as being available for distribution (for the purposes of this Clause 3.9, the "**Recoveries**"), shall be applied by the Company at any time as the Company (acting reasonably) sees fit, to the extent permitted by applicable law, in the following order of priority:

- 3.9.1 in discharging any sums owing by the Company to any Creditor which are due or overdue on such date;
- 3.9.2 pro rata and *pari passu* in payment or distribution to any Authority which has been required to make a payment in respect of its Guarantee, for application towards the discharge of the sums due from the Company to each relevant Authority in respect of such Authority's right of subrogation;
- 3.9.3 pro rata and *pari passu* in payment or distribution to the Authorities which made Contribution Loans pursuant to an Individual Authority Contribution Notice, in proportion to the amounts of such Contribution Loans, for application towards the discharge of the sums due from the Company to the

relevant Authorities in respect of such Contribution Loans and any Contribution Interest thereon;

3.9.4 pro rata and *pari passu* in payment or distribution to the Authorities which made Contribution Loans pursuant to a Further Contribution Notice, in proportion to the amounts of such Contribution Loans, for application towards the discharge of the sums due from the Company to the relevant Authorities in respect of such Contribution Loans and any Contribution Interest thereon;

3.9.5 pro rata and *pari passu* in payment or distribution to the Authorities which made Contribution Loans pursuant to a Contribution Notice, in proportion to the amounts of such Contribution Loans, for application towards the discharge of the sums due from the Company to the relevant Authorities in respect of such Contribution Loans and any Contribution Interest thereon;

3.9.6 the balance, if any, to be held by the Company.

### 3.10 **Payment obligations continue**

Nothing in this Agreement shall release any Authority from the liability to make any Payment (including of default interest, which shall continue to accrue) under any Authority Loan.

### 3.11 **Guiding principle**

In addition to the specific obligations of the Company set out in this Agreement (including the obligation to issue Contribution Notices as set out in Clauses 3.3.3(a) and 3.3.3(b)):

3.11.1 in exercising any of its rights under this Agreement, the Company shall, where practicable, act with the aim of avoiding any demand on a Guarantee ever being made; and

3.11.2 the Company shall issue such Contribution Notices in accordance with Clause 3.3 as will ensure (provided the relevant Authorities comply with such Contribution Notices) that it has sufficient funds to enable it to pay amounts falling due under the Finance Documents and thus prevent any demands being made under any Guarantee.

## 4. **BORROWING**

The Company and any Authority may from time to time agree terms upon which the Company will make an Authority Loan to such Authority. The Company and such Authority will either (i) execute a Loan Confirmation in order to document such terms, which shall incorporate the Loan Standard Terms, save as modified or supplemented by the relevant Loan Confirmation or (ii) execute an agreement in such other form as may be agreed between the Company and such Authority.

## 5. **UNDERTAKINGS OF THE COMPANY**

The Company undertakes to the Authorities as follows:

## 5.1 Credit assessments

The Company will carry out a credit assessment of each Authority:

- 5.1.1 at the time of accession;
- 5.1.2 at the time of entry into an Authority Loan;
- 5.1.3 in any event, not less than once per year whilst Authority Loans to that Authority are outstanding,

and will perform ongoing monitoring. The Company will undertake an external review of its credit assessment process by an appropriately qualified adviser not less than once every five years.

## 5.2 Concentration Limits

The Company will not enter into any agreement as contemplated by Clause 4 (*Borrowing*) if, as a result of doing so and making the relevant Authority Loan, the applicable limits on the Outstanding Loan Amount of any one Authority and of the three highest borrowing Authorities as set out below would be breached (where the limits which apply shall be determined by the Total Outstanding Loan Amount at such time assuming the relevant Authority Loan and all other Authority Loans committed to be made on the same date are made):

<b>Total Outstanding Loan Amount</b>	<b>Outstanding Loan Amount of any one Authority to be no greater than the lower of:</b>	<b>Outstanding Loan Amount of the three highest borrowing Authorities to be no greater than:</b>
Less than £1billion	(i) 15 per cent. of the Total Outstanding Loan Amount and (ii) £125million	40 per cent. of the Total Outstanding Loan Amount
From and including £1billion up to and excluding £2billion	(i) 12.5 per cent. of the Total Outstanding Loan Amount and (ii) £200million	35 per cent. of the Total Outstanding Loan Amount
From and including £2billion up to and excluding £5billion	(i) 10 per cent. of the Total Outstanding Loan Amount and (ii) £375million	30 per cent. of the Total Outstanding Loan Amount
From and including £5billion up to and excluding £10billion	(i) 7.5 per cent. of the Total Outstanding Loan Amount and (ii) £500million	22 per cent. of the Total Outstanding Loan Amount
£10billion and above	5 per cent. of the Total Outstanding Loan Amount	15 per cent. of the Total Outstanding Loan Amount

In the event of any reorganisation of UK local authorities, the Company may propose amendments to the concentration limits set out in this Clause, and such amendments shall be effective if approved by the Directing Authorities.

### 5.3 Matched financing arrangements

5.3.1 The Company shall only designate documents as Finance Documents if such documents are entered into for the purpose of obtaining funds to be on-lent to one or more Authorities as Authority Loans or otherwise to provide liquidity or other support in respect of payments under the Finance Documents. The Company shall not designate any hedging arrangements as Finance Documents.

5.3.2 The Company shall only borrow amounts under Finance Documents where the funds are borrowed in order to on-lend such funds to one or more Authorities as Authority Loans and:

- (a) at the time of such borrowing, the amount borrowed under the Finance Documents will be no more than 105 per cent. of the Total Outstanding Loan Amount at such time; and
- (b) the interest payable in respect of amounts drawn under the relevant Finance Document is and can be no more than the interest payable under the Authority Loans to be funded by such drawdown,

provided that this Clause shall not restrict the Company from borrowing amounts under any Finance Document (including any Liquidity Facility Agreement) to make a payment when due under a Finance Document where a Defaulting Authority fails to make a payment to the Company which would otherwise fund such payment falling due under the original Finance Document, and, for the avoidance of doubt, this Clause shall not restrict the Company from borrowing under any Contribution Loan nor shall it restrict the entry into by the Company of Finance Documents which provide for commitments by lenders in excess of the borrowing limit above (but rather shall only restrict the actual borrowing of funds under such Finance Documents).

5.3.3 If an Authority elects to prepay an Authority Loan, the Company shall apply the proceeds of such prepayment within 10 Business Days of receipt to repay principal under the relevant Finance Document pursuant to which funds were borrowed by the Company to fund the Authority Loan or, where Notes were issued to fund the relevant Authority Loan, to either redeem or purchase and cancel such Notes, in each case in a principal amount at least equal to the principal amount of the Authority Loan being repaid.

5.3.4 The Company shall ensure that each Finance Document provides for a grace period of at least 5 Business Days from a failure to pay before an event of default (howsoever worded) will occur.

5.3.5 The Company shall not borrow amounts under Finance Documents where the term of such borrowing exceeds 50 years.

#### **5.4 Restriction of borrowing**

The Company will not enter into or borrow any sums under any Finance Documents, or issue any further Notes, if instructed not to do so by Authorities where both (i) the number of such Authorities is more than 50 per cent. of the number of all Authorities, and (ii) the aggregate Outstanding Loan Amounts of such Authorities is greater than 50 per cent. of the Total Outstanding Loan Amount at the relevant time, provided that this shall not restrict the Company from borrowing further amounts under any Finance Document (including any Liquidity Facility Agreement) to make a payment when due under a Finance Document where another Defaulting Authority fails to make a payment to the Company which would otherwise fund such payment falling due under the original Finance Document, nor (for the avoidance of doubt) shall it restrict the Company from borrowing under any Contribution Loan.

#### **5.5 Record-keeping**

The Company shall maintain proper books, accounts, records and procedures in relation to its business and undertaking sufficient to record and monitor its borrowings and Authority Loans, and the amounts guaranteed by each Authority.

#### **5.6 Reporting**

5.6.1 The Company shall establish and maintain a public, freely accessible, electronic website, on which it shall post (with signatures redacted, where relevant):

- (a) copies of all executed Guarantees, and notices of termination of any Guarantee in accordance with Clause 2.4.1;
- (b) a copy of each Certificate of Approval (without attachments); and
- (c) a monthly report setting out the borrowings of each Authority and the liabilities of the Company under the Finance Documents as at the end of each calendar month, to be posted within 10 Business Days of the relevant month-end.

5.6.2 The Company shall notify each Authority promptly if any Authority gives the Company notice that it intends to prepay all of its Authority Loans.

5.6.3 The Company shall notify each Authority promptly of any event or circumstance which the Company reasonably believes might have a material adverse effect on the Company's assets, operations, condition (financial or otherwise), prospects, or its ability to comply with the Finance Documents.

#### **5.7 Business of the Company**

The Company shall not carry on any business other than as contemplated herein and ancillary thereto, and provided that the Company shall be permitted to incorporate subsidiaries which may carry out other business.

## 6. GENERAL

### 6.1 Representations

Each Party represents and warrants to each other Party that:

- 6.1.1 the obligations expressed to be assumed by it in this Agreement are, subject to any general principles of law limiting its obligations which are applicable to creditors generally, legal, valid, binding and enforceable obligations; and
- 6.1.2 the entry into and performance by it of this Agreement does not and will not:
  - (a) conflict with any law or regulation applicable to it, its constitutional documents or any agreement or instrument binding upon it or any of its assets; or
  - (b) constitute a default or termination event (however described) under any agreement or instrument binding on it or any of its assets.

### 6.2 Information: Miscellaneous

- 6.2.1 Each Authority shall notify the Company in writing (forthwith upon becoming aware of the same):
  - (a) if such Authority is unable to pay its debts as they fall due;
  - (b) of any report issued in respect of it under Section 114 of the Local Government Finance Act 1988 (or any replacement or equivalent provision);
  - (c) of any failure to 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, as amended or reissued from time to time;
  - (d) of any failure to set a balanced budget in accordance with Section 31A and Section 42A of the Local Government Finance Act 1992;
  - (e) if the chief finance officer's report on robustness of budget estimates and adequacy of reserves under section 25 of the Local Government Act 2003 states either that the estimates are not robust and/or the reserves are inadequate, and the Authority passes that budget without action to remedy those deficiencies;
  - (f) if external auditors issue a qualified audit opinion in respect of such Authority's accounts;
  - (g) if the Authority is or will be unable to publish audited accounts by the statutory deadline;
  - (h) any Change of Status of the Authority (as defined in the Loan Standard Terms);

- (i) promptly upon becoming aware that any representation or statement made or deemed to be made by it in this Agreement, any Authority Loan or any other document delivered by or on behalf of it in relation to such documents was incorrect or misleading when made or deemed to be made;
- (j) promptly upon becoming aware of them, the status and description of any dispute, litigation, arbitration, expert determination or administrative proceedings which are current, threatened or pending against it, which is reasonably likely to be adversely determined, and which, if adversely determined either individually or taken as a whole, are reasonably likely to have a material adverse effect on the status or governance of the Authority, its assets, its operations, its condition (financial or otherwise), its prospects, or its ability to comply with the Finance Documents;
- (k) promptly upon becoming aware of them, any event or circumstance which the Authority reasonably believes might have a material adverse effect on the status or governance of the Authority, its assets, its operations, its condition (financial or otherwise), its prospects, or its ability to comply with the Finance Documents; or
- (l) promptly on request, such additional information as may be reasonably requested by the Company from time to time.

and, in each case, the Authority shall set out in such notice reasonable details associated therewith, the effects of such an event or occurrence and any actions being undertaken to mitigate or remedy such event or occurrence.

- 6.2.2 Each Authority acknowledges that the Company may provide any information provided to it under this Clause 6.2 to any Authority, rating agency or other person the Company reasonably believes to have a legitimate interest in such information.

### **6.3 Amendments**

The Company may agree with the Directing Authorities to amend or waive any provision of this Agreement, provided that unless specific provisions relating to amendments are included in any particular clause (in which case such provisions shall apply), no amendment or waiver which imposes additional obligations on an Authority may be made without the consent of that Authority.

### **6.4 Assignments and transfers**

- 6.4.1 The Company may not assign any of its rights or transfer any of its rights and obligations in respect of this Agreement.
- 6.4.2 No Authority may assign any of its rights or transfer any of its rights and obligations in respect of this Agreement, other than pursuant to Clause 6.5 below.



## 6.5 **Statutory Successor to an Authority**

Any statutory successor to an Authority shall, on the date on which the relevant amending legislation is enacted and to the extent permitted by such amending legislation or any other applicable laws, become a successor Authority under this Agreement without the execution or filing of any paper or any further act of either an Authority or the Company and, from such date, all references in this Agreement to an Authority shall be construed accordingly. Each such successor Authority shall execute all such further documents and do all such further acts and things as may be necessary at any time or times in the opinion of the Company to give effect to the provisions of this Agreement.

## 6.6 **Payments**

6.6.1 On each date on which an Authority is required to make a payment under this Agreement, that Authority shall make the same available to the Company for value on the due date by no later than 11 a.m. London time.

6.6.2 Payment shall be made to such account in London as the Company may specify by written notice.

## 7. **NOTICES**

### 7.1 **Communications in writing**

Any communication to be made under or in connection with this Agreement shall be made in writing and, unless otherwise stated, may be made by letter sent by registered post or electronic mail. All communications made by electronic mail shall be followed with a letter sent by registered post, and such letter will be the effective communication for the purposes of this Agreement, save that all communications under Clauses 3.2 (*Notification by the Company of a Defaulting Authority*) and 3.3 (*Contribution Notices*) shall be sent by electronic mail only and such communication shall be effective for the purposes of this Agreement.

### 7.2 **Addresses**

The address and electronic mail address (and the department or officer, if any, for whose attention the communication is to be made) of each Party for any communication or document to be made or delivered under or in connection with this Agreement is identified with its name below or will be set out in the relevant Authority Accession Deed, or any substitute address, email address or department or officer which that Party may notify to the Company (or the Company may notify to the other Parties, if a change is made by the Company) by not less than five Business Days' notice.

### 7.3 **Delivery**

Any communication or document made or delivered by one person to another under or in connection with this Agreement will only be effective:

1.1.1 if by way of letter, three Business Days after being sent by registered post to the relevant address; or

1.1.2 if by way of electronic mail, when actually received in readable form, and, if a particular department or officer is specified as part of its address details provided under Clause 7.2 (*Addresses*), if addressed to that department or officer.

#### **7.4 English language**

Any notice and all other documents provided under or in connection with this Agreement must be in English.

### **8. PRESERVATION**

#### **8.1 Partial invalidity**

If, at any time, any provision of this Agreement is or becomes illegal, invalid or unenforceable in any respect under any law of any jurisdiction, neither the legality, validity or enforceability of the remaining provisions nor the legality, validity or enforceability of that provision under the law of any other jurisdiction will in any way be affected or impaired.

#### **8.2 No impairment**

If, at any time after its date, any provision of this Agreement is not binding on or enforceable in accordance with its terms against a person expressed to be a party to it, neither the binding nature nor the enforceability of that provision or any other provision of this Agreement will be impaired as against the other parties to this Agreement.

#### **8.3 Remedies and waivers**

No failure to exercise, nor any delay in exercising, on the part of any Party, any right or remedy under this Agreement shall operate as a waiver of any such right or remedy or constitute an election to affirm this Agreement. No single or partial exercise of any right or remedy shall prevent any further or other exercise or the exercise of any other right or remedy. The rights and remedies provided in this Agreement are cumulative and not exclusive of any rights or remedies provided by law.

#### **8.4 Waiver of defences**

The provisions of this Agreement will not be affected by an act, omission, matter or thing which, but for this Clause 8.4, would reduce, release or prejudice the provisions of this Agreement including (without limitation and whether or not known to any Party):

8.4.1 any time, waiver or consent granted to, or composition with, any Authority or other person;

8.4.2 the release of any Authority or any other person under the terms of any composition or arrangement with any creditor of the Company;

8.4.3 the taking, variation, compromise, exchange, renewal or release of, or refusal or neglect to perfect, take up or enforce, any rights against, or security over

assets of, any Authority or other person or any non-presentation or non-observance of any formality or other requirement in respect of any instrument;

- 8.4.4 any incapacity or lack of power, authority or legal personality of or dissolution or change in the status of any Authority or other person;
- 8.4.5 any amendment, novation, supplement, extension (whether of maturity or otherwise) or restatement (in each case, however fundamental and of whatsoever nature, and whether or not more onerous) or replacement of this Agreement or any other document;
- 8.4.6 any unenforceability, illegality or invalidity of any obligation of any person under this Agreement or any other document or security;
- 8.4.7 any intermediate Payment of any of the Liabilities owing by the Company in whole or in part; or
- 8.4.8 any insolvency or similar proceedings.

## 9. **CONFIDENTIALITY**

### 9.1 **Disclosure of Information**

Each Authority acknowledges that the Company will post information as regards such Authority onto its public website, as set out in Clause 5.6.1, and may provide copies of each Guarantee to various persons, including any Creditor.

### 9.2 **Confidentiality**

Each Authority and the Company agrees to keep all Confidential Information confidential and not to disclose it to anyone, save to the extent permitted by Clause 9.3 (*Disclosure of Confidential Information*), and to ensure that all Confidential Information is protected with security measures and a degree of care that would apply to its own confidential information.

### 9.3 **Disclosure of Confidential Information**

Each Party may disclose:

- 9.3.1 to any of its subsidiaries and any of its or their officers, directors, employees, professional advisers, auditors, partners and representatives such Confidential Information as such Party shall consider appropriate if any person to whom the Confidential Information is to be given pursuant to this Clause 9.3.1 is informed in writing of its confidential nature and that some or all of such Confidential Information may be commercially sensitive and/or price-sensitive information except that there shall be no such requirement to so inform if the recipient is subject to professional obligations to maintain the confidentiality of the information or is otherwise bound by requirements of confidentiality in relation to the Confidential Information;
- 9.3.2 to any person:

- (a) to whom information is required or requested to be disclosed by any court of competent jurisdiction or any governmental, taxation or other regulatory authority or similar body, the rules of any relevant stock exchange or pursuant to any applicable law or regulation;
- (b) to whom information is required to be disclosed in connection with, and for the purposes of, any litigation, arbitration, administrative or other investigations, proceedings or disputes; or
- (c) with the consent of the relevant Party;

in each case, such Confidential Information as the Party shall consider appropriate if in relation to paragraphs 9.3.2(a) and 9.3.2(b) above, the person to whom the Confidential Information is to be given is informed of its confidential nature and that some or all of such Confidential Information may be commercially sensitive and/or price-sensitive information except that there shall be no requirement to so inform if, in the opinion of the relevant Party, it is not practicable so to do in the circumstances; and

- 9.3.3 to any rating agency (including its professional advisers) such Confidential Information as may be required to be disclosed to enable such rating agency to carry out its normal rating activities in relation to such Party if the rating agency to whom the Confidential Information is to be given is informed of its confidential nature and that some or all of such Confidential Information may be commercially sensitive and/or price-sensitive information.

#### **9.4 Inside information**

Each Party acknowledges that some or all of the Confidential Information is or may be commercially sensitive and/or price-sensitive information and that the use of such information may be regulated or prohibited by applicable legislation including securities law relating to insider dealing and market abuse and each Party undertakes not to use any Confidential Information for any unlawful purpose.

#### **9.5 Notification of disclosure**

Each Authority and the Company agrees (to the extent permitted by law and regulation) to inform the Company or the relevant Authority (as relevant):

- 9.5.1 of the circumstances of any disclosure of Confidential Information made pursuant to Clause 9.3.2(a) (*Disclosure of Confidential Information*) except where such disclosure is made to any of the persons referred to in that paragraph during the ordinary course of its supervisory function; and
- 9.5.2 upon becoming aware that Confidential Information has been disclosed in breach of this Clause 9.

#### **9.6 Continuing obligations**

The obligations in this Clause 9 are continuing and, in particular, shall survive and remain binding on each Party following termination of this Agreement.

## 10. COUNTERPARTS

This Agreement may be executed in any number of counterparts, and this has the same effect as if the signatures on the counterparts were on a single copy of this Agreement.

## 11. WAIVER OF IMMUNITY

To the extent that an Authority may in any jurisdiction claim for itself or its assets or revenues immunity from suit, execution, attachment (whether in aid of execution, before judgement or otherwise) or other legal process and to the extent that such immunity (whether or not claimed) may be attributed in any such jurisdiction to the Authority or its assets or revenues, the Authority agrees not to claim and irrevocably waives such immunity to the full extent permitted by the laws of such jurisdiction.

## 12. GOVERNING LAW AND JURISDICTION

### 12.1 Governing Law

This Agreement and any non-contractual obligations arising out of or in connection with it are governed by English law.

### 12.2 Jurisdiction

12.2.1 The courts of England have exclusive jurisdiction to settle any dispute arising out of or in connection with this Agreement (including a dispute relating to the existence, validity or termination of this Agreement or the consequences of its nullity or any non-contractual obligation arising out of or in connection with this Agreement) (a "**Dispute**").

12.2.2 The Parties agree that the courts of England are the most appropriate and convenient courts to settle Disputes and accordingly no Party will argue to the contrary.

**This Agreement has been entered into on the date stated at the beginning of this Agreement and executed as a deed by the Parties and is intended to be and is delivered by them as a deed on the date specified above.**

**SCHEDULE 1  
FORM OF AUTHORITY ACCESSION DEED**

**THIS AGREEMENT** is made on [•] and made between:

- (1) [Insert name of New Authority] (the "**Acceding Authority**"); and
- (2) **UK Municipal Bonds Agency PLC** (the "**Company**"), for itself and on behalf of the other Authorities which are currently parties to the framework agreement referred to below.

This Agreement is made on [date] by the Acceding Authority in relation to a local authority financing framework agreement (the "**Framework Agreement**") dated [•] between, amongst others, UK Municipal Bonds Agency PLC and the other Authorities (as defined in the Framework Agreement).

**IT IS AGREED** as follows:

- 1. Terms defined in the Framework Agreement shall, unless otherwise defined in this Agreement, bear the same meaning when used in this Agreement.
- 2. The Acceding Authority confirms that it intends to be party to the Framework Agreement as an Authority, undertakes to perform all the obligations expressed to be assumed by an Authority under the Framework Agreement and agrees that it shall be bound by all the provisions of the Framework Agreement as if it had been an original party to the Framework Agreement.
- 3. This Agreement and any non-contractual obligations arising out of or in connection with it are governed by English law.

**THIS AGREEMENT** has been executed as a deed by the Company and the Acceding Authority and is delivered on the date stated above.

**The Acceding Authority**

**EXECUTED AS A DEED** )  
by [Name of Acceding Authority] )

.....  
.....

Address:

Email:

Attention:

**The Company**

**EXECUTED AS A DEED** )  
**by UK Municipal Bonds Agency PLC** )

[..... Director

..... Director/Secretary]

## SCHEDULE 2 FORM OF GUARANTEE

**THIS GUARANTEE** is made on [date] by [AUTHORITY] (the "**Guarantor**") of [address] in favour of each "**Beneficiary**" (as defined below) and shall be effective on and from the Effective Date.

### 1. DEFINITIONS

#### 1.1 In this Guarantee:

"**Beneficiary**" means each and every Creditor under each Finance Document.

"**Company**" means UK Municipal Bonds Agency PLC of Local Government House, Smith Square, London SW1P 3H2.

"**Creditor**" means:

- (a) the Trustee for itself in respect of the Trust Deed and on behalf of the Noteholders in respect of the Notes;
- (b) the European Investment Bank in respect of any EIB Loan Document;
- (c) each Liquidity Facility Provider in respect of any Liquidity Facility Agreement;
- (d) each Lending Authority; and
- (e) each lender or other provider of credit or financial accommodation to the Company pursuant to a Finance Document.

"**EIB Loan Document**" means each facility agreement entered into between the Company (as borrower) and the European Investment Bank (as lender), as the same may be amended from time to time.

"**Effective Date**" means the date of the first agreement between the Guarantor and the Company pursuant to which the Company (as lender) agrees (subject to the terms of that agreement) to make a loan to the Guarantor (as borrower), which may be documented by way of a loan confirmation modifying and supplementing standard terms, or by any other documentation as may be agreed between the Company and the Guarantor.

"**Finance Document**" means each of the Note Documents, the EIB Loan Documents, each Liquidity Facility Agreement and any facility, agreement or other instrument entered into by the Company for any credit or other financial accommodation and designated in the relevant facility, agreement or other instrument as a "Finance Document" for the purposes of this Guarantee, as the same may be amended from time to time.

"**Guaranteed Liabilities**" means any and all present and future obligations and liabilities (whether actual or contingent and whether owed jointly or severally or in any other capacity whatsoever) of the Company to any Beneficiary arising under each



Finance Document or, in the case of the Note Documents, arising in respect of Notes issued, prior to or following the Effective Date of this Guarantee and on or prior to the date of termination of this Guarantee in accordance with Clause 7 (*Determination of Guarantee*) but, for the avoidance of doubt, excluding any further amounts borrowed under each existing Finance Document, any Finance Documents entered into, and any Notes issued (including any Notes issued following such termination date which are intended to be fungible with Notes issued on or prior to such date) following the date of termination of this Guarantee in accordance with Clause 7 (*Determination of Guarantee*).

**"Lending Authority"** means any local authority that provides a loan or other financial accommodation to the Company pursuant to a Finance Document.

**"Liquidity Facility Agreement"** means each liquidity facility agreement or working capital facility agreement entered into by the Company (as borrower) and designated in the relevant facility agreement as a "Liquidity Facility Agreement" for the purposes of this Guarantee, as the same may be amended from time to time.

**"Liquidity Facility Provider"** means each lender under a Liquidity Facility Agreement.

**"Note"** shall have the meaning given to such term in the Trust Deed.

**"Note Documents"** means the Trust Deed and any Notes.

**"Noteholders"** shall have the meaning given to such term in the Trust Deed.

**"Trust Deed"** means the trust deed dated [•] between the Company and [•] as Trustee, as the same may be supplemented and amended from time to time.<sup>1</sup>

## 2. GUARANTEE

2.1 With effect from the Effective Date, the Guarantor irrevocably and unconditionally:

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

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<sup>1</sup> May require amendment for initial guarantees.

loss being the amount which such Beneficiary would otherwise have been entitled to recover from the Company.

### 3. **PRESERVATION OF RIGHTS**

- 3.1 The obligations of the Guarantor contained in this Guarantee shall be in addition to and independent of every other security which any Beneficiary may at any time hold in relation to any of the Guaranteed Liabilities.
- 3.2 Neither the obligations of the Guarantor contained in this Guarantee nor the rights, powers and remedies conferred in respect of the Guarantor upon the Beneficiaries by this Guarantee or by law shall be discharged, impaired or otherwise affected by:
- 3.2.1 the winding-up, dissolution, administration or reorganisation of the Company or any other person or any change in its status, function, control or ownership;
  - 3.2.2 any of the Guaranteed Liabilities or any of the obligations of the Company or any other person under any security relating to any of the Guaranteed Liabilities being or becoming illegal, invalid, unenforceable or ineffective in any respect;
  - 3.2.3 any time or other indulgence being granted or agreed to be granted to the Company or any other person in respect of any of the Guaranteed Liabilities or under any other security;
  - 3.2.4 any amendment, novation, supplement, extension, (whether of maturity or otherwise) or restatement (in each case, however fundamental and of whatsoever nature) or replacement, waiver or release of, any of the Guaranteed Liabilities or any obligation of any person under any other security or other guarantee or indemnity in respect thereof including without limitation any change in the purposes for which the proceeds of the issue of any Note or other credit obtained pursuant to a Finance Document are to be applied and any extension of or any increase of the obligations of the Company under any Finance Documents or the addition of any new obligations for the Company under the Finance Documents;
  - 3.2.5 any increase in the Guaranteed Liabilities;
  - 3.2.6 any failure to take, or fully to take, any security agreed to be taken in relation to any of the Guaranteed Liabilities;
  - 3.2.7 any failure to realise or fully to realise the value of, or any release, discharge, exchange or substitution of, any security taken in respect of any of the Guaranteed Liabilities; or
  - 3.2.8 any other act, event or omission which, but for this Clause 3.2, might operate to discharge, impair or otherwise affect any of the obligations of the Guarantor contained in this Guarantee or any of the rights, powers or remedies conferred upon any Beneficiary by this Guarantee or by law.
- 3.3 Any settlement or discharge given by any Beneficiary to the Guarantor in respect of the Guarantor's obligations under this Guarantee or any other agreement reached

between any Beneficiary and the Guarantor in relation to it shall be, and be deemed always to have been, void if any act on the faith of which the relevant Beneficiary gave the Guarantor that settlement or discharge or entered into that agreement is subsequently avoided by or in pursuance of any provision of law.

3.4 The Beneficiaries shall not be obliged before exercising any of the rights, powers or remedies conferred upon them in respect of the Guarantor by this Guarantee or by law:

3.4.1 to make any demand of the Company, save for the presentation of the relevant Note (as relevant);

3.4.2 to take any action or obtain judgment in any court against the Company;

3.4.3 to make or file any claim or proof in a winding-up or dissolution of the Company; or

3.4.4 to enforce or seek to enforce any security taken in respect of any of the obligations of the Company in respect of the Guaranteed Liabilities,

and (save as aforesaid) the Guarantor hereby expressly waives presentment, demand, protest and notice of dishonour in respect of any Note.

3.5 The Guarantor agrees that, so long as an amount owing by the Company in respect of any of the Guaranteed Liabilities is overdue, the Guarantor shall not exercise any rights which the Guarantor may at any time have by reason of performance by it of its obligations under this Guarantee:

3.5.1 to be indemnified by the Company or to receive any collateral from the Company;

3.5.2 to claim any contribution from any other guarantor of any of the Guaranteed Liabilities; and/or

3.5.3 to take the benefit (in whole or in part and whether by way of subrogation or otherwise) of any rights of a Beneficiary in respect of any of the Guaranteed Liabilities or of any other security taken pursuant to, or in connection with, any of the Guaranteed Liabilities by any Beneficiary.

#### 4. **REPRESENTATIONS AND WARRANTIES**

The Guarantor represents that:

4.1.1 it has and will have the necessary power to enable it to enter into and perform its obligations under this Guarantee;

4.1.2 this Guarantee constitutes its legal, valid and binding obligations, enforceable against it in accordance with its terms;

4.1.3 all necessary authorisations to enable it to enter into this Guarantee have been obtained and are and will remain in full force and effect; and

4.1.4 the execution, delivery and performance of this Guarantee will not conflict with (a) any agreement binding on it or any of its assets; (b) its constitutive documents; or (c) any applicable law.

## **5. PAYMENTS**

All payments to be made by the Guarantor to a Beneficiary under this Guarantee shall be made without set-off or counterclaim and without any deduction or withholding whatsoever. If the Guarantor is obliged by law to make any deduction or withholding from any such payment, the amount due from the Guarantor in respect of such payment shall be increased to the extent necessary to ensure that, after the making of such deduction or withholding, the Beneficiary receives a net amount equal to the amount the Beneficiary would have received had no such deduction or withholding been required to be made.

## **6. CONTINUING SECURITY**

The obligations of the Guarantor contained in this Guarantee shall constitute and be continuing obligations notwithstanding any settlement of account or other matter or thing whatsoever, and shall not be considered satisfied by any intermediate payment or satisfaction of all or any of the obligations of the Company in relation to any of the Guaranteed Liabilities and shall continue in full force and effect until final payment in full of all amounts owing by the Company in respect of the Guaranteed Liabilities and total satisfaction of all the Company's actual and contingent obligations in relation to the Guaranteed Liabilities. If for any reason this Guarantee ceases to be a continuing security, any Beneficiary may either continue any then existing account(s) or open new account(s) for the Company, but in any case the Guarantor's obligations under this Guarantee shall be unaffected by, and shall be calculated without regard to, any payment into or out of any such account after this Guarantee has ceased to be a continuing security.

## **7. DETERMINATION OF GUARANTEE**

The Guarantor may terminate this Guarantee as a continuing security by notice to the Company, and following the date of such termination the Guaranteed Liabilities of the Company covered by this Guarantee shall not include any further amounts borrowed under each existing Finance Document, any Finance Documents entered into, and any Notes issued (including any Notes issued following such termination date which are intended to be fungible with Notes issued on or prior to such date) following the date of termination of this Guarantee in accordance with this Clause.

## **8. SUSPENSE ACCOUNT**

All monies received, recovered or realised by any Beneficiary under or pursuant to this Guarantee (including the proceeds of any conversion of currency) may in its discretion be credited to and held in any suspense or impersonal account pending their application from time to time in or towards the discharge of this Guarantee.

9. **DEMANDS**

The Company shall act as agent of the Guarantor in relation to receipt of any demands under this Guarantee. Any demand made on the Guarantor in respect of this Guarantee shall be served by leaving it at the address of the Company specified above (or such other address as the Company may previously have specified by notice to each Creditor provided in accordance with the relevant Finance Document) or by letter posted by prepaid first-class post to such address (which shall be deemed to have been served on the tenth day following the date of posting), in each case with a copy to the Guarantor at the address specified above (or such other address as the Guarantor may previously have specified and the Company has notified to each Creditor in accordance with the relevant Finance Document).

10. **ASSIGNMENTS AND SUCCESSORS**

10.1 Each Beneficiary may at any time assign all or any of its rights and benefits under this Guarantee and this Guarantee shall remain in effect despite any amalgamation or merger (however effected) relating to any Beneficiary. References to a Beneficiary or the Beneficiaries shall be deemed to include any assignee or successor in title of a Beneficiary and any person who, under the laws of its jurisdiction of incorporation or domicile, has assumed the rights and obligations of a Beneficiary under this Guarantee or to which under such laws the same have been transferred.

10.2 Any statutory successor to the Guarantor shall, on the date on which the relevant amending legislation is enacted and to the extent permitted by such amending legislation or any other applicable laws, become a successor Guarantor under this Guarantee without the execution or filing of any paper or any further act of either a Guarantor or a Beneficiary and, from such date, all references in this Guarantee to the Guarantor shall be construed accordingly. Each such successor Guarantor shall execute all such further documents and do all such further acts and things as may be necessary at any time or times to give effect to the provisions of this Guarantee.

11. **PARTIAL INVALIDITY**

If at any time, any provision of this Guarantee is or becomes illegal, invalid or unenforceable in any respect under the law of any jurisdiction, neither the legality, validity or enforceability of the remaining provisions of this Guarantee nor of such provisions under the law of any other jurisdiction shall in any way be affected or impaired thereby.

12. **WAIVER OF IMMUNITY**

To the extent that the Guarantor may in any jurisdiction claim for itself or its assets or revenues immunity from suit, execution, attachment (whether in aid of execution, before judgement or otherwise) or other legal process and to the extent that such immunity (whether or not claimed) may be attributed in any such jurisdiction to the Guarantor or its assets or revenues, the Guarantor agrees not to claim and irrevocably waives such immunity to the full extent permitted by the laws of such jurisdiction.

13. **LAW AND JURISDICTION**

This Guarantee and any non-contractual obligations arising out of or in connection with it shall be governed by English law and the English courts shall have exclusive jurisdiction to settle any dispute which may arise out of or in connection with this Guarantee (including a dispute relating to the existence, validity or termination of this Guarantee or the consequences of its nullity or any non-contractual obligation arising out of or in connection with this Guarantee).

**IN WITNESS WHEREOF** this Guarantee has been executed as a deed by the Guarantor and is intended to be and is hereby delivered by it as a deed on the date specified above.

EXECUTED as a DEED

by [AUTHORITY]

## SCHEDULE 3 LOAN STANDARD TERMS

### 1. DEFINITIONS AND INTERPRETATION

#### 1.1 Definitions

In these Standard Terms:

**"Agreement"** means these Standard Terms as supplemented, amended and/or replaced by the relevant Loan Confirmation.

**"Authorisation"** means an authorisation, consent, approval, resolution, licence, exemption, filing, notarisation or registration.

**"Business Day"** means a day (other than a Saturday or Sunday) on which banks are open for general business in London.

**"Change of Status"** means any legislative amendment which results in the Authority ceasing to be treated as a "local authority" within the meaning of the Local Government Act 2003 and the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, or in each case, any re enactment or amendment thereof, or any other legislation which regulates capital finance in connection with local authorities.

**"Day Count Fraction"** means, in respect of the calculation of an amount for any period of time, the actual number of days in such period divided by 360.

**"Default"** means an Event of Default or any event or circumstance specified in Clause 13 (*Events of Default*) which would (with the expiry of a grace period, the giving of notice, the making of any determination or any combination of any of the foregoing) be an Event of Default.

**"Determination Date"** means:

- (a) in the case of a prepayment under Clause 6.3 (*Voluntary Prepayment*), be a date selected by the Company falling after delivery of the notice of prepayment by the Authority to the Company but before the date falling 30 days prior to the date of prepayment; or
- (b) in the case of a prepayment following an Event of Default, any date selected by the Company falling on or after the occurrence of the Event of Default.

**"Event of Default"** has the meaning given to such term in Clause 13.

**"Final Repayment Date"** means the date specified as such in the relevant Loan Confirmation.

**"Fixed Interest Amount"** has the meaning given in the relevant Loan Confirmation.

**"Framework Agreement"** means the local authority financing framework agreement dated [•] between, amongst others, the Company and the Authority.

**"Gross Redemption Yield"** means a yield calculated in accordance with principles consistent with those used in the United Kingdom Debt Management Office notice *"Formulae for Calculating Gilt Prices from Yields"* page 5, Section One: Price/Yield Formulae *"Conventional Gilts; Double-dated and Undated Gilts with Assumed (or Actual) Redemption on a Quasi-Coupon Date"* published on 8 June 1998 and updated on 15 January 2002 and 16 March 2005 (and as further updated, supplemented, amended or replaced from time to time).

**"Increased Costs"** means:

- (a) a reduction in the rate of return from the Loan or on the Company's overall capital;
- (b) an additional or increased cost; or
- (c) a reduction of any amount due and payable under the Agreement,

which is incurred or suffered by the Company to the extent that it is attributable to the Company having entered into a commitment or funding or performing its obligations under the Agreement.

**"Interest Payment Date"** has the meaning given in the relevant Loan Confirmation.

**"Interest Period"** means each period beginning on (and including) the Utilisation Date (in respect of the first Interest Period) or any Interest Payment Date and ending on (but excluding) the next Interest Payment Date.

**"Interest Rate"** has the meaning given in the relevant Loan Confirmation.

**"Loan"** has the meaning given to such term in Clause 2.

**"Loan Confirmation"** means a loan confirmation in the form set out in Schedule 4 to the Framework Agreement, with such terms as may be agreed between the Company and the Authority.

**"Material Adverse Effect"** means a material adverse effect on the status or governance of the Authority, its assets, its operations, its condition (financial or otherwise), its prospects or its ability to comply with the Agreement.

**"Prepayment Amount"** means an amount equal to the principal amount outstanding of the Loans to be prepaid multiplied by the higher of:

- (a) 1; and
- (b) the price (as reported to the Company by a leading broker and/or primary dealer operating in the gilt-edged market selected by the Company) expressed as a percentage and rounded up to four decimal places at which the Gross Redemption Yield on the Loan (if the Loan was to remain outstanding to its original Repayment Date(s)), on the Determination Date would be equal to the sum of the Gross Redemption Yield on the Determination Date of the Reference Gilt and the Prepayment Margin.



"**Prepayment Margin**" has the meaning given in the relevant Loan Confirmation.

"**Principal Amount**" has the meaning given in the relevant Loan Confirmation.

"**Reference Gilt**" has the meaning given in the relevant Loan Confirmation.

"**Representations**" means the representations set out in Clause 12 (*Representations*) or specified as additional Representations in the relevant Loan Confirmation.

"**Taxes**" means any tax, levy, impost, duty or other charge or withholding of a similar nature (including any penalty or interest payable in connection with any failure to pay or any delay in paying any of the same).

"**Tax Deduction**" means a deduction or withholding for or on account of Tax from a payment under the Agreement.

"**Utilisation Date**" has the meaning given in the relevant Loan Confirmation.

"**Voluntary Prepayment Date(s)**" has the meaning given in the relevant Loan Confirmation.

## 1.2 Construction

1.2.1 Terms used in these Standard Terms have the meanings given to such terms in the Framework Agreement, unless otherwise specified herein.

1.2.2 Unless a contrary indication appears, a reference in these Standard Terms to:

- (a) any person shall be construed so as to include its successors in title permitted assigns and permitted transferees to, or of, its rights and/or obligations under these Standard Terms;
- (b) any agreement or instrument is a reference to that agreement or instrument as amended, novated, supplemented, extended or restated in accordance with its terms;
- (c) "**indebtedness**" includes any obligation (whether incurred as principal or as surety) for the payment or repayment of money, whether present or future, actual or contingent;
- (d) a "**person**" includes any individual, firm, company, corporation, government, state or agency of a state or any association, trust, joint venture, consortium, partnership or other entity (whether or not having separate legal personality);
- (e) a "**regulation**" includes any regulation, rule, official directive, request or guideline (whether or not having the force of law) of any governmental, intergovernmental or supranational body, agency, department or of any regulatory, self-regulatory or other authority or organisation; and

- (f) a provision of law is a reference to that provision as amended or re-enacted.

1.2.3 Clause and Schedule headings are for ease of reference only.

## 2. **THE FACILITY**

Subject to the terms of the Agreement, the Company makes available to the Authority on the Utilisation Date a sterling term loan facility (the "**Loan**") in an amount equal to the Principal Amount.

## 3. **CONDITIONS PRECEDENT**

The Company will only be obliged to make the Loan available to the Authority if:

- 3.1 it has received prior to the Utilisation Date, in form and substance satisfactory to it:
  - 3.1.1 evidence of the authority of a specified person or persons, on behalf of the Authority, to sign and/or despatch all documents and notices to be signed and/or despatched by it under or in connection with the Loan, and a specimen of the signature of each person so authorised;
  - 3.1.2 a copy of the Loan Confirmation in the form agreed between the Company and the Authority executed by the Company and the Authority; and
  - 3.1.3 any other conditions precedent set out in the relevant Loan Confirmation;
- 3.2 on the Utilisation Date no Event of Default is continuing or would result from the proposed Loan and the Representations are true in all material respects and the Authority provides the Company with a certificate dated the Utilisation Date confirming the same; and
- 3.3 on or prior to the Utilisation Date, the Company has received the funds it expects to receive on or by such date pursuant to any funding arrangements which the Company entered into in order to fund the making of the Loan.

## 4. **UTILISATION**

If the conditions set out in Clause 3 have been met, the Company shall make the Loan to the Authority on the Utilisation Date.

## 5. **REPAYMENT**

- 5.1 The Authority shall repay the Loan on the Repayment Date(s) and in the amounts set out in the relevant Loan Confirmation.
- 5.2 The Authority may not reborrow any part of the Loan which is repaid.

## 6. **PREPAYMENT**

### 6.1 **Illegality Prepayment**

If, in any applicable jurisdiction, it becomes unlawful for the Company to perform any of its obligations as contemplated by the Agreement or to fund or maintain the Loan:

- 6.1.1 the Company shall promptly notify the Authority upon becoming aware of that event whereupon the facility will be immediately cancelled; and
- 6.1.2 the Authority shall repay the Loan on the Interest Payment Date immediately following the date on which the Company has notified the Authority, or if earlier, the date specified by the Company in the notice delivered to the Authority, together with interest accrued (if any).

## 6.2 **Mandatory prepayment of funding arrangements**

If the Company is required to prepay any funding which the Company entered into in order to fund the making of the Loan, the Company shall promptly notify the Authority of such requirement and the Authority shall repay the Loan on the Interest Payment Date immediately following the date on which the Company has notified the Authority, or if earlier, the date specified by the Company in the notice delivered to the Authority, together with interest accrued (if any).

## 6.3 **Voluntary Prepayment for Tax**

If the Authority is required to pay any additional amounts pursuant to Clause 9 (*Tax Gross Up*), the Authority may elect to prepay the Loan in whole on any Interest Payment Date at the relevant Prepayment Amount on the Authority giving not less than 60 days' notice to the Company (which notice shall be irrevocable and shall oblige the Authority to prepay the Loan in whole plus accrued interest (if any) to such date).

## 6.4 **Change of Status**

If at any time a Change of Status occurs then the Company may by notice to the Authority require it to prepay the Loan on the Interest Payment Date immediately following the date of such notice, together with interest accrued (if any).

## 6.5 **Voluntary Prepayment**

Unless otherwise specified in the relevant Loan Confirmation, the Loan may be prepaid at the option of the Authority in whole or in part on any Voluntary Prepayment Date at the relevant Prepayment Amount on the Authority giving not less than 60 days' notice to the Company, or such other period(s) as may be specified in the relevant Loan Confirmation (which notice shall be irrevocable and shall oblige the Authority to prepay the Loan in whole or, as the case may be, in part, as specified in such notice on the relevant Voluntary Prepayment Date at the Prepayment Amount plus accrued interest (if any) to such date), provided that the Loan may not be prepaid pursuant this Clause prior to the date falling 12 months after the Utilisation Date or following the date falling 12 months prior to the Final Repayment Date.

## 6.6 **No other prepayment**

The Authority shall not, without the prior written consent of the Company, be entitled to prepay the Loan otherwise than as provided in Clauses 6.1 to 6.5 above.

## 7. **INTEREST**

### 7.1 **Calculation of interest**

7.1.1 Interest shall accrue on the Loan at the Interest Rate, and shall be payable in arrear on each Interest Payment Date (subject as provided in Clause 8 (*Payments*)).

7.1.2 For so long as the full Principal Amount of the Loan is outstanding, the amount of interest payable on each Interest Payment Date shall be the Fixed Interest Amount.

7.1.3 The amount of interest payable in respect of the Loan for any period for which a Fixed Interest Amount is not specified or does not apply shall be calculated by applying the Interest Rate to the principal amount of the Loan, and multiplying the product by the Day Count Fraction, rounding the resulting figure to the nearest penny (half a penny being rounded upwards).

### 7.2 **Default Interest**

7.2.1 If the Authority fails to pay any amount payable by it under the Agreement on its due date, interest shall accrue on the overdue amount from the due date up to the date of actual payment (both before and after judgment) at a rate which is two per cent. per annum above the Interest Rate.

7.2.2 Any interest accruing under this Clause 7.2 shall be immediately payable by the Authority on demand by the Company.

7.2.3 Default interest (if unpaid) arising on an overdue amount will be compounded with the overdue amount at the end of each Interest Period but will remain immediately due and payable.

## 8. **PAYMENTS**

8.1 If any sum falls due on a day that is not a Business Day, payment will be postponed to the next Business Day or, if such day would fall in the next succeeding calendar month, the immediately preceding Business Day.

8.2 The Authority shall fund all payments due to the Company under the Agreement by transferring the relevant amounts to an account nominated by the Company by no later than 11 a.m. on the tenth Business Day in respect of principal, or the fifth Business Day in respect of any other amounts, prior to the due date of such amount (the required date for transfer in respect of each payment being the "**Funding Date**").

8.3 Any adjustment to the date of payment as a result of this Clause 8 shall not result in a corresponding adjustment in the amount payable on such date.

8.4 In respect of payments of principal only, any amount of interest which the Company actually obtains by placing the amounts received by it from the Authority pursuant to Clause 8.2 in an interest-bearing account or on deposit with a bank following receipt of such amounts up until no later than the due date of such amounts shall, to the extent reasonably practicable, be for the account of the Authority, **provided that** nothing in this Clause 8.4 shall oblige the Company to place such amounts in an interest-bearing account or on deposit.

## 9. **TAX GROSS UP**

9.1 The Authority shall make all payments to be made by it without any Tax Deduction, unless a Tax Deduction is required by law.

9.2 If a Tax Deduction is required by law to be made by the Authority, the amount of the payment due from the Authority shall be increased to an amount which (after making any Tax Deduction) leaves an amount equal to the payment which would have been due if no Tax Deduction had been required.

9.3 If the Company is required to make a Tax Deduction in respect of any funding arrangement which the Company entered into in order to fund the making of the Loan, the Company shall promptly notify the Authority of such requirement and the Authority shall pay such amount as the Company certifies to the Authority as being the amount required to meet its obligations.

9.4 The Company confirms that it is a company resident in the United Kingdom for United Kingdom tax purposes.

## 10. **INCREASED COSTS**

### 10.1 **Increased costs**

Subject to Clause 10.3 (*Exceptions*) the Authority shall, within three Business Days of a demand by the Company, pay for the account of the Company the amount of any Increased Costs incurred by the Company as a result of:

10.1.1 the introduction of or any change in (or in the interpretation, administration or application of) any law or regulation after the date of the Agreement; or

10.1.2 compliance with any law or regulation made after the date of the Agreement.

### 10.2 **Increased cost claims**

If the Company intends to make a claim pursuant to Clause 10.1 (*Increased costs*), the Company shall promptly notify the Authority.

### 10.3 **Exceptions**

Clause 10.1 (*Increased costs*) does not apply to the extent any Increased Cost is:

10.3.1 attributable to a deduction or withholding for or on account of UK Taxes required by law to be made by the Authority; or

10.3.2 attributable to the wilful breach by the Company of any law or regulation.

## 11. INDEMNITY

### 11.1 Indemnity

11.1.1 The Authority shall, within three Business Days of demand, indemnify the Company against any cost, loss or liability incurred by the Company as a result of:

- (a) the occurrence of any Event of Default;
- (b) a failure by the Authority to pay any amount due under the Agreement on its due date or otherwise to comply with Clause 8.2 (*Payments*);
- (c) funding, or making arrangements to fund, the Loan where the Loan is not made by reason of the operation of any one or more of the provisions of the Agreement (other than by reason of default or negligence by the Company); or
- (d) the Loan not being prepaid in accordance with a notice of prepayment given by the Authority.

11.1.2 The Authority shall promptly indemnify the Company against any cost, loss or liability incurred by the Company (acting reasonably) as a result of:

- (a) investigating any event which it reasonably believes is a Default; or
- (b) acting or relying on any notice, request or instruction which it reasonably believes to be genuine, correct and appropriately authorised.

### 11.2 Enforcement costs

The Authority shall, within three Business Days of demand, pay to the Company the amount of all costs and expenses (including legal fees) incurred by the Company in connection with the enforcement of, or the preservation of any rights under, the Agreement.

## 12. REPRESENTATIONS

The Authority makes the representations and warranties set out in this Clause 12 on the date of the Agreement.

### 12.1 Binding Obligations

The obligations expressed to be assumed by it in the Agreement are legal, valid, binding and enforceable obligations.

### 12.2 Non-conflict with other obligations

The entry into and performance by it of, and the transactions contemplated by, the Agreement do not and will not conflict with:

- 12.2.1 any law or regulation applicable to it;
- 12.2.2 its constitutional documents; or
- 12.2.3 any agreement or instrument binding upon it or any of its assets.

### **12.3 Power and authority**

It has the power to enter into, perform and deliver, and has taken all necessary action to authorise its entry into, performance and delivery of, the Agreement and the transactions contemplated by the Agreement.

### **12.4 Compliance with statutory requirements**

In entering into the Agreement and borrowing thereunder, it is acting in compliance with all statutory requirements relating to borrowing which are applicable to it, including (without limitation) 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, as amended or reissued from time to time.

### **12.5 Validity and admissibility in evidence**

All Authorisations required or desirable:

- 12.5.1 to enable it lawfully to enter into, exercise its rights and comply with its obligations in the Agreement; and
  - 12.5.2 to make the Agreement admissible in evidence,
- have been obtained or effected and are in full force and effect.

### **12.6 Pari passu ranking**

Its obligations in respect of the Loan will be secured by a statutory charge under Section 13(3) of the Local Government Act 2003 and such obligations and charge will rank at least pari passu with all its obligations to other lenders.

### **12.7 No proceedings**

- 12.7.1 No litigation, arbitration or administrative proceedings of or before any court, arbitral body or agency which, if adversely determined, might reasonably be expected to have a Material Adverse Effect has or have (to the best of its knowledge and belief) been started or threatened against it.
- 12.7.2 No judgment or order of a court, arbitral tribunal or other tribunal or any order or sanction of any governmental or other regulatory body which is reasonably likely to have a Material Adverse Effect has (to the best of its knowledge and belief (having made due and careful enquiry)) been made against it or its assets.

## 12.8 **Repetition**

The foregoing Representations, and any additional Representations specified in the relevant Loan Confirmation, are deemed to be repeated by the Authority by reference to the facts and circumstances then existing, on the date of the relevant Loan Confirmation, on the Utilisation Date and on each Interest Payment Date.

## 13. **EVENTS OF DEFAULT**

Each of the events or circumstances set out in this Clause 13 is an Event of Default (save for Clause 13.10):

- 13.1 The Authority is a Failed Contribution Authority or otherwise fails to pay any amount due under the Agreement on its due date or to comply with Clause 8.2 (*Payments*);
- 13.2 The Authority is in breach of any other obligation under the Agreement and has failed to remedy same within 15 days of being requested to do so;
- 13.3 The Authority is unable to pay its debts as they fall due;
- 13.4 The Authority enters into any composition with its creditors;
- 13.5 The High Court has appointed a receiver under Section 13(5) of the Local Government Act 2003 in respect of the Authority;
- 13.6 The Authority is dissolved or otherwise ceases to exist (other than as a result of the enactment of legislation creating a statutory successor to the Authority which becomes responsible for substantially all of the Authority's obligations, including hereunder);
- 13.7 The Authority fails to pay on its due date any amount due under the Framework Agreement;
- 13.8 An event of default (howsoever described) occurs under any other loan agreement, Loan Confirmation or other instrument evidencing indebtedness of the Authority to the Company; or
- 13.9 The occurrence of any additional Event of Default specified in the relevant Loan Confirmation.
- 13.10 On, or at any time after the occurrence of an Event of Default, the Company may, by notice to the Authority declare that the Loan, together with accrued interest be immediately due and payable, at which time they shall become immediately due and payable at the Prepayment Amount.

## 14. **CHANGES TO THE COMPANY AND AUTHORITY**

### 14.1 **Transferability of the Company's rights and obligations**

The Company may not assign any of its rights or transfer any of its rights and obligations in respect of the Agreement, other than following the occurrence of an Event of Default which is continuing. The Authority may not assign or transfer any



of its rights or obligations under the Agreement, other than pursuant to Clause 14.2 below.

## **14.2 Statutory Successor to the Authority**

Any statutory successor to the Authority shall, on the date on which the relevant amending legislation is enacted and to the extent permitted by such amending legislation or any other applicable laws, become the successor Authority under the Agreement without the execution or filing of any paper or any further act of either the Authority or the Company and, from such date, all references in the Agreement to the Authority shall be construed accordingly. Each such successor Authority shall execute all such further documents and do all such further acts and things as may be necessary at any time or times in the opinion of the Company to give effect to the provisions of the Agreement.

## **15. MISCELLANEOUS**

### **15.1 Account details**

All payments to the Company in respect of the Loan should be made to the account specified in the relevant Loan Confirmation.

### **15.2 Third Party Rights**

A person who is not a party to the Agreement has no right under the Contracts (Rights of Third Parties) Act 1999 to enforce or to enjoy the benefit of any term of the Agreement.

### **15.3 Notices**

15.3.1 Any communication to be made under or in connection with the Agreement shall be made in writing and, unless otherwise stated, may be made by letter sent by registered post or electronic mail. All communications made by electronic mail shall be followed with a letter sent by registered post, and such letter will be the effective communication for the purposes of the Agreement.

15.3.2 The address and electronic mail address (and the department or officer, if any, for whose attention the communication is to be made) of each party for any communication or document to be made or delivered under or in connection with the Agreement shall be as specified in the Loan Confirmation, or any substitute address, email address or department or officer which that party may notify to the other party by not less than five Business Days' notice.

15.3.3 Any such communication will only be effective:

(a) if by way of letter, three Business Days after being sent by registered post to the relevant address; or

(b) if by way of electronic mail, when actually received in readable form,

and, if a particular department or officer is specified as part of its address details, if addressed to that department or officer.

15.3.4 Any notice and all other documents provided under or in connection with this Agreement must be in English.

## 16. **GOVERNING LAW AND JURISDICTION**

### 16.1 **Governing Law**

The Agreement and any non-contractual obligations arising out of or in connection with it are governed by English law.

### 16.2 **Jurisdiction**

The courts of England have exclusive jurisdiction to settle any dispute arising out of or in connection with the Agreement (including a dispute relating to the existence, validity or termination of the Agreement or the consequences of its nullity or any non-contractual obligations arising out of or in connection with the Agreement).

**SCHEDULE 4  
FORM OF LOAN CONFIRMATION**

Date:

This Loan Confirmation is entered into between [*Insert name of Authority*] (the **Authority**) and UK Municipal Bonds Agency PLC (the "**Company**"). The parties hereto acknowledge that, in connection with the provision of funds to the Authority, payments and repayments are due from it in accordance with the standard terms set out in Schedule 3 (*Loan Standard Terms*) to the local authority financing framework agreement dated [•] between, amongst others, the Company and the Authority (the "**Standard Terms**"), as supplemented, amended and/or replaced by this Loan Confirmation. Terms used in this Loan Confirmation have the meanings given to such terms in the Standard Terms, unless otherwise specified herein.

PRINCIPAL AMOUNT	GBP [•]								
UTILISATION DATE	[•]								
ADDITIONAL CONDITIONS PRECEDENT (IF ANY)	[•] / [Not applicable]								
REPAYMENT DATE[S] AND AMOUNT OF PRINCIPAL TO BE REPAYED ON SUCH REPAYMENT DATE[S]	<table style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="text-align: left;">Repayment Date</th> <th style="text-align: left;">Repayment Amount</th> </tr> </thead> <tbody> <tr> <td>[•]</td> <td>GBP [•]</td> </tr> <tr> <td>[•]</td> <td>GBP [•]</td> </tr> <tr> <td>[•] (the "<b>Final Repayment Date</b>")</td> <td>GBP [•]</td> </tr> </tbody> </table>	Repayment Date	Repayment Amount	[•]	GBP [•]	[•]	GBP [•]	[•] (the " <b>Final Repayment Date</b> ")	GBP [•]
Repayment Date	Repayment Amount								
[•]	GBP [•]								
[•]	GBP [•]								
[•] (the " <b>Final Repayment Date</b> ")	GBP [•]								
ADDITIONAL PREPAYMENT PROVISIONS (IF ANY)	[•] / [Not applicable]								
PREPAYMENT AMOUNT	[•] / REFERENCE GILT: [•] PREPAYMENT MARGIN: [•]								
VOLUNTARY PREPAYMENT DATE(S)	[•] / [Any date prior to the Final Maturity Date.]								
INTEREST PAYMENT DATES	[•] [and [•]] in each year								
INTEREST RATE	[•]								
FIXED INTEREST AMOUNT	[•]								
ADDITIONAL REPRESENTATIONS (IF ANY)	[•] / [Not applicable]								

ADDITIONAL EVENTS OF DEFAULT (IF ANY)	[•] / [Not applicable]
ACCOUNT DETAILS	Company: [•] Authority: [•]
ADDRESS DETAILS	Company: [•] Authority: [•]
OTHER	<i>[Insert any other amendments or additions to the Standard Terms, including any provisions relating to indexation if applicable]</i>

By: \_\_\_\_\_  
[Authority]

By: \_\_\_\_\_  
**UK MUNICIPAL BONDS AGENCY PLC**

**SIGNATURES**

**The Company**

**EXECUTED AS A DEED**  
by **UK MUNICIPAL BONDS AGENCY PLC**

[..... Director  
..... Director/Secretary]

Address:

Email:

Attention:

**Original Authorities**

**EXECUTED AS A DEED**  
by [*insert name of Authority*]

.....  
.....

Address:

Email:

Attention:

**DOCUMENT FOUR**

**FOLLOW-UP MEMORANDUM**  
**(prepared by Allen & Overy)**

Allen & Overy LLP

## MEMORANDUM

To Birmingham City Council  
Reading Borough Council  
Southwark Borough Council

From Allen & Overy LLP

Our ref GWF/0115333-0000001 ICM:22664913.9

Date 21 December, 2015

Subject **UK Municipal Bonds Agency PLC : Local Authority Financing Framework Agreement**

### 1. INTRODUCTION

- 1.1 You have asked us to consider the terms of a draft Local Authority Financing Framework Agreement dated 18 December, 2015 (the **Final Framework Agreement**) which is proposed to be entered into by UK Municipal Bonds Agency PLC (**UK MBA**) and each English Local Authority (**LA**) wishing to borrow from UK MBA. We have, at your request, agreed to provide advice to LAs as to the matters, and to the extent, set out in this memorandum and the Executive Summary preceding this memorandum (the **Executive Summary**) (the **Advice**). The scope of the Advice is limited to those matters: however, we are able to provide further advice to any LA on the documents or transactions referred to therein, which can be arranged separately and to which separate fee arrangements will apply.
- 1.2 You are acting as an informal working group to assist UK MBA in developing the Final Framework Agreement and related arrangements to a form which addresses concerns (including in relation to potential financial exposure, vires issues and *Wednesbury* reasonableness issues) which LAs may

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have in deciding whether to enter into the Final Framework Agreement, whilst still leaving UK MBA able to achieve its commercial objective of providing LAs with finance on cheaper terms than would otherwise be available to them. Your role has not been to negotiate terms on behalf of LAs, merely to identify issues and areas of concern that LAs may have and to assist UK MBA in addressing them (with the decision whether to enter into the Final Framework Agreement being for each individual LA to make). This memorandum accordingly reflects that approach.

- 1.3 Individual LAs will, as part of their decision-making process, need to demonstrate that they have understood the structure and the risks to which they will be exposed. For this purpose, we envisage that one of the documents that they should review and fully consider will be an analysis of their contractual risks and protections under the Final Framework Agreement. That is the purpose of this memorandum. This memorandum therefore (other than where indicated):
- (a) records in outline the areas of risk that we identified in our memorandum dated 17 July, 2015 (the **Original Memorandum**) in relation to the Original Framework Agreement (as defined below) that may make it problematic for LAs to agree to enter into the Final Framework Agreement;
  - (b) records in outline the suggested amendments proposed in the Original Memorandum as to how our concerns in (a) above might be addressed;
  - (c) records in outline the suggested amendments to the Revised Framework Agreement (as defined below) proposed by Jonathan Swift QC during the process of preparing the final form of his opinion (**Counsel's Opinion**);
  - (d) records UK MBA's responses, by way of (amongst other things) a memorandum from Clifford Chance LLP dated 4 August, 2015 (the **CC Memorandum**), on the matters raised in the Original Memorandum and by Jonathan Swift QC and the extent to which those matters have been dealt with in the Final Framework Agreement; and
  - (e) identifies any residual risks which, in our opinion, are or may be relevant for LAs' consideration before entering into the Final Framework Agreement.

**However, each LA should consider for itself (i) the risks which we have identified as being, in our opinion, relevant and (ii) whether there are any other risks which it should take into account.**

- 1.4 For the purpose of this memorandum, we have reviewed:
- (a) a draft of the Local Authority Financing Framework Agreement dated 10 April, 2015 (the **Original Framework Agreement**);



- (b) a draft of the Local Authority Financing Framework Agreement dated 2 September, 2015;
  - (c) a draft of the Local Authority Financing Framework Agreement dated 9 September, 2015;
  - (d) a draft of the Local Authority Financing Framework Agreement dated 16 September, 2015 (the **Revised Framework Agreement**);
  - (e) a draft of the Local Authority Financing Framework Agreement dated 14 December, 2015; and
  - (f) the Final Framework Agreement.
- 1.5 Each LA which originally enters into the Final Framework Agreement or subsequently accedes to it is referred to in this memorandum as a **Participating LA**.
- 1.6 For the purposes of this memorandum, we have replicated in outline the risks and corresponding suggested amendments highlighted by us in the Original Memorandum. This is for ease of reference only and priority should be given to the Original Memorandum in this regard.
- 1.7 Unless otherwise defined in this memorandum, words and expressions used in this memorandum shall have the meaning given to them in the Final Framework Agreement.
- 1.8 As with the Original Memorandum, we have divided our review of the Final Framework Agreement (and UK MBA's responses) into seven categories, namely:
- (a) accession of Participating LAs (section 2);
  - (b) scope of the Guarantees (section 3);
  - (c) scope of liabilities under the contribution arrangements (section 4);
  - (d) recovery of contribution amounts (section 5);
  - (e) loan terms (section 6);
  - (f) failure by UK MBA (section 7); and
  - (g) additional amendments to the Final Framework Agreement (section 8).

In addition, we discuss (in section 9) the possibility of a Participating LA committee, (in section 10) the possibility that two or more Participating LAs may join to form a "combined authority" and any implications this may have, and (in section 11) any mitigation arising by operation of law which is available to Participating LAs and the extent to which such mitigation is or is not precluded by virtue of the Final Framework Agreement.

## **2. ACCESSION OF PARTICIPATING LAS**

### **2.1 *Risks to Participating LAs identified in the Original Framework Agreement***

In the Original Memorandum, we identified that there was no express provision in the Original Framework Agreement requiring UK MBA to undertake any form of due diligence as to compliance by each LA of its relevant internal procedures, including that each LA should evidence that:

- (a) its constitution and internal governance arrangements have been complied with;
- (b) it has been satisfied as to the prudence and reasonableness of the arrangements from its perspective; and
- (c) appropriate decision-making procedures have been followed and completed.

Although we would expect UK MBA to request evidence of the above as part of its due diligence of LAs that wish to become Participating LAs or wish to borrow, there was nothing in the Original Framework Agreement requiring it to do so. Given that, as a consequence of the Guarantee and contribution arrangements, each Participating LA will take credit risk against each other Participating LA, it will be important for each Participating LA to know that each other Participating LA has validly authorised its entry into, or accession to, both the Final Framework Agreement as a whole and each individual borrowing thereunder.

### **2.2 *Suggested amendments to the Original Framework Agreement***

In the Original Memorandum, we suggested the following amendments to remedy or mitigate the risk identified above:

- (a) evidence (satisfactory to UK MBA) of the matters referred to in 2.1 above be included as a condition precedent to any LA becoming a Participating LA and that such evidence should be available for inspection by other Participating LAs at their request (with the possibility that the Participating LAs may have a right to veto the accession of an LA on the basis that such evidence provided by the relevant LA is not satisfactory to the Participating LAs);
- (b) that the obligation to provide evidence to UK MBA of the satisfaction of governance requirements should extend throughout the life of each Participating LA's participation in the structure (and in particular in relation to any new borrowing by a Participating LA), and that there should be an obligation on UK MBA's part to perform robust checks on the Participating LAs' compliance with governance requirements; and

- (c) a procedural checklist of points for each LA considering becoming a Participating LA to consider, which could either form part of the Final Framework Agreement or be set out separately as guidance.

### 2.3 ***UK MBA response and current position in the Final Framework Agreement***

- (a) Pursuant to the Final Framework Agreement, each Participating LA will be expected to deliver a Certificate of Approval to UK MBA, such certificate to be delivered by an original Participating LA in accordance with clause 2.1.2 (*Participation required to borrow*) of the Final Framework Agreement and an acceding Participating LA in accordance with clause 2.2.1 (*Accession of Authorities*) of the Final Framework Agreement. The definition of Certificate of Approval is purposely broad in nature, presumably to address UK MBA's concern that flexibility would be required (bearing in mind the different internal requirements and processes applicable across the various Participating LAs). UK MBA is now also obliged to carry out credit assessments on each Participating LA at the time of their accession to the Final Framework Agreement (and at other prescribed times) and to monitor each Participating LA on an on-going basis (see clause 5.1 (*Credit Assessments*) of the Final Framework Agreement).
- (b) UK MBA has included an obligation in clause 5.6 (*Reporting*) of the Final Framework Agreement whereby it shall establish and maintain a public, freely accessible electronic website upon which it shall post each Certificate of Approval received from any Participating LA (as outlined in 2.3(a) above), therefore making it possible for all Participating LAs to have access to each other Participating LA's Certificate of Approval. UK MBA has not, however, added a right for Participating LAs to veto the accession of an LA. This is explained in the CC Memorandum on the basis that Participating LAs should be able to take comfort from the independence of UK MBA and of its governing body and decision making processes, this being a key benefit of the proposed structure.
- (c) In relation to the satisfaction of on-going governance requirements throughout the life of each Participating LA's participation in the structure, UK MBA (correctly) notes that representations as to status (contained in the standard loan terms) are repeated throughout the period of any borrowing under the structure. It has additionally included an obligation (see clause 6.2.1(i) (*Information: Miscellaneous*) of the Final Framework Agreement) on the Participating LAs to notify UK MBA in the event that any representation within the Final Framework Agreement or any loan agreement is breached at any time or there is a change of status of the Participating LA. UK MBA acknowledges the importance of on-going monitoring of Participating LAs (and cites, for example, the watch list provisions in the credit policy) but has otherwise pushed back on further surveillance requirements being embedded in the Final Framework Agreement (other than the broad undertaking to "perform on-going monitoring" in clause 5.1 (*Credit Assessments*) of the Final Framework Agreement) to

avoid administrative and financial burden. For additional comfort, UK MBA has agreed in the Final Framework Agreement to obtain an external review of its credit assessment process every five years. It has also agreed to refresh credit assessments of Participating LAs every year.

#### 2.4 *Residual risks/concerns*

- (a) The suggestion in the Original Memorandum that Participating LAs might be given a right of veto in respect of acceding Participating LAs has not been taken. Instead, the intention is that Participating LAs should rely upon UK MBA's due diligence processes. UK MBA's obligations in this area have been made considerably more robust, not least through the requirement of the Certificate of Approval and also UK MBA's undertaking to carry out credit assessments on each acceding Participating LA (and also at other prescribed times). This is especially so given that Participating LAs have been granted visibility to an extent in this process through UK MBA's reporting requirements (as discussed in 2.3(b) above). We note that each of the Certificates of Approval that will be available on the freely accessible website will not include the relevant attachments (i.e. copies of all documentation required to evidence the chain of authority from the council to the relevant signatories), but presumably this will be satisfactory to Participating LAs to avoid any concerns surrounding confidentiality.
- (b) The structure of the Final Framework Agreement is designed such that a Guarantee would only need to be called upon where the contribution arrangements have failed to fill any shortfall under UK MBA's underlying borrowing facilities. However, where more than one LA has defaulted under its obligations under the Final Framework Agreement (which may be, in part, because UK MBA has not pursued its due diligence processes in a diligent manner, as described above) and the contribution arrangements are insufficient to cover the shortfall, the remaining Non-Defaulting LAs shall be liable to make payments under the Guarantees. Participating LAs therefore should consider whether they are comfortable with relying on UK MBA to exercise its discretion (in relation to its due diligence processes and governance) prudently and reasonably and in accordance with the terms of the Final Framework Agreement.

### 3. **SCOPE OF THE GUARANTEES**

#### 3.1 *Risks to Participating LAs identified in the Original Framework Agreement*

In the Original Memorandum, we identified the following potential risks to Participating LAs:

- (a) the possibility of each Guarantee being called independently of any other Guarantee and for the full amount owing by UK MBA under any financing document which is covered by it (and consequently, each Participating LA being jointly and severally liable for all amounts owing by UK

MBA in respect of financing arrangements entered into by UK MBA during the term of the Guarantee);

- (b) the operative provisions of the Guarantee referring to liabilities which UK MBA may "now or hereinafter have" and the possibility that this could therefore be construed as including all existing debts of UK MBA;
- (c) the concept of "Creditors" being very broad and defined by reference to the various financing documents they may enter into with UK MBA. These documents are themselves defined (and do exclude hedging arrangements). However, the Original Framework Agreement did not set out a pro forma of terms or describe the core terms/any limitations on the scope of the terms of such documents;
- (d) the lack of any requirement to seek the consent of any Participating LA prior to UK MBA entering into any such financing document and the resulting lack of control over the terms on which UK MBA may enter into financing arrangements, Participating LAs therefore being subject to the risk that:
  - (i) UK MBA may enter into borrowings on terms which are not matched by the terms of loans to Participating LAs; and/or
  - (ii) UK MBA may enter into borrowings at a high rate of interest for the purpose of funding one or more loans to Participating LAs which are considered to be a higher credit risk than the other Participating LAs.

The extent of the Participating LAs' overall risk could not therefore be quantified or properly considered for the purpose of assessing the reasonableness of the Participating LA entering into its Guarantee; and

- (e) after its termination, a Guarantee would continue to be binding on a Participating LA in respect of further issues of bonds which are issued after the date of such termination but which are intended to be fungible with bonds issued during the term of the Guarantee and there being no consent requirements in respect of any such further issues and no restrictions on UK MBA in respect of the amount of any such further bonds (the Guarantee therefore potentially remaining uncapped).

### 3.2 *Suggested amendments to the Original Framework Agreement*

- (a) In the Original Memorandum we suggested that each Participating LA only guarantees financing documents which were entered into for the purpose of funding its borrowings from UK MBA.

However, we recognised that this approach may not be acceptable to UK MBA (and indeed would undermine the efficacy of the structure).

- (b) We therefore suggested the following amendments/additional provisions to remedy or mitigate the risks identified above (particularly to give comfort as to the potential extent of each Participating LA's liability under their respective Guarantees):
- (i) a covenant that UK MBA will only enter into matched funding arrangements (i.e. will only incur borrowings where the proceeds thereof will be on-lent to Participating LAs which will repay interest and principal in corresponding amounts and on corresponding dates (subject to the requirement to actually pay a specified number of dates earlier) and will pay an additional amount in respect of the expected fees and expenses of UK MBA);
  - (ii) (notwithstanding the prohibition on UK MBA designating any hedging arrangements as Finance Documents) an explicit restriction on UK MBA entering into any hedging arrangements;
  - (iii) a restriction on any further borrowing by UK MBA if a specified proportion (perhaps 75 per cent.) of Participating LAs so required;
  - (iv) a covenant as to the maximum amount of outstanding borrowings UK MBA could incur at any time without specifically seeking the consent of Participating LAs;
  - (v) a set of framework terms on which UK MBA is permitted to borrow without specifically seeking the consent of Participating LAs;
  - (vi) limitations on the amount that any single Participating LA may borrow from UK MBA at any time;
  - (vii) limitations on the early repayment of borrowings by Participating LAs where this would result in the borrowings of any remaining Participating LAs exceeding an agreed threshold (as a percentage of the aggregate borrowings of all Participating LAs);
  - (viii) subject to an initial "ramp-up" period, a requirement that there be a minimum number of Participating LAs at any time with outstanding borrowings (accompanied by either (i) restrictions on early repayments, (ii) increased control rights of the remaining Participating LAs and/or (iii) a restriction on entering into new borrowings, in the event that it is breached);

- (ix) either (i) a prohibition on UK MBA issuing bonds which will be fungible with bonds issued previously where a Guarantee that covers the original issue of bonds has since been terminated or (ii) where a Participating LA will continue to be liable under its Guarantee in respect of bonds issued after the term of the Guarantee which will be fungible with bonds issued during the term of the Guarantee, limitations on the amount by which UK MBA may increase the nominal amount of such bonds (either in monetary terms and/or as a percentage of the nominal amount of such bonds as at the date the relevant Participating LA terminates its Guarantee);
- (x) a requirement to maintain records of, amongst other things, the amount of borrowings by UK MBA, the number of Participating LAs and the amount of borrowings by each and the amount of each Participating LA's exposure under its Guarantee and the contribution arrangements, and either to deliver copies of such records to each Participating LA periodically or to make such records available for inspection by Participating LAs at their request; and
- (xi) a requirement to hold an annual meeting to discuss the financial position of UK MBA and to answer any questions that Participating LAs may have in respect of its governance, credit exposure etc.

### 3.3 ***Suggested amendments to the Revised Framework Agreement***

As a result of discussions with Jonathan Swift QC in the course of obtaining the Counsel's Opinion, further amendments were also suggested, as follows:

- (a) that references in clause 2, clause 3.5, clause 3.6 and clause 6 of the standard guarantee (contained at Schedule 2 to the Revised Framework Agreement) should refer to the "Relevant Liabilities" (as opposed to the "Liabilities", as drafted);
- (b) it was queried whether clause 3.6 of the standard guarantee (contained at Schedule 2 to the Revised Framework Agreement) may have the effect of "cutting away" the provisions of clause 3.9.2 (*Order of application of proceeds*) of the Framework Agreement (given the reference to "contingent obligations" which includes all future payments) and so it was suggested that clause 3.6 of the standard guarantee (contained at Schedule 2 to the Revised Framework Agreement) be amended so as to apply only where the "Relevant Liabilities" are overdue;
- (c) that the obligations under a Guarantee should only commence once funds have been lent by UK MBA to a Participating LA (rather than upon acceding to the Framework Agreement as was the position in the Revised Framework Agreement); and

- (d) that the obligations to which a Guarantee is subject should be subject to some form of longstop, i.e. that a borrowing limit be imposed on UK MBA's borrowings. 25 years was suggested as a possible limit.

#### 3.4 ***UK MBA response and current position in the Final Framework Agreement***

- (a) As anticipated at 3.2(a) above, UK MBA stresses the importance of all Participating LAs guaranteeing all debt obligations of UK MBA to avoid its investors/lenders wishing to conduct due diligence on each individual Participating LA (and negating some of the key benefits of the structure) as opposed to relying on the support of the LA sector as a whole. Such a structure is a necessity in order to allow UK MBA to provide LAs with finance on cheaper terms than would otherwise be possible. Participating LAs can take comfort from the additional protections included in the Final Framework Agreement and the basic aim of the structure that the Guarantees should never need to be called upon (the achievement of which has been enhanced by the additional measures included in the Final Framework Agreement).
- (b) In relation to our proposed amendment at 3.2(b)(i) above, pursuant to the new clause 5.3 (*Matched financing arrangements*) of the Final Framework Agreement, UK MBA can only designate documents as "Finance Documents" (and therefore make them subject to a Participating LA's Guarantee) where such documents are entered into for the purpose of obtaining funds to be on-lent as loans to Participating LAs. Furthermore, UK MBA may only borrow amounts under "Finance Documents" (i) where the funds borrowed are for the purposes of on-lending to Participating LAs and (ii) where the interest payable in respect of such amounts is no more than the interest payable by Participating LAs under any loan to such Participating LA.
- (c) In response to our proposed amendment at 3.2(b)(ii) above, an explicit restriction has been included on UK MBA designating any hedging arrangement as a "Finance Document" (see clause 5.3.1 (*Matched Funding Arrangements*) of the Final Framework Agreement).
- (d) UK MBA has included a restriction (in line with our proposed amendment at 3.2(b)(iii) above) precluding it from borrowing any further sums (see clause 5.4 (*Restriction of borrowing*) of the Final Framework Agreement) where instructed to do so by both (i) more than 50 per cent. of Participating LAs and (ii) where the outstanding loan amounts attributable to such Participating LAs is greater than 50 per cent. of the total outstanding loan amounts attributable to all Participating LAs. Note that this provision does not preclude UK MBA (a) from borrowing further amounts under any Finance Document to make a payment when due under a Finance Document where a Defaulting LA has failed to make such payment and (b) from borrowing under any Contribution Loan.



- (e) UK MBA has not included a covenant as to the maximum amount of outstanding borrowings it can incur without seeking the consent of Participating LAs (as per our suggestion at 3.2(b)(iv)). UK MBA explain that this is to avoid the administrative burden of obtaining consents from each Participating LA when the reason for exceeding the limit may be that UK MBA has been successful and the demand from LAs to borrow is great. However, Participating LAs now have the power to restrict UK MBA from entering into or borrowing any sums due under any Finance Documents (see 3.4(d) above) which would effectively preclude UK MBA from borrowing more than Participating LAs are comfortable with and Participating LAs potentially becoming over exposed on their Guarantees.
- (f) Similarly, UK MBA has not included restrictions on the terms upon which it can borrow from lenders under any Finance Document (pursuant to our suggestion at 3.2(b)(v) above) on the basis that Participating LAs should be able to rely on UK MBA's governance policies and the fact that it is obliged to on-lend such funds received to the Participating LAs. Our concerns have been partially addressed by virtue of the restriction placed on UK MBA to only borrow amounts under Finance Documents where the interest payable thereon is no more than the interest payable under the relevant Participating LA loan.
- (g) In response to our proposed amendment at 3.2(b)(vi), UK MBA has incorporated concentration limits (previously contained in the credit policy) into the Final Framework Agreement (see clause 5.2 (*Concentration Limits*) of the Final Framework Agreement). However, the proposed amendment at 3.2(b)(vii) (i.e. the suggestion that early repayments by one Participating LA are restricted where such a repayment would lead to another Participating LA's borrowings breaching the concentration limit) has not been adopted in order to protect Participating LA's right to pre-pay their loans (and potentially exit the structure) and to avoid placing any restrictions on this autonomy throughout the life of the structure.
- (h) We suggested at 3.2(b)(viii) above that, subject to an initial "ramp-up" period, there should be a minimum number of Participating LAs at any one time with outstanding borrowings. The Final Framework Agreement has not been amended to reflect this concern, presumably for the same reasons as above (i.e. to avoid restricting the autonomy of Participating LAs prepaying their loans and leaving the structure). We note, however, that, pursuant to clause 5.6.2 (Reporting) of the Final Framework Agreement, UK MBA is now obliged to notify each Participating LA promptly if any Participating LA gives UK MBA notice that it intends to prepay all of its loans.
- (i) UK MBA has amended the Final Framework Agreement so that, where a Guarantee is terminated, it will not apply to any subsequent fungible issue of bonds (and therefore, in effect, no tap issuance will be possible without a release of the terminated guarantee by the existing bondholders).

- (j) Our proposal at 3.2(b)(x) above, in relation to the record keeping of UK MBA, has been addressed by the inclusion of clause 5.5 (*Record-keeping*) of the Final Framework Agreement, requiring UK MBA to maintain robust record keeping policies sufficient to record and monitor its borrowings and loans made to Participating LAs, as well as the amounts guaranteed by each Participating LA. UK MBA has not included the proposal of an annual meeting (allowing Participating LAs to discuss its financial position and to answer any questions posed by them) as it anticipates that the shareholder AGM will perform this function.
- (k) The suggested amendments at 3.3(a) above have been incorporated in the Final Framework Agreement, but by using a new term "Guaranteed Liabilities" rather than "Relevant Liabilities" as previously.
- (l) The suggested amendment at 3.3(b) above has been incorporated in the Final Framework Agreement. However, UK MBA was concerned to prevent Participating LAs that had paid out under their Guarantees from taking action against UK MBA to recover sums when UK MBA had not recovered from the relevant Defaulting Authority, and thereby potentially making UK MBA insolvent. Consequently, it has inserted a new clause 3.8.2 in the Final Framework Agreement to make it clear that Participating LAs cannot do that (but still leaving them able to pursue other claims, eg for breach of covenant etc) - which we regard as a satisfactory solution.
- (m) The suggested amendment at 3.3(c) above has been incorporated in the Final Framework Agreement.
- (n) The suggested amendment at 3.3(d) above has been incorporated in the Final Framework Agreement and a limit of 50 years has been included.

### 3.5 ***Residual risks/concerns***

- (a) In relation to 3.4(d) above, and the requirement that UK MBA be instructed in these circumstances by *both* (i) more than 50 per cent. of Participating LAs and (ii) where the outstanding loan amounts attributable to such Participating LAs is greater than 50 per cent. of the total outstanding loan amounts attributable to all Participating LAs, Participating LAs should consider whether they are comfortable with this.
- (b) As discussed at 3.4(f) above, UK MBA still has autonomy (to an extent) to agree to borrow funds under Finance Documents on terms it chooses (other than with the limitations identified above). This therefore, theoretically, still leaves Participating LAs with exposure to the risk that UK MBA may enter into borrowings at a high rate of interest for the purpose of funding loans to Participating LAs which are deemed to be a higher credit risk. The extent to which Participating LAs can quantify or properly consider their exposure and risk to the structure (and the reasonableness of the Participating LA entering into the Guarantee) is therefore potentially restricted. Participating LAs therefore should

consider whether they are comfortable with relying on UK MBA to exercise its discretion (in relation to the terms upon which it borrows) prudently and reasonably and in accordance with the terms of the Final Framework Agreement.

- (c) We note above that UK MBA considers that the annual AGM will be the platform upon which Participating LAs can participate in the governance and running of the structure. We note that the intention of UK MBA is that all Participating LAs become shareholders in UK MBA, however, in the interim, there will potentially be Participating LAs without recourse to such annual AGM and therefore without direct access to UK MBA and its governance processes.
- (d) However, we note that, by operation of law, where a Participating LA has paid more than its rateable proportion of any debt under its Guarantee, such Participating LA shall have the right to seek rateable contributions from the other Participating LAs (as further described in 11.2(b) below).

#### **4. SCOPE OF LIABILITIES UNDER CONTRIBUTION ARRANGEMENTS**

##### **4.1 *Risks to Participating LAs identified in the Original Framework Agreement***

In the Original Memorandum, we identified the following potential risks to Participating LAs:

- (a) unlike the terms of each Participating LA's Guarantee, the contribution provisions set out in the Original Framework Agreement:
  - (i) apply in respect of any defaults occurring for so long as an LA is a Participating LA and not by reference to when the original borrowing was entered into; and
  - (ii) cease to apply (by virtue of how the proportionate shares are calculated) upon a Participating LA having repaid its borrowings from UK MBA in full.

This therefore created a potential mismatch in respect of the amounts for which an LA could be liable under its Guarantee and amounts for which an LA could be liable under the contribution provisions;

- (b) as mentioned above, the contribution amounts required of each Non-Defaulting LA are calculated by reference to the outstanding loan amount of such Non-Defaulting LA as a proportion of the aggregate outstanding loan amount of all Non-Defaulting LAs. Therefore, once a Participating LA has repaid its borrowings from UK MBA in full, its proportionate share of any shortfall will be zero. Consequently, the repayment of borrowings by one or more Participating LAs will result in the proportionate level of exposure of the remaining Participating LAs, in the event of a default by a Defaulting LA, increasing. This will be the case even where a Participating LA has purposely repaid

its borrowings in full to reduce its obligations under the contribution arrangements after becoming aware, or anticipating, that another Participating LA will become a Defaulting LA;

- (c) the contribution amounts which may be required of any Participating LA at any time will therefore be subject to:
  - (i) the number of Participating LAs with outstanding borrowings from UK MBA at such time; and
  - (ii) the amount of outstanding borrowings from UK MBA which each Participating LA may incur,

and the Original Framework Agreement did not envisage any limitations on the above, nor did the Participating LAs have any controls over these; and

- (d) the Original Framework Agreement provided that contribution loans bear interest at a rate equal to the rate payable by the Defaulting LA under its loan minus a certain number of basis points, “or otherwise at 2 per cent per annum”. A Non-Defaulting LA that makes a contribution loan may have to borrow at short notice, or divert funds from other sources, to fund the contribution loan, and the interest rate provided for under the Original Framework Agreement may not adequately compensate it for its actual funding costs. In addition, it was not clear what the reference to “or otherwise” means (and, in particular, whether it is meant to be a minimum or a maximum).

#### 4.2 *Suggested amendments to the Original Framework Agreement*

In the Original Memorandum, we suggested the following amendments to remedy or mitigate the risks identified above:

- (a) the additional provisions suggested in 3.2(b) above which would also give Participating LAs some comfort as to the potential extent of their liability under the contribution provisions;
- (b) to address the concern that some Participating LAs may (upon believing that another Participating LA is likely to become a Defaulting LA) side-step the obligation to make contribution amounts by repaying their outstanding borrowings to UK MBA (and thereby increasing the potential obligations of other Participating LAs), building in a provision requiring that each Participating LA fund a specified minimum amount of any such request (for example, the lower of a specified monetary amount and a percentage of the shortfall) for so long as it would otherwise be required to make payment under its Guarantee;

- (c) providing for a minimum interest rate on a contribution loan at least equal to the relevant Non-Defaulting LA's actual funding cost (with an appropriate adjustment to the interest rate owing by the Defaulting LA to match this) and that the reference to "or otherwise at 2 per cent per annum" be clarified; and
- (d) for UK MBA to explore and model the effects of providing for LAs' contribution obligations to be capped, for example at various percentage levels above the amounts of their borrowings, and to confirm whether, if such caps were built in, the contribution arrangements would still be robust enough to ensure that, in practice, the Guarantees would be unlikely to be called.

#### 4.3 *Suggested amendments to the Revised Framework Agreement*

As a result of discussions with Jonathan Swift QC for the purposes of producing the Counsel's Opinion, it was also proposed that, to prevent a situation whereby a Participating LA makes prepayments under its loan in order to limit its exposure to the contribution arrangements (for example, to address a concern as to the financial health of another Participating LA), contributions under the contribution arrangements be calculated by reference to outstanding borrowings, disregarding any early repayments that a Participating LA may have made, whether for valid commercial reasons or otherwise.

#### 4.4 *UK MBA response and current position in the Final Framework Agreement*

- (a) In relation to the potential mismatch in respect of amounts for which a Participating LA could be liable under its Guarantee and amounts for which a Participating LA could be liable under the contribution provisions, UK MBA acknowledge this mismatch but note that the structure is designed to operate in this way. UK MBA notes that clearly it is of importance to allocate any default amongst Participating LAs and that using outstanding loans as the criteria upon which to do this was selected as (i) it links the risks with those taking the benefits of using the Final Framework Agreement and the UK MBA structure to borrow funds and (ii) it permits Participating LAs to exit the UK MBA structure (even though they may still remain liable under their Guarantee).
- (b) UK MBA has not included any requirement for each Participating LA to fund a specified minimum amount of any contribution request (as suggested at 4.2(b) above). This is on the basis that such a concept would (i) undermine the intention that Participating LAs are able to achieve a "clean exit" (as discussed above) and (ii) would make the structure unduly complex.
- (c) UK MBA has also not included a mechanism whereby any contribution is calculated on the basis of outstanding borrowings (disregarding any early repayment) (as suggested at 4.3 above). This is on the basis that, to prohibit a Participating LA from making early prepayments and releasing itself

from its obligations under the contribution arrangements would unfairly penalise those Participating LAs legitimately making prepayments for valid commercial reasons (eg the ability to source funding on cheaper terms elsewhere).

- (d) Similarly, UK MBA has not included a cap on contribution obligations in the Final Framework Agreement on the basis that this could result in a shortfall and eventually a call on one or more of the Participating LAs' Guarantee, being the worst case scenario for the structure for both UK MBA and the Participating LAs.
- (e) Clause 3.4 (*Contribution Loans*) of the Final Framework Agreement has been amended to reflect the amendment suggested at 4.2(c) above. Interest on Contribution Loans will (as amended) accrue at a rate equal to the higher of (i) the interest rate payable by the Defaulting LA under the relevant Participating LA loan and (ii) the prevailing rate offered by the Public Works Loan Board (**PWLB**) in respect of loans having the same maturity and interest basis as the relevant Participating LA loan.

#### 4.5 ***Residual risks/concerns***

As described above, UK MBA has not accepted all of our suggested amendments in relation to the scope of a Participating LA's liabilities under the contribution arrangements (particularly those in 4.4(b), 4.4(c) and 4.4(d) above). Despite the fact that the points raised in our Original Memorandum and Counsel's Opinion do entail risks to an extent for the Participating LAs, in our opinion, it would be reasonable for Participating LAs to take the view that the benefit of Participating LAs being able to exit the structure cleanly (other than those liabilities remaining under Guarantees) without future potential liabilities of a nature that they cannot quantify outweigh those risks.

## 5. **RECOVERY OF CONTRIBUTION AMOUNTS**

### 5.1 ***Risks to Participating LAs identified in the Original Framework Agreement***

In the Original Memorandum, we identified the following potential risks to Participating LAs:

- (a) the Original Framework Agreement does not permit any Non-Defaulting LA to take action against a Defaulting LA. While we recognise that it would be more efficient for UK MBA to do so (rather than individual Non-Defaulting LAs) and the directors of UK MBA will be incentivised to do so (to ensure that they recover amounts which will then be owing to the Non-Defaulting LAs under the contribution loans), the Original Framework Agreement does not include any covenant on UK MBA to do so nor does it contain any mechanics for the Non-Defaulting LAs to take action on its behalf if it fails to do so; and

- (b) upon recovering amounts from a Defaulting LA, the Original Framework Agreement provides that such amounts will be applied in the order set out therein, which is broadly as follows:
- (i) to pay amounts owing to Creditors;
  - (ii) to repay amounts owing to an LA under its Guarantee;
  - (iii) to repay contribution loans to Participating LAs which agreed to pay more than their required contribution amounts;
  - (iv) to repay contribution loans advanced following a Further Contribution Notice; and
  - (v) to repay contribution loans advanced following a Contribution Notice.

It may be possible that recovered amounts could be applied by refunding LAs which have paid under their Guarantees prior to repaying contribution loans. Given the potential mismatch described under 4.1(a) above, this could result in an LA being repaid under its Guarantee where it had not been obliged to make a contribution amount in respect of the relevant shortfall that is being repaid.

## 5.2 *Suggested amendments to the Original Framework Agreement*

In the Original Memorandum, we suggested the following amendments to remedy or mitigate the risks identified above:

- (a) requiring UK MBA to exercise all its rights (promptly) to recover all amounts owing by a Defaulting LA to UK MBA;
- (b) permitting Non-Defaulting LAs to take action in the name of UK MBA to recover amounts owing by a Defaulting LA in the event that UK MBA fails to do so within a specified period of time. This could be an ability for any individual Non-Defaulting LA to take action, but it is probably more practicable to provide for the formation of a steering committee by the Non-Defaulting LAs at the relevant time, with power for one Non-Defaulting LA to act on behalf of the others, on such terms as they may agree at the time, and with an obligation on UK MBA's part to give the Non-Defaulting LAs all relevant information to enable the formation of the committee and to enable the committee to perform its functions; and
- (c) amending the order of priorities in which recovered amounts are applied to ensure that these are applied in the repayment of contribution loans prior to amounts owing by UK MBA in respect of any Guarantee.

## 5.3 *UK MBA response and current position in the Final Framework Agreement*

- (a) In relation to the suggested amendment at 5.2(a) above, UK MBA has included an obligation to promptly exercise its rights and take action to recover all amounts owing to it by a Defaulting LA (see clause 3.7 (*Enforcement by the Company*) of the Final Framework Agreement). Further, in a situation where UK MBA fails to take such action within 90 days, pursuant to clause 3.8 (*Action to recover debt through Company only*) of the Final Framework Agreement, UK MBA will now be obliged to take such action as the "Directing Authorities" (i.e. both (i) 50 per cent. of the number of all Participating LAs and (ii) where the aggregate outstanding amount of loans extended to such Participating LAs is greater than 50 per cent. of the total outstanding loan amounts at that time extended to all Participating LAs) direct.
- (b) In relation to our suggested amendment at 5.2(c) above, UK MBA query why Participating LAs would prefer amounts payable under contribution loans to be paid prior to those amounts payable in respect of any Guarantee. This is on the basis that a call on a Guarantee means that one or more Participating LA is taking the burden of the default as opposed to the whole Participating LA group (in accordance with the principles of the Final Framework Agreement). In our opinion, this does seem a reasonable justification.

#### 5.4 *Residual risks/concerns*

In relation to 5.3(a) above, and the requirement that UK MBA be instructed in these circumstances by *both* (i) more than 50 per cent. of Participating LAs and (ii) where the outstanding loan amounts attributable to such Participating LAs is greater than 50 per cent. of the total outstanding loan amounts attributable to all Participating LAs, Participating LAs should consider whether they are comfortable with this.

## 6. LOAN TERMS

### 6.1 *Risks to Participating LAs identified in the Original Framework Agreement*

In the Original Memorandum, we identified the following potential risks to Participating LAs:

- (a) the standard terms pursuant to which it is envisaged that Participating LAs will borrow from UK MBA which were set out in the Original Framework Agreement did not include any conditions precedent requiring the Participating LA to evidence, for example, the fact that it will be acting in compliance with the Prudential Code for Capital Finance in Local Authorities (the **Prudential Code**) or that it would otherwise be able to satisfy the additional checks which would be required if it were to seek to borrow from the PWLB;
- (b) the standard terms included provisions requiring the Participating LA to gross up amounts owing to UK MBA in the event of a withholding or deduction of tax which is required by law and to pay any



increased costs incurred by UK MBA as a result of a change of law or regulation. While these provisions are not unusual, they would typically be accompanied by a right of the borrower to repay the loan at par in such circumstances. The standard terms set out in the Original Framework Agreement did not include such a right;

- (c) the standard loan terms also did not address circumstances in which UK MBA may be required to redeem bonds it has issued (or repay loans it has entered into) early, for example where it is required to gross up amounts in respect of tax or where its obligations thereunder become illegal. In such circumstances, if there is no corresponding mandatory redemption of the loans to Participating LAs which were funded by such borrowings, either:
  - (i) UK MBA will need to draw on liquidity facilities to do so (where possible) which will increase costs payable by all Participating LAs;
  - (ii) UK MBA will need to rely on its paid up share capital (which would unfairly burden those Participating LAs which are also members of UK MBA); and/or
  - (iii) UK MBA will default and the bondholders/lenders will call on one or more of the Guarantees (as UK MBA would not have been able to make a prior claim for contribution amounts); and
- (d) the Original Framework Agreement envisaged that loans to Participating LAs could be made on terms other than the standard terms set out therein. The ability for UK MBA to agree different terms with one or more Participating LAs may be detrimental to the other Participating LAs, for example by increasing the likelihood that they will be required to fund contribution amounts or that their Guarantees will be called.

## 6.2 *Suggested amendments to the Original Framework Agreement*

In the Original Memorandum, we suggested the following amendments to remedy or mitigate the risks identified above:

- (a) that evidence (satisfactory to UK MBA) of a Participating LA's compliance with the Prudential Code and other checks similar to those that the PWLB would carry out be required as a condition precedent to any LA borrowing from UK MBA and that such evidence should be available for inspection by other Participating LAs at their request. As above in relation to the accession of Participating LAs, consideration may also be given as to whether the Participating LAs should have a right to veto any borrowing on the basis that such evidence provided by the relevant LA is not satisfactory to the Participating LAs; and

- (b) we suggested amending the standard loan terms to provide for:
  - (i) a right of repayment (at par) in the event that the Participating LA is required to gross up in respect of any withholding or deduction or to pay increased costs;
  - (ii) a mandatory repayment obligation in the event that UK MBA is required to redeem bonds it has issued (or to repay loans it has entered into) early and such bonds were issued (or such loan was entered into) for the purpose of funding the relevant loan to the Participating LA; and
  - (iii) either:
    - (A) removing the ability of UK MBA to on-lend to Participating LAs on terms other than the standard terms set out in the Original Framework Agreement; or
    - (B) providing a set of framework or core terms on which UK MBA is permitted to enter into such on-lending.

### 6.3 ***UK MBA response and current position in the Final Framework Agreement***

- (a) UK MBA has pushed back on imposing a requirement on Participating LAs to provide evidence of their compliance with the PWLB's checks as a condition precedent to any Participating LA borrowing from UK MBA. They have, however, included, at clause 12.4 (*Compliance with statutory requirements*) of the standard loan terms, a representation to be given by each Participating LA upon entering into a loan with UK MBA (and to be repeated upon the date of the relevant Loan Confirmation, the Utilisation Date and on each Interest Payment Date in relation to that loan) as to compliance with statutory requirements and related regulations (including, amongst other things, the Prudential Code), as proposed at 6.2(a) above.
- (b) For the reasons given at 2.3(b) above, UK MBA has not added a power of veto for Participating LAs where the evidence provided by other Participating LAs in relation to compliance with statutory requirements is not satisfactory.
- (c) In relation to our suggested amendment at 6.2(b)(i) above, UK MBA has included such right of repayment (see clause 6.3 (*Voluntary Prepayment for Tax*) of the standard loan terms), in relation to tax gross up but not in relation to increased costs, on the relevant Participating LA giving not less than 60 days' notice to UK MBA.
- (d) In relation to our suggested amendment at 6.2(b)(ii) above, UK MBA has included a mandatory prepayment provision (see clause 6.2 (*Mandatory prepayment of funding arrangements*) of the

standard loan terms) requiring Participating LAs to prepay their relevant loan where UK MBA is required to prepay any funding entered into in order to fund any loan to a Participating LA.

- (e) UK MBA has not included any amendments to address our concerns surrounding loans being made to individual Participating LAs on terms other than the standard terms set out in the Final Framework Agreement. UK MBA argue that the expectation is that all lending will be on the terms as set out in the Final Framework Agreement but that UK MBA prefers to retain flexibility to make amendments if it deems necessary or beneficial. UK MBA's intention is that its strict governance requirements should give Participating LAs the protection and comfort they need in this regard.

#### 6.4 *Residual risks/concerns*

- (a) In relation to the absence of provisions providing a framework or core terms on which UK MBA is permitted to enter into on-lending to Participating LAs, Participating LAs should consider whether this is a concern to them or not. In our opinion, the extent to which Participating LAs can quantify or properly consider their exposure and risk to the structure (and the reasonableness of the Participating LA entering into the Guarantee) is potentially restricted as the potential for Participating LAs to be required to fund contribution amounts or for their Guarantees to be called is, at least theoretically, increased. Each Participating LA should assess for itself whether this is in practice a concern to it or not.
- (b) We believe that there is still a potential cost risk to Participating LAs in respect of the absence of any right of prepayment where UK MBA is subject to increased costs. Currently, Participating LAs (by virtue of clause 10 (*Increased Costs*) of the standard loan terms) are obliged to pay to UK MBA the amount of any such increased costs, without the power to prepay their loans at par (as we would expect to see in a standard bank loan agreement) other than by repayment on a Voluntary Prepayment Date at the (potentially costly) Prepayment Amount. We note that, to avoid any mismatch under the bonds, there could be an early redemption right inserted into the bonds. If this is not acceptable to UK MBA, we think that Participating LAs should consider whether to require that there be an obligation on UK MBA to pass through increased costs on a pro rata basis across all Participating LAs (or indeed that the right to charge increased costs be removed altogether).

## 7. **FAILURE BY UK MBA**

### 7.1 *Risks to Participating LAs identified in the Original Framework Agreement*

In the Original Memorandum, we identified the following potential risks to Participating LAs:

- (a) the Original Framework Agreement did not include any restrictions on the activities of UK MBA or include the ability of the Participating LAs to step in (or appoint another entity to take control of UK

MBA) in the event that it fails to comply with its obligations under the Original Framework Agreement. Although, in certain circumstances, an administrator may step in and enforce UK MBA's rights under the Original Framework Agreement, in practice this would take time to put in place; and

- (b) should UK MBA fail, for example, to issue Contribution Notices when required and have insufficient funds to pay its Creditors, the Creditors are likely to call the Guarantees, in which case, a Participating LA could be required to pay, under its respective Guarantee, an amount which would exceed the amount it would otherwise have been required to fund under the contribution arrangements.

## 7.2 *Suggested amendments to the Original Framework Agreement*

In the Original Memorandum, we suggested the following amendments to remedy or mitigate the risks identified above (whilst acknowledging that, as UK MBA is intended to be a financing vehicle, the risk of its default may be considered low):

- (a) restrictive covenants limiting the scope of its activities (including, for example, a restriction on the establishment of subsidiaries);
- (b) obligations on UK MBA's part to notify Participating LAs of any problems or material adverse developments (not only in relation to LAs but also in relation to UK MBA itself), in order to provide Participating LAs with an early warning of potential problems;
- (c) provisions relating to Participating LA representation on the board of UK MBA; and
- (d) the ability for individual Participating LAs to issue Contribution Notices where UK MBA is obliged to but fails to do so. It may also be helpful to provide for the ability to form a steering committee, on the basis described in 5.2(b) above.

## 7.3 *UK MBA response and current position in the Final Framework Agreement*

- (a) UK MBA has included a restrictive covenant limiting the scope of its activities (see clause 5.7 (*Business of the Company*) of the Final Framework Agreement). UK MBA notes that there are additionally restrictions on its activities in its constitutional documents. Reporting requirements have also been included (see clause 5.6.3 (*Reporting*) of the Final Framework Agreement) whereby UK MBA is obliged to notify all Participating LAs promptly of any event or circumstance which it believes might have a material adverse effect on UK MBA's assets, operations, condition (financial or otherwise), prospects, or its ability to comply with the Finance Documents.

- (b) Our proposal at 7.2(c) above in relation to representation of Participating LAs on the board of UK MBA has not been addressed. UK MBA explains that the Local Government Association currently has a right of veto over appointments to the board of UK MBA and that this should be considered as adequate protection for Participating LAs. UK MBA further argues that Participating LAs can also participate in governance matters in their capacity as shareholders.
- (c) We note that UK MBA has not included the ability for individual Participating LAs to issue Contribution Notices where UK MBA is obliged but fails to do so (as per our proposed amendment at 7.2(d) above).

#### 7.4 *Residual risks/concerns*

- (a) The restrictive covenant as to activities that UK MBA can carry out (as discussed at 7.3(a) above) does not include a restriction on the establishment of subsidiaries (and indeed provides that UK MBA shall be permitted to incorporate subsidiaries which may carry out other business). Participating LAs should consider whether or not they should require some parameters as to what business any subsidiary may carry out or a total restriction on incorporating subsidiaries (as originally proposed).
- (b) In relation to UK MBA's suggestion that Participating LAs shall be able to participate in governance matters in their capacity as shareholders in UK MBA, we note that the intention of UK MBA is that all Participating LAs shall eventually become shareholders in UK MBA. However, in the interim, there will potentially be Participating LAs who are not shareholders and will therefore be excluded from any such participation.
- (c) A potential risk remains in relation to a scenario where UK MBA fails to issue Contribution Notices and, as a result, UK MBA's creditors resort to calling on the Participating LAs' Guarantees. In the Original Memorandum, we suggested for consideration whether individual Participating LAs should have the ability to issue Contribution Notices where UK MBA is obliged to but fails to do so. However, we note that, under clause 3.3 (*Contribution Notices*) of the Final Framework Agreement, UK MBA is obliged to issue Contribution Notices where it is unable to obtain funding from liquidity facilities or other sources of finance available to it, and it is stated as a general principle (see clause 3.11 (*Guiding principle*) of the Final Framework Agreement) that UK MBA should exercise its rights under the Final Framework Agreement such as to avoid Guarantees ever being called.
- (d) LAs are further subject to the potential risk that UK MBA fails to comply with its obligations under the Final Framework Agreement, either through (i) the failure to service (i.e. pass through funds received from LAs) its debt obligations (whether to LAs, or under bilateral borrowing facilities or bond issues), or (ii) failure on the part of UK MBA to sustain and police robust due diligence and

credit checks in relation to acceding LAs pursuant to its obligations under the Final Framework Agreement. Participating LAs should make their own assessment as to whether these potential risks are a concern to them or not.

## **8. ADDITIONAL AMENDMENTS TO THE FRAMEWORK AGREEMENT**

### **8.1 *Suggested amendments to the Original Framework Agreement***

In the Original Memorandum, in addition to the points raised above, we also proposed the following amendments which are more general in nature:

(a) as the Original Framework Agreement did not include any express provisions for making amendments to it, if any amendments are required these would require the unanimous consent of all parties. Given the potential number of Participating LAs, this may be impractical. We therefore suggested that provisions are included whereby amendments could be made which require consent of, for example:

(i) only a certain percentage of Participating LAs (either by number or by reference to then outstanding borrowings, or both); or

(ii) a committee of the kind referred to in section 9 below,

which, in either case, could if thought appropriate, carve out a specified list of reserved matters for which unanimous consent of all Participating LA is required;

(b) if a Participating LA has repaid its borrowings and wishes to terminate its obligations under its Guarantee, the Original Framework Agreement provided that it must first request confirmation from UK MBA that the relevant conditions have been satisfied. Although UK MBA is required to give such confirmation within a specified time period, we queried the necessity of this, given that the relevant conditions can be objectively determined. To avoid any delay as a result of the need for UK MBA to give such confirmation (or where it fails to do so), we suggested that these provisions be amended to remove this requirement or to allow a Participating LA to give its termination notice if UK MBA fails to respond within a specified time limit;

(c) the Original Framework Agreement included obligations of confidentiality on Participating LAs. However, these obligations did not extend to UK MBA. We suggested that the Final Framework Agreement be amended to make these obligations reciprocal;

- (d) we suggested that both the events of default set out in the loan standard terms and the definition of Defaulting Authority be amended to remove reference to a report under section 114 of the Local Government Finance Act 1988; and
- (e) we understand that, for those Participating LAs that are also shareholders in UK MBA, the commercial intention is that there will be some mechanism for compensating them for the use of the money representing their share capital to cover UK MBA's initial costs. There was no such mechanism in the Original Framework Agreement, and we suggested that this be included. One possibility would be to provide that, in relation to those Participating LAs, the top-up element in the interest rate paid by them on loans to them (i.e. the top-up to cover UK MBA's costs) be lower than that payable by other Participating LAs that are not shareholders, until they have been sufficiently compensated.

## 8.2 ***Suggested amendments to the Revised Framework Agreement***

As a result of discussions with Jonathan Swift QC in the course of obtaining the Counsel's Opinion, the following further suggestions were also made:

- (a) that the drafting of clause 3.11 of the Revised Framework Agreement be amended so that UK MBA is *obliged* to resort in the first instance to the contribution arrangements, unless it was not reasonably practicable to do so;
- (b) that clause 5.1 of the Revised Framework Agreement be amended so as (a) to be more prescriptive as to what was required in terms of credit assessment and (b) to include a requirement to assess creditworthiness not only at the time of accession, but also at the time any decision is made to lend to a Participating LA, as well as periodically on other occasions; and
- (c) that clause 3.7 of the Revised Framework Agreement be amended to also refer to section 13(3) of the Local Government Act 2003.

## 8.3 ***UK MBA response and current position in the Final Framework Agreement***

- (a) In response to our proposed amendment at 8.1(a) above, UK MBA has included a provision allowing for amendments to the Final Framework Agreement (see clause 6.3 (*Amendments*) of the Final Framework Agreement) with the agreement of the "Directing Authorities" (i.e. both (i) 85 per cent. of the number of all Participating LAs and (ii) where the aggregate outstanding amount of loans extended to such Participating LAs is greater than 85 per cent. of the total outstanding loan amounts at that time extended to all Participating LAs), provided that no amendment or waiver which imposes additional obligations on any Participating LA may be made without the consent of that Participating LA.

- (b) In relation to our concerns as to the process for Participating LAs giving termination notices under the Original Framework Agreement (see 8.1(b) above), the relevant provision (see clause 2.4 (*Resignation of an Authority*) of the Final Framework Agreement) has been amended such that, where UK MBA has not provided confirmation that the relevant conditions have been fulfilled within 10 days, the relevant Participating LA shall be able to terminate its Guarantee by notice to UK MBA in accordance with clause 7 (*Determination of Guarantee*) of the Guarantee. The corresponding amendments have been made in respect of a Participating LA ceasing to be a party to the Final Framework Agreement (see clause 2.4.3 (*Resignation of an Authority*) of the Final Framework Agreement).
- (c) In relation to our concerns surrounding the confidentiality provisions of the Original Framework Agreement (see 8.1(c) above), clause 9 (*Confidentiality*) of the Final Framework Agreement has been amended to make such provisions reciprocal as between UK MBA and each Participating LA.
- (d) In relation to our suggestion at 8.1(d) above, references to a report under section 114 of the Local Government Finance Act 1988 have been removed from both the events of default set out in the loan standard terms and the definition of "Defaulting Authority" as requested.
- (e) No mechanism has been included to compensate Participating LAs who are also shareholders for using funds representing their share capital to cover UK MBA's initial costs. As noted in the CC Memorandum, this is a commercial point and we understand that discussions are taking place on this subject.
- (f) In relation to the suggestion at 8.2(a) above, clause 3.11 of the Revised Framework Agreement has been amended to make it clear that UK MBA is obliged to issue Contribution Notices so as to prevent demands being made under any Guarantee.
- (g) In relation to the suggestions at 8.2(b) above, UK MBA has not amended the Final Framework Agreement to provide more detail as to what is required in terms of a credit assessment. This is on the basis that, to do so, would be too restrictive and not practical given the various external factors dictating the process (e.g. credit rating agency criteria). UK MBA has, however, included in the Final Framework Agreement provision for an external review of the credit assessment process every five years. The Final Framework Agreement also now requires credit assessments to take place on accession of a Participating LA and at the point of lending to a Participating LA, and to be refreshed annually.
- (h) In relation to the suggestion at 8.2(c), UK MBA has included reference to section 13(3) of the Local Government Act 2003 in clause 3.7 (*Enforcement by the Company*) of the Final Framework Agreement.



#### 8.4 *Residual risks/concerns*

Other than in the case of 8.1(e) above (which, as noted, is being discussed at a commercial level), all of the suggested amendments have been addressed.

### 9. **PARTICIPATING LA COMMITTEE**

#### 9.1 *Suggested amendments to the Original Framework Agreement*

In the Original Memorandum, we also suggested that given a number of the suggestions referred to (and outlined above) will result in greater oversight of the Participating LAs in the running of UK MBA, it may be appropriate to provide for the establishment of a Participating LA committee which is required to act on behalf of all Participating LAs where any consents or approvals would be required. We suggested that this might be either a permanent committee (with provision for changes in membership over time) or provisions for ad hoc committees to be formed for particular purposes at relevant times. The appointment of any such committee (if required) could be incorporated within the Final Framework Agreement or separately agreed between the Participating LAs (though, in the case of the latter, each acceding LA would need to accede to (or be deemed (by virtue of the Final Framework Agreement) to accede to) such separate agreement, and could include such terms as to voting rights, meeting governance, etc. as the Participating LAs agree therein.

#### 9.2 *UK MBA response and current position in the Final Framework Agreement*

UK MBA has considered this suggestion and notes that whilst it is not opposed to this as a concept, it does raise practical issues such as to how the committee is selected and how to establish its terms of reference. It suggests that such issues would be more appropriately dealt with and documented outside of the Final Framework Agreement. Alternatively, UK MBA propose that Participating LAs simply arrange ad-hoc committees to carry on negotiations on behalf of the Participating LA group as and when required (and that the extent to which binding powers are granted to such a committee are decided by the Participating LAs at that time).

### 10. **COMBINED AUTHORITIES**

#### 10.1 *Background to combined authorities*

The Secretary of State may by order establish a "combined authority" consisting of two or more LAs (pursuant to section 103 of the Local Democracy, Economic Development and Construction Act 2009 (the **2009 Act**) (a **Combined Authority**). The order of the Secretary of State shall set out the constitution of the Combined Authority and provide details as to (amongst other things) membership, authority and remuneration. A Combined Authority is a body corporate, has its own legal personality and has general powers similar (but not as extensive) to those granted to LAs under

the general power of competence pursuant to the Localism Act. We note that, pursuant to section 113B(3) of the 2009 Act, the 2009 Act does not authorise a Combined Authority to borrow money (but the power to borrow or invest may be included in the order of the Secretary of State).

## 10.2 *Current position in the Final Framework Agreement and residual risks/concerns*

- (a) In our opinion, were Combined Authorities to have the vires to enter into loans under the Final Framework Agreement, the Final Framework Agreement (and the definition of Authority) is sufficiently wide to cater for a group of LAs combining to form a Combined Authority (as, pursuant to clause 1.2.1 (*Construction*) of the Final Framework Agreement, any person is construed so as to include its successors in title).
- (b) The Final Framework Agreement is also sufficiently flexible such that, were LAs to combine to form a single Combined Authority, UK MBA has the power, pursuant to clause 5.2 (*Concentration Limits*) of the Final Framework Agreement, to propose amendments to the concentration limits set out therein (such amendments to be effective if approved by the Directing Authorities (i.e. both (i) 85 per cent. of the number of all Participating LAs and (ii) where the aggregate outstanding amount of loans extended to such Participating LAs is greater than 85 per cent. of the total outstanding loan amounts at that time extended to all Participating LAs)).
- (c) Were Combined Authorities to have the vires to enter into loans under the Final Framework Agreement, in our opinion, the transfer of borrowing responsibilities from a group of Participating LAs to a Combined Authority would not make the original granting by the LAs of their Guarantee ultra vires given that vires is relevant as at the time the Guarantee was entered into (i.e. when the Participating LA acceded to the Final Framework Agreement). In relation to any further loans entered into by a Combined Authority under the Final Framework Agreement (i.e. a new transaction in the name of the Combined Authority), it is a condition precedent to any borrowing under the Final Framework Agreement (pursuant to clause 3.1.1 (*Conditions Precedent*) of the loan standard terms) to ensure that UK MBA receives evidence (to which it is satisfied) of the authority of persons on behalf of such Combined Authority (which in itself is evidence of vires).
- (d) Upon the occurrence of a Change of Status (as defined in the loan standard terms), UK MBA has the option (pursuant to clause 6.4 (*Change of Status*) of the loan standard terms) to require the Authority to prepay its relevant loan. It would therefore be important, upon the amalgamation of two or more Participating LAs to form a Combined Authority for the purposes of borrowing under the Final Framework Agreement, that Participating LAs consult UK MBA before any such decision is made (to ensure that such a decision to form a Combined Authority would not cause UK MBA to exercise its right of prepayment). In our opinion, Participating LAs could reasonably take the view that this prepayment provision provides a suitable balance as to (i) the need to protect other Participating LAs

who may be prejudiced by two or more Participating LAs forming a Combined Authority and (ii) the right of such Participating LAs to form a Combined Authority.

## 11. MITIGATION ARISING BY OPERATION OF LAW

### 11.1 *Background to such protections*

- (a) In the absence of contractual provisions to the contrary, a Participating LA who has issued a Guarantee that is outstanding (such Participating LA being referred to in this paragraph 11 as a **Guarantor**) would, by operation of law, have available to it a number of legal mitigants which may apply to reduce the ultimate loss to be suffered by way of making a payment under its Guarantee. These include (i) the right of indemnity (being the immediate right of the Guarantor to be indemnified by the principal debtor (being, in the case of a bond issue, the bond issuer)) where such Guarantor has made a payment in respect of any claim under its Guarantee, (ii) the right of subrogation (being the right of the Guarantor to, once it has paid all amounts due under the debt, (in the case of a bond issue) "step into the shoes" of the bondholders and assume all the rights the bondholders had in relation to the bond issuer), and (iii) the right of contribution (being the right to, once a Guarantor has paid more than its proportion of the debt, seek rateable contributions from the other Guarantors).
- (b) We would, however, note that it is common practice to contractually exclude the legal mitigants identified above. For further detail as to how the Final Framework Agreement excludes these legal mitigants, please see 11.2 below.

### 11.2 *Current position in the Final Framework Agreement*

- (a) Our view is that:
- (i) where a Participating LA has defaulted on its loan payments to UK MBA, clause 3.8 of the Final Framework Agreement has the effect that only UK MBA can pursue recovery rights against that Defaulting LA, and the Non-Defaulting LAs may not take direct action against the Defaulting LA; and
  - (ii) when amounts owing by UK MBA in respect of the Guaranteed Liabilities are overdue, clause 3.5 of the form of Guarantee precludes a Guarantor that has paid out under its guarantee from exercising any rights it has (x) to be indemnified by UK MBA and/or (y) to claim any contribution from any other Guarantor and/or (z) to exercise subrogation rights against UK MBA.
- (b) However, our view is that clause 3.5 of the Guarantee does not exclude the right of contribution arising by operation of law (see 11.1(a) above) where a Guarantor has paid out under its Guarantee

(such that none of the amounts owing by UK MBA in respect of the Guaranteed Liabilities are overdue). This right (which is not to be confused with the contractual contribution mechanism under the Final Framework Agreement (see paragraph 4 above)) entitles a Guarantor, once it has paid more than its rateable proportion of any debt under its Guarantee, to seek rateable contributions from the other Guarantors. The consequence of this right is that, if a Guarantee were to be called, there is a mechanism for ultimately spreading the cost rateably across all the Guarantors. This right, which is exercisable against all Guarantors, regardless of when they became a Guarantor, is therefore an additional element of mitigation (as well as the other contractual mitigations identified in this Memorandum) which Participating LAs should take into account when considering whether to enter into the Final Framework Agreement.

## **12. RELIANCE**

- (a) Allen & Overy has agreed to provide the Advice to the LAs and, in providing the Advice, we have taken instructions solely from Birmingham City Council, Reading Borough Council and Southwark Borough Council. We have not advised any LA on the contents of any document or its rights and obligations thereunder except to the extent set out in the Executive Summary and the Documents Package (as defined in the Executive Summary). However, A&O is able to provide further advice to any LA on these matters should it wish. This can be arranged separately and separate fee arrangements will apply.
- (b) We accept a duty of care to LAs in relation to the Advice, but (subject to any separate arrangements agreed as envisaged in paragraph 12(a)) we do not owe, and the provision of the Advice is not to be taken as implying that we owe, LAs any wider duty of care in relation to the transactions envisaged by the Documents Package (as defined in the Executive Summary) (and in particular the Final Framework Agreement) or otherwise and/or their commercial or financial implications.
- (c) Any LA who is entitled to, and does, rely upon the Advice agrees, by so relying, that, to the fullest extent permitted by law and regulation (and except in the case of wilful misconduct and fraud) there is no assumption of personal duty of care by, and such person will not bring claim against, any individual who is a partner of, member of, employee of or consultant to Allen & Overy LLP or any other member of the group of Allen & Overy undertakings and that such person will instead confine any claim to Allen & Overy LLP (and for this purpose "claim" means (save only where law and regulation applied otherwise) any claim, whether in contract, tort (including negligence), for breach of statutory duty, or otherwise).

**DOCUMENT FIVE**

**COUNSEL'S OPINION OF JONATHAN SWIFT QC  
(and accompanying Instructions to Counsel, prepared by Allen & Overy)**

IN THE MATTER OF BIRMINGHAM CITY COUNCIL  
IN THE MATTER OF READING BOROUGH COUNCIL  
IN THE MATTER OF THE LONDON BOROUGH OF SOUTHWARK  
AND IN THE MATTER OF A PROPOSED FRAMEWORK AGREEMENT

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OPINION

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**A. Introduction**

1. I am instructed to advise Birmingham City Council, Reading Borough Council, and the London Borough of Southwark (“the Councils”) in respect of a proposed decision to enter into arrangements with the UK Municipal Bonds Agency PLC (“UKMBA”)<sup>1</sup>.
2. UKMBA was established by the Local Government Association and 56 local authorities<sup>2</sup>, for the purpose of enabling local authorities to borrow on better rates of interest than would otherwise be available to

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<sup>1</sup> I am instructed that the Councils are an informal working group, considering the provisions of the Framework Agreement on behalf of a group of local authorities. My Instructions state that other local authorities may also be shown the advice set out in this Opinion, because it will be provided with the pack of documents provided to each such authority, and I have no objection to this. However – as explained in the course of this Opinion – each local authority (whether within the group or outside it) will need to consider its own circumstances in order to satisfy itself that a decision to enter into the Framework Agreement would be a reasonable use of the powers available to it. This is particularly so for any authority which sees this Opinion, and which is not one of the Councils who instruct me.

<sup>2</sup> Each of those local authorities and the LGA is currently a shareholder in UKMBA.

the local authority. In order to be able to borrow from UKMBA a local authority must accept the terms of the Framework Agreement.

3. I am asked to advise on the following matters. *First*, whether in principle the Councils (each of which is an English local authority) have the power to enter into the Framework Agreement. I address this question by reference only to the powers of English local authorities. *Second* (assuming that in principle it is within the powers of the Councils to enter into the Framework Agreement), whether it would be likely that a decision to enter into the agreement would be a lawful use of the power available to the Councils. *Third*, what consequences might flow in the event that a participating authority became a combined authority, by order made pursuant to section 103 of the Local Democracy, Economic Development and Construction Act 2009 ("the 2009 Act"). If this happened would it invalidate, retrospectively, the guarantee that is given pursuant to the Framework Agreement. *Fourth*, whether the "Guide to the Framework Agreement" document should be provided as part of the information given to local authorities who are considering entering into the Framework Agreement. *Fifth*, whether there are any evidential requirements that the Councils should satisfy in order to ensure that any decision to enter into the Framework Agreement is lawful. *Sixth*, whether before entering into the Framework Agreement, the Councils should take advice on the accounting implications of the contents of the Framework Agreement.

**B. A summary of the provisions of the Framework Agreement**

4. There is a detailed summary of the provisions of the Framework Agreement in my Instructions, there are further summaries of the agreement in the "Executive Summary" and "Introductory Guide"

documents that accompany my Instructions. There is commentary on the provisions of the Framework Agreement in the *“Follow-up Memorandum”* document that accompanies my Instructions.

5. By way of summary for present purposes, I note the following. As its name suggests the Framework Agreement is not itself a loan agreement; rather it provides a structure under which local authorities may enter into loan agreements with UKMBA. In this Opinion, simply for convenience, I will refer to authorities who have entered into the Framework Agreement as “participating authorities”. Where necessary I shall refer to participating authorities who have obtained loans from UKMBA under the Framework Agreement either as participating authorities who have borrowed, or if it is more convenient to do so, as “borrowing authorities”.
6. The structure provided is to the following effect: UKMBA will only lend to participating authorities (clause 2.1.1); UKMBA is not obliged to lend to any participating authority (clause 2.1.3); UKMBA lends on the basis of a matched transaction under which UKMBA borrows (from a third party) the amount that it is to lend to the relevant participating authority (clause 5.3); when UKMBA does lend it does so on the basis that re-payments from the borrowing authority are scheduled so as to mirror the requirements on UKMBA to repay under the matched transaction (clause 3.3.1); otherwise, the terms of lending are as agreed between UKMBA and the relevant participating authority (clause 4)<sup>3</sup>.

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<sup>3</sup> To the extent that terms on which UKMBA will borrow are prescribed by the Framework Agreement, the relevant provisions are at clause 5.3 of the Framework Agreement – see in particular at clause 5.3.1 and 5.3.2. Further statements on the “Pricing of the UK MBA’s loans” are contained in the Introductory Guide document. My assumption is that the statements in the Introductory Guide are not intended to comprise warranties or legally binding representations.



7. In addition to the costs associated with each loan it obtains under the Framework Agreement, the cost to each participating authority of the agreement arises from two matters. *First*, each participating authority is required to guarantee UKMBA's liabilities (referred to as "Guaranteed Liabilities", see clause 2.3; the form of the guarantee is set out at Schedule 2 to the agreement). Each participating authority guarantees all UKMBA's liabilities under agreements entered into by it before or following the date of the guarantee (clause 2.3.1); and the guarantee extends across all liabilities incurred by UKMBA up to the date on which the authority terminates the guarantee in accordance with clause 2.4.1. These liabilities incurred in this period are guaranteed until such time as UKMBA has discharged its obligations in respect of them (see further below at paragraph 10).
8. The *second* matter is the possibility of contribution payments in the event that any other participating authority defaults under its own loan obligations. Each participating authority can be liable to make payments to UKMBA in the event that another participating authority defaults on its obligations to UKMBA. In the event that any one participating authority defaults on its obligations, UKMBA may issue a contribution notice to each participating authority specifying the amount that each participating authority is required to pay (clause 3.3.3). The contribution will be calculated by reference to the proportion that each participating authority's current borrowing under the Framework Agreement bears to the then total amount of borrowing under the agreement: see the definitions, respectively of "Authority Contribution" and "Authority Proportion". Thus if, for example, at the date of the contribution notice a participating authority's current borrowing is zero, the amount that that authority is required to contribute will (according to the terms of the Framework Agreement) also be zero. It should also be noted that as the Framework Agreement

is presently drafted it appears possible for a participating authority to reduce its exposure under the contribution notice provisions by making early repayment of its loans. The contribution required of a participating authority can be increased if any of the other participating authorities issued with a contribution notice fails to pay the amount required of it (clause 3.3.5). Payments made by participating authorities under contribution notices are treated as loans, repayable by UKMBA (clause 3.4, and clause 3.9).

9. In practice, there is an expectation that obligations arising under the contribution notice provisions will be the primary source of exposure for participating authorities – i.e. that a contribution notice (rather than liability under the guarantee provisions) will be the option of first resort in the event of default by another participating authority. In some instances, UKMBA becomes subject to an obligation to issue contribution notices – see clause 3.3.3 of the Framework Agreement. Clause 3.11.1 states a “*guiding principle*” that UKMBA shall operate the Framework Agreement with the aim of avoiding any call being made on the guarantee. Clause 3.11.2 goes on to state “*the Company shall issue such Contribution Notices in accordance with Clause 3.3 as will ensure (provided the relevant Authorities comply with such Contribution Notices) that it has sufficient funds to enable it to pay amounts falling due under the Finance Documents and thus prevent any demands being made under any Guarantee*”. This seems to me to provide a reasonable level of comfort that liability under the guarantee ought to be an event of last resort.
10. No participating authority may exit the Framework Agreement until it has discharged all its liabilities to UKMBA, including any liabilities which have accrued under the guarantee (clause 2.4.2). Thus once an authority has become party to the Framework Agreement, the length of its exposure under the guarantee is likely to be significant. The

exposure will continue until such time as the “*Guaranteed Liabilities*” of UKMBA have been discharged by UKMBA. As to the duration of that exposure, note the modified meaning of “*Guaranteed Liabilities*” which applies once the guarantee has been terminated (standard form guarantee at clause 7)

11. The Framework Agreement does contain some provisions which will serve to mitigate the risks for participating authorities arising from the agreement. These provisions are generally within clause 5 of the Framework Agreement, and include the following.
  - (1) UKMBA is required to undertake credit assessment of each participating authority, both when it accedes to the Framework Agreement, and then periodically thereafter (clause 5.1)
  - (2) The Framework Agreement sets limits on the amount each participating authority may borrow from time to time (clause 5.2).
  - (3) The matched transaction basis on which UKMBA will itself borrow money (clause 5.3).
  - (4) UKMBA borrowing may not ordinarily exceed 105% of the amount it has lent to participating authorities (clause 5.3.2).
  - (5) Participating authorities may collectively instruct UKMBA not to undertake further borrowing. This power is exercisable at any time by 50% of the participating authorities provided that between them, they are responsible for more than 50% of the loans outstanding to UKMBA (clause 5.4).

- (6) There are obligations on participating authorities to report to UKMBA certain specified circumstances which may affect their ability to meet their obligations under the Framework Agreement, including any loans made to them under that agreement (clause 6.2).

### C. Advice

#### (1) Power, in principle, to enter into the Framework Agreement

12. Local authorities have express general powers to borrow in Part 1 of the Local Government Act 2003 (“the 2003 Act”). These provisions provide an express power to borrow “(a) for any purpose relevant to its functions under any enactment, or (b) for the purposes of the prudent management of its financial affairs ...”: see section 1 of the 2003 Act. That broadly-framed power is then subject to the limitations at sections 2 – 5 of the 2003 Act.
13. The Framework Agreement is not itself a borrowing transaction. Rather it is a means to that end; it provides the terms on which local authorities may access the lending terms that UKMBA is able to offer<sup>4</sup>. The premise of the arrangements is that those lending terms will be preferable to the terms otherwise available to an authority that makes its own borrowing arrangements. Thus although when obtaining any specific loan under the Framework Agreement a local authority would most likely<sup>5</sup> act in exercise of its powers under section 1 of the 2003 Act

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<sup>4</sup> The generic terms on which UKMBA will lend to participating authorities are at Schedule 3 to the Framework Agreement.

<sup>5</sup> A local authority would on that occasion employ the section 1 of the 2003 Act power unless in the specific circumstances of the transaction a more specific power applied.

(and therefore, at that time would also have to act consistently with the restrictions on the general power, elsewhere within Part 1 of the 2003 Act), the 2003 Act powers may not themselves be most natural basis or comprehensive basis for entering into the Framework Agreement.

14. One obvious candidate as an additional in principle source of power is the general power of competence at section 1 of the Localism Act 2011 (“the 2011 Act”). To the extent that the Framework Agreement gives rise (as it does) to a more complicated set of obligations than would be necessary in the event of a more “straightforward” borrowing transaction (i.e. one in which the local authority borrower dealt directly and independently with the person providing the moneys to be borrowed), the section 1 general power of competence is in my opinion a suitable and available source of power. For the avoidance of doubt, I confirm that for this purpose there is no relevant limitation on the section 1 power pursuant to the provisions of section 2 of the 2011 Act.
15. Thus my view is that the Councils do have the power in principle to enter into the Framework Agreement, relying on the general power of competence at section 1 of the 2011 Act, together with the broadly-framed power to borrow at section 1 of the 2003 Act<sup>6</sup>.

(2) Lawful exercise of the in principle powers

16. It is trite law that public authorities must exercise the powers available to them in accordance with well-established *Wednesbury* principles –

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<sup>6</sup> For the avoidance of doubt, I do not disagree with the points set out at paragraphs 7 – 19 of the Opinion of James Goudie QC dated 10 February 2014. However, as explained above my preferred analysis is to find the power to enter into the Framework Agreement in the combination of section 1 of the 2011 Act with section 1 of the 2003 Act.

i.e. powers are to be used (a) within the terms of any express limitations applicable to them; (b) having regard only to relevant considerations, and disregarding all irrelevant considerations; (c) only for a proper purpose; and (d) only in a manner which, having regard to all material circumstances can be considered to be reasonable (in the now well-understood *Wednesbury* sense of the word).

17. In the context of financial transactions such as the Framework Agreement and the transactions envisaged under that agreement, it is also imperative that a local authority is able to demonstrate to a court (if called on to do so) that it has exercised its powers consistent with its fiduciary obligations to local tax payers. In practice this places a burden on local authorities to be able to demonstrate that financial transactions (including loans) are made on terms that are prudent, rather than (for example) unduly optimistic, (a) as to the level of risk that the local authority is undertaking (proportionate to its own resources), and (b) as to the local authority's ability to meet the obligations that might arise, from time to time, under the transaction.
18. Such matters need to be assessed taking into account the specific circumstances of the local authority at the time it enters into the relevant transaction, and by reference to the circumstances likely to affect the local authority during the lifetime of the transaction (e.g., if the transaction required payments by a local authority spread over a number of years, some form of assessment of the likely future capability of the authority to meet such obligations would be required).
19. Thus in the present case, each of the Councils (and any local authority considering becoming a participating authority) must assess for itself the relative advantages and disadvantages of the Framework Agreement.

- (1) As regards both the possible advantages and the possible disadvantages, a local authority is entitled to work from the premise that the Framework Agreement will operate in accordance with its terms.
  - (2) So far as concerns advantages, the authority will need to evaluate the extent to which it will obtain better borrowing terms under the Framework Agreement and, taking account of its likely borrowing requirements over the period it intends to make use of the opportunities provided by the Framework Agreement, the likely value to it of those better terms<sup>7</sup>.
  - (3) As to disadvantages, these will arise from the aspects of the Framework Agreement that put the local authority at risk of financial obligation because of the default of any other participating authority - i.e. the guarantee requirement under clause 2.3 of the Framework Agreement (taking into account all the terms of the guarantee set out in Schedule 2 to the Framework Agreement); and the contribution requirements under clause 3 of the Framework Agreement).
20. The consequence of the above is that it is not possible to state definitively that it is open to each of the Councils, lawfully to decide to enter into the Framework Agreement, regardless of its specific financial circumstances at the time it intends to do so<sup>8</sup>. The power in principle does exist (see above at paragraph 15). The question whether it is

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<sup>7</sup> As stated above, the generic terms on which UKMBA will lend to participating authorities are at Schedule 3 to the Framework Agreement. Obviously, these terms do not address the specific cost of borrowing to any specific authority on any specific occasion.

<sup>8</sup> My Instructions do not contain any information on the present or likely future financial position of any of the Councils.

reasonable for each of the Councils, respectively, to use that power to enter into this Framework Agreement depends on the evaluation of the matters sketched at paragraphs 17 – 19 above.

21. In the absence of specific information covering the balance of likely advantage/possible disadvantage referred to above, the best that can be said is that I consider that it would be lawful for a reasonably (in financial terms) robust local authority to take on the obligations set out in the Framework Agreement. I assume for this purpose that the authority in question forms the opinion, on reasonable grounds, that the terms of borrowing likely to be available under the Framework Agreement will be advantageous to it (by contrast to the terms likely to be available absent the Framework Agreement). That being so, “reasonably robust” in this context refers to that local authority’s ability (a) to meet the possibility of having to make contribution payments under clause 3 of the Framework Agreement (which are required to be made at short notice, as short as 2 business days); and (b) to meet the obligations under the guarantee which will endure even after the termination of the guarantee, until such time as UKMBA has discharged every relevant liability. Yet that general conclusion will give way in the face of the local authority’s specific financial circumstances at the time it was deciding whether or not to enter into the agreement.
22. Thus the decision to enter into the Framework Agreement must be a reasonable use of the local authority’s powers not just by reference to the generic risks arising from the terms of the Framework Agreement itself, but also by reference to that generic risk taking into account the specific financial circumstances of the local authority concerned. The authority must have reasonable grounds for the conclusion that it will be likely to be able to meet the obligations under the Framework



Agreement (above and beyond the obligation to repay the moneys it is likely itself to borrow); and overall there must be a reasonable basis for an overall assessment that, taking into account the likely advantages and disadvantages for the authority, it would be to the authority's advantage to enter into the Framework Agreement<sup>9</sup>.

23. In undertaking this assessment, the local authority can (and in my opinion should) have regard to the specific risks that arise from the provisions that are integral to the nature of the Framework Agreement. It should also take into account the measures contained in the Framework Agreement with a view to mitigating those risks. I have already referred above (at paragraph 9) both to the intended effect of clause 3.11 and to the limitations of that provision as presently drafted, from the point of view of participating authorities. In addition, there are the provisions at clause 5 of the Framework Agreement which provide some limitations on the powers of UKMBA in respect of borrowing and lending. Yet the local authority should evaluate these matters from the starting point of its own financial position, and its likely financial position over the period that it envisages remaining a participating authority. All this entails assessment of likely future circumstances; this includes evaluation of the risk that other participating authorities may default. None of this is likely to be straightforward; careful judgement will be required. However the need for this exercise arises from the nature of the Framework Agreement, an agreement that seeks to secure the potential benefits of collective action by local authorities over an extended period of time.
24. Evaluation of this last mentioned risk will take account of the likely effectiveness of the steps taken by UKMBA pursuant to clause 5.1 of

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<sup>9</sup> These points (at paragraphs 16 – 22) would apply to any local authority which wished to enter into the Framework Agreement, not just the Councils.

the Framework Agreement, to assess the creditworthiness of participating authorities. Clause 5.1 prescribes the occasions on which those assessment will take place; and also provides for UKMBA, every 5 years, to take outside advice on its credit assessment procedures.

25. By reference to the provisions of the Framework Agreement, there are two general sources of risk to any participating authority. As already indicated, the *first* is the collective nature of the Framework Agreement. It is the collaboration of local authorities as participating authorities with the intention that this will permit UKMBA to borrow on better terms than would be available to many local authorities acting alone. The “price” of this is the extent to which the contribution notice provisions and the guarantee requirement impose responsibilities on all participating authorities that are capable of extending beyond the day to day costs of financing the borrowing each participating authority undertakes with UKMBA. This risk (and its possible extent) is evident from the terms of the Framework Agreement (although see below at paragraph 30 as to some specific points arising from the present drafting of the guarantee provisions).
26. The *second* source of risk for each participating authority arises from the role of UKMBA itself. Although local authorities are entitled to work from the premise that UKMBA will work in accordance with its obligations under the Framework Agreement, the terms of that agreement do leave a number of important matters largely within UKMBA’s control. UKMBA is responsible for determining the terms on which it borrows (and therefore the terms on which participating authorities borrow from UKMBA<sup>10</sup>); UKMBA is responsible for determining which local authorities are permitted to become participating authorities (no participating authority has a power of

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<sup>10</sup> In this regard, note the points at paragraph 6 and Footnote 3 above.

veto over the accession of any other local authority; and no participating authority is in a position to require any local authority to cease to be a participating authority); UKMBA is also responsible for operating the contribution notice provisions (both on their own terms, and for determining when those contribution notice provisions will be applied in preference to calls on the guarantee); and UKMBA's actions may bring the guarantee obligations into play, even long after the guarantee has been terminated. Here too this source of risk is part and parcel of the cost of obtaining access to the "better" borrowing terms to be available to participating authorities - for the model to work it is necessary that some entity such as UKMBA (with the role and powers that UKMBA has) is interposed between the lenders and the local authority borrowers.

27. In my opinion, the sources of risk are inherent in the scheme that the Framework Agreement establishes; if each source of risk were eliminated, it is unlikely that the benefits that the scheme is designed to secure could be achieved.
  
28. But quite apart from the source of the risk, is the way in which the terms of the Framework Agreement, as presently drafted, leave open the extent of the risk for participating authorities. The extent of the risk that does remain is analysed in the "*follow-up memorandum*" that is part of the documentation that accompanies the Framework Agreement. I agree with the assessments in that document: see specifically at paragraphs 2-3 - 2.4; 3.3 - 3.4 (the guarantee); 4.3 - 4.4, and 5.3 - 5.4 (the contribution notice arrangements, and arrangements for the recovery of the contribution payments); 6.3 - 6.4 (the loan terms available to participating authorities); and 7.3 - 7.4 (risks arising in the event of the failure of UKMBA). It is also my opinion that those risks

are as low as reasonably practicable given the nature of the Framework Agreement scheme.

29. The risks referred to in the “follow up memorandum”, together with the further matters referred to in this section of this Opinion are the matters I consider should be taken into account by the Councils (and also by any other local authority which is considering whether or not to enter into the Framework Agreement).

30. In addition, I also draw attention to the following matters.

(1) The contribution notice provisions contain no provision which prevents a participating authority from limiting its exposure by paying off loans early in response to any concern that it may have that other authorities may default triggering the contribution notice provisions. On one view it might be fairer if contributions are calculated by reference to outstanding borrowing disregarding any early repayment that may have been made. However, this is not a matter on which there is any “right” answer. The basis on which contributions are calculated is a matter to note; each authority will form its own view on the merits of the matter.

(2) The present drafting of clause 5.1 (see paragraph 24 above). Although this provision does prescribe when credit assessments are to be undertaken, it should be noted that this clause does not prescribe what is required in terms of those credit assessments.

(3) Clause 2 of the standard guarantee (at Schedule 2 to the Framework Agreement). This appears to be a guarantee in respect of all UKMBA’s “*Guaranteed Liabilities*” as defined. This

is mitigated by the modified definition of "*Guaranteed Liabilities*" which operates once an authority has terminated the guarantee (see clause 7 of the standard guarantee). Even so, the guarantee obligation will therefore continue to exist over an extended period.

- (4) Clause 3.5 of the standard guarantee (at Schedule 2 to the Framework Agreement). This delays any rights a participating authority may have as guarantor, against UKMBA, for so long as any amount owed by UKMBA under any of the *Guaranteed Liabilities* remains overdue. Given the definition of "*Guaranteed Liabilities*" (and notwithstanding the modified meaning given to "*Guaranteed Liabilities*" following the termination of the guarantee - see clause 7), this could be a very significant period. In this regard, the provisions of clause 3.8.2 of the Framework Agreement should also be noted - authorities may not take action against UKMBA to recover sums they have paid pursuant to the guarantee provisions, save to the extent necessary to give effect to the provisions of clause 3.9 of the Framework Agreement.
  - (5) Clause 6 of the standard guarantee (at Schedule 2 to the Framework Agreement). Note that this too is framed by reference to the notion of "*Guaranteed Liabilities*", and therefore also the modified definition of that term (see clause 7 of the standard guarantee) that applies when an authority has terminated the guarantee.
31. Drawing the points above together, my opinion is that the terms of the Framework Agreement are such that it would be open to a local authority that is reasonably financially robust to enter into them (see

above at paragraph 21). However, each local authority proposing to accede to the Framework Agreement (including each of the Councils, respectively) ought also to have particular regard to the following matters specific to its own position: (a) the likely benefit to it of borrowing under the terms obtainable under the Framework Agreement over borrowing on the terms otherwise available to it; (b) its own financial position – i.e. its ability, from time to time to meet the calls that might be made on it under the Framework Agreement other than those arising from its own borrowing commitments under that agreement, i.e. calls under the contribution notice, and guarantee provisions which will arise from failures by other participating authorities to meet their obligations under the Framework Agreement, and/or failures by UKMBA (see above, generally, from paragraph 16).

32. One specific point is raised (at §3.7 of my Instructions) as to whether the document “*Guide to the Framework Agreement*” should be included in the documentation available to local authorities who are considering whether or not to become participating authorities<sup>11</sup>. The point made is that if the *Guide* is included, those authorities may look only (or primarily) to the contents of that document rather than scrutinising the terms of the Framework Agreement itself. I accept that such a risk does exist. However, the opening sentence of the *Guide* contains health warning (to the effect that the Agreement will take precedence over the *Guide* “in the event of a dispute”). I see no reason to remove the *Guide* from the documentation made available to local authorities, so long as it is understood by them (as I assume would be UKMBA’s intent) that the *Guide* should not be taken to include any representation that goes beyond the terms set out in the Framework Agreement. Ultimately it will be a matter for UKMBA to decide what documentation should be

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<sup>11</sup> This is the document at Appendix 1 to the “Introductory Guide” at Appendix 3 to my Instructions.

provided to authorities who are considering whether or not to enter into the Framework Agreement, and what words by way of “health warnings” should be attached to such documentation.

(3) What consequences might flow in the event that a participating authority became a combined authority (by order made pursuant to section 103 of the Local Democracy, Economic Development and Construction Act 2009)?

33. The specific question raised in my Instructions (at §2.6) is whether if a participating authority became part of a combined authority (pursuant to an order under section 103 of the 2009 Act) that would render void, the guarantee given by the participating authority under clause 2.3 of the Framework Agreement<sup>12</sup>. My view is that this ought not to be the consequence of a section 103 order. The provisions of the 2009 Act (taking account of the alterations now proposed by the Cities and Local Government Devolution Bill) do not make any specific provision either (a) affecting the legality of the past transactions of a local authority that becomes a part of a combined authority; or (b) permitting the terms of a section 103 order to have any such retrospective impact on existing rights and liabilities. It is to be expected that a section 103 order could make provision (if such were necessary) for a transfer of existing rights and liabilities to a new combined authority. In the event that a participating authority was a party to a section 103 order, and if at that time any doubt arose as to the position, for the future of rights and liabilities arising under the Framework Agreement, it might in such circumstances be prudent to see if specific provision should be made, for the avoidance of doubt. But this is a matter to be considered only

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<sup>12</sup> I will address this issue on the basis of the provisions of the 2009 Act, as amended by the Cities and Local Government Devolution Bill.

when and if such a doubt were expressed; and it would be a step taken out of an abundance of caution.

(4) Are there evidential requirements that the Councils must meet in order, lawfully, to enter into the Framework Agreement?

34. There are no specific formal evidential requirements. However, a decision to accede to the Framework Agreement will be a significant practical step for any local authority. For this reason it would be prudent for any local authority to ensure that there is a clear record of its decision-making process - i.e. of what matters have been considered; or what evaluations have been made, and on what bases etc. In the event of any legal action arising out of a decision to accede to the Framework Agreement such an evidence base is likely to be invaluable. Moreover, the same evidence is likely to be of great practical benefit to any local authority called on to justify its decisions, in any context. Good record keeping in respect of such a decision is certainly a matter going to good public administration.

(5) Should local authorities take advice as to the accounting implications of the contents of the Framework Agreement?

35. This point is raised at paragraph 4.1 of my Instructions. In my opinion every local authority should ensure that it is properly informed as to how its participation in the Framework Agreement will impact upon its accounting obligations. It will be for the officers of each of the Councils to advise whether this requires advice from external advisers, or whether each Council itself has the experience and expertise required from amongst its own officers to address this issue. No doubt



the terms of reference within which such advice is obtained can be informed by the matters referred to in the Grant Thornton document (which is to accompany the Framework Agreement documentation), even though I note that the Councils may not themselves place specific reliance on the conclusions that Grant Thornton state.

#### **D. Conclusions**

36. In summary form, the primary conclusions arising from the above are as follows.
37. *First*, I consider that in principle the Councils (and for the same reasons, other English local authorities too) do have the power to enter into arrangements as set out in the Framework Agreement (see above at paragraphs 12 - 15).
38. *Second*, the final assessment of whether a decision to enter into the Framework Agreement will need to be made taking into account the specific financial position of each Council, respectively. See generally above at paragraphs 16 - 31. Thus unlike the issue as to the in principle power to enter into the Framework Agreement; the question as to whether a decision to enter into the Framework Agreement would be a reasonable use of the in principle power, is not an issue that can be answered either yes or no, in the abstract. The furthest that I think it is possible to go in the absence of consideration of the specific circumstances of each of the Councils is that it would be lawful for a reasonably financially robust local authority to enter into the commitments entailed in the Framework Agreement. See above at paragraph 21. Yet this conclusion must, if necessary, yield to the specific circumstances of each Council.

39. Paragraphs 32, 33, 34 and 35 above record my conclusions on the four other matters raised in my Instructions.
  
40. I hope that the above addresses the points raised in my Instructions. If there are any matters arising from the above, or if I can be of further assistance in respect of the Framework Agreement proposals, my Instructing Solicitor should not hesitate to contact me.

JONATHAN SWIFT QC

18 December 2015

11, King's Bench Walk,  
Temple. EC4Y 7EQ.

IN THE MATTER OF  
BIRMINGHAM CITY COUNCIL

IN THE MATTER OF READING  
BOROUGH COUNCIL

IN THE MATTER OF THE LONDON  
BOROUGH OF SOUTHWARK

AND IN THE MATTER OF A  
PROPOSED FRAMEWORK  
AGREEMENT

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OPINION

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**BIRMINGHAM CITY COUNCIL  
READING BOROUGH COUNCIL  
and  
SOUTHWARK BOROUGH COUNCIL**

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**INSTRUCTIONS TO COUNSEL**

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**BIRMINGHAM CITY COUNCIL**

**READING BOROUGH COUNCIL**

**and**

**SOUTHWARK BOROUGH COUNCIL**

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**INSTRUCTIONS TO COUNSEL**

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**1. Introduction**

- 1.1 Instructing Solicitors are acting on behalf of Birmingham City Council, Reading Borough Council and Southwark Borough Council as an informal working group on behalf of a number of local authorities (each, an **LA**) and are seeking advice from Counsel in relation to a Local Authority Financing Framework Agreement (the **Framework Agreement**) which is proposed to be entered into by UK Municipal Bonds Agency PLC (**UK MBA**) and each LA wishing to borrow from UK MBA.
- 1.2 UK MBA has been established by the Local Government Association with the objective of reducing LAs' financing costs by sourcing finance on behalf of LAs on more competitive terms than would be obtainable by individual LAs on their own behalf. UK MBA will borrow money from a variety of third parties and on-lend the proceeds, on a matched basis, to LAs.
- 1.3 In order to enable UK MBA to achieve competitive pricing, LAs that wish to borrow from UK MBA will guarantee, on a joint and several basis, UK MBA's payment obligations under all its borrowings from bilateral lenders and bonds issued by it in the capital markets (the **Guarantees**). UK MBA will lend the proceeds of each bilateral borrowing and bond issue to one or more of the LAs that have given Guarantees (the **Loans**).
- 1.4 The terms of the Loans will require that each payment of interest or principal by an LA borrower to UK MBA be made a specific number of days prior to the corresponding payment being due from UK MBA under its bilateral borrowing facility or bond issue.

- 1.5 If any LA borrower defaults in making one of these payments to UK MBA, UK MBA may require each other LA that is a party to the Framework Agreement to put UK MBA in funds to cover the shortfall (the **contribution arrangements**). The amount payable by each LA under the contribution arrangements will be the proportion of the shortfall equal to that LA's borrowings as a proportion of the borrowings of all LAs from UK MBA.
- 1.6 The intention behind the structure, therefore, is that:
- (a) the timing of payment dates under the Loans, combined with the contribution arrangements, should mean that the Guarantees should never need to be called, because UK MBA would have been put in funds before a default would occur under its bilateral borrowing facilities and bond issues; and
  - (b) therefore, the real exposure of the LAs, from a practical perspective, should be under the contribution arrangements rather than the Guarantees, and that the exposure of each LA (though necessarily greater than merely the amount borrowed by it) should nevertheless be calculated by reference to the amount borrowed by it as a proportion of all LA borrowings under the structure.
- 1.7 Instructing Solicitors are seeking advice from Counsel in relation to:
- (a) the vires of an English LA entering into the proposed Framework Agreement, executing a Guarantee, entering into Loans and providing contribution loans pursuant to the contribution arrangements;
  - (b) whether, upon receipt and diligent review of the final package of documents as further described at paragraph 1.3 of the Executive Summary (as defined in the Schedule to these instructions) (the **Documents Package**) (and assuming that all relevant appropriate procedural requirements are followed and that the relevant LA can demonstrate that it has read and understood the Documents Package), a court would agree that an LA has acted in accordance with requirements of *Wednesbury* reasonableness in entering into the transactions envisaged by the Documents Package;
  - (c) any other risks identified by Counsel in LAs entering into the transactions envisaged by the Documents Package;
  - (d) what matters LAs could or should take into account in their decision making process in order to demonstrate that they have reached a decision that will not be susceptible to successful legal challenge or fall foul of the requirements of *Wednesbury* reasonableness; and

(e) various associated specific queries as described further below.

1.8 Instructing Solicitors note that the documents that will form the Documents Package are currently in various stages of working draft form. Instructing Solicitors attach (as appendices to these instructions) current drafts of these documents for Counsel's information and review. A description of the key elements of the draft documents attached hereto (along with a description of Instructing Solicitors' view as to the finality of the draft documents) is contained at the Schedule to these instructions. Counsel may assume for the purposes of his Opinion that there will be no material changes to the documents attached hereto as against those forming the final Documents Package. Instructing Solicitors are proposing to give confirmation to LAs in the Executive Summary that, in their view, none of the changes to the documents are material for the purposes of assessing compliance with the requirements of *Wednesbury* reasonableness, if they feel able to do so upon review of the final Documents Package.

## **2. The general power of competence**

2.1 Section 1(1) of the Localism Act 2011 (the **Localism Act**) gives LAs the power to "*do anything that individuals generally may do*" (the **General Power**).

2.2 Instructing Solicitors refer to the opinion of James Goudie QC dated 10 February, 2014 addressed to the Local Government Association (the **2014 Opinion**) (attached as Appendix 1 to these instructions). In the 2014 Opinion, Mr Goudie QC opines that, in the context of English LAs only, the General Power is available as a source of vires, subject to compliance with *Wednesbury* reasonableness requirements in relation to the exercise of that power. Mr Goudie QC also states that such power "*must be exercised in a lawful manner, including reasonably and properly*".

2.3 Instructing Solicitors note that the 2014 Opinion only considers whether English LAs granting guarantees falls within the General Power and does not extend to the broader circumstances and transactions considered in these instructions.

2.4 Instructing Solicitors' view is that Mr Goudie QC's analysis in the 2014 Opinion in relation to the vires of English LAs to provide guarantees is equally applicable to the broader transactions envisaged by the Documents Package.

2.5 Counsel is asked to confirm that the entry by an English LA into the transactions envisaged by the Documents Package (namely, entry into the Framework Agreement, execution of a Guarantee, entry into Loans under the Framework Agreement and the provision of contribution loans (if required) pursuant to the contribution arrangements) would, subject to compliance with the requirements of *Wednesbury* reasonableness (as to which, see section 3 below), fall within the General Power (and

not be subject to any limitations on the use of the General Power pursuant to the Localism Act or any public law limitations on the exercise of the General Power).

2.6 Instructing Solicitors refer to the first sentence of paragraph 10.2(c) of the Follow-up Memorandum (as defined in the Schedule to these instructions). Counsel is asked to confirm that he agrees with Instructing Solicitors' interpretation.

### **3. *Wednesbury* reasonableness**

3.1 In entering into the Framework Agreement (and the related transactions envisaged by the Documents Package), LAs will need to be able to satisfy themselves that a court would not deem their decision to do so to be "*so unreasonable that no reasonable authority could ever have come to it*" (*Associated Provincial Picture Houses v Wednesbury Corporation* [1948] 1 KB 223 at [230]) or that they acted with "*conduct which no sensible authority acting with due appreciation of its responsibilities would have decided to adopt*" (*Education Secretary v Tameside Council* [1977] AC 1014, at [1064]).

3.2 Instructing Solicitors note that recent judicial focus has been on whether "*the view or decision of the primary decision-maker was reasonably open to it on the material before it*" and that undue attention to the "*fair reading*" or "*proper interpretation*" of documents can be unhelpful (*The Queen (on the application of Drax Power Limited) v Secretary of State for Energy and Climate Change* [2014] EWCA Civ 1153 at [69]).

3.3 To enable LAs to reach a reasonable and well informed decision whether or not to enter into the Framework Agreement, each LA shall have access to the Documents Package containing, among other things, the Follow-up Memorandum (as defined in the Schedule to these instructions). This has been drafted by Instructing Solicitors and identifies the history of their review process of the Framework Agreement, the adequacy of how historical comments have been addressed in the Framework Agreement (if at all) and, in Instructing Solicitors' opinion, any residual risks for LAs to consider. Instructing Solicitors note that some level of risk to LAs is necessary to ensure the efficacy of the structure and to support UK MBA's overarching objective to obtain funding for LAs at cheaper rates than is otherwise available to them.

3.4 To assist LAs in reaching a decision as to whether to enter into the Framework Agreement, Instructing Solicitors have identified in the Follow-up Memorandum that the inherent risks associated with entry by LAs into the Framework Agreement can, in principle, be broken down into two key categories:

- (a) failure of UK MBA, for example, in the event that it fails to comply with its obligations under the Framework Agreement either through the failure to service (i.e. pass through funds



received from LAs) its debt obligations (whether to LAs or under bilateral borrowing facilities or bond issues), failure (or inability) to operate the contribution arrangements as envisaged under the Framework Agreement, or a failure on the part of UK MBA to sustain and police robust due diligence and credit checks in relation to acceding LAs pursuant to its obligations under the Framework Agreement; and

- (b) failure or default of one or more LA. The structure of the Framework Agreement is designed such that a Guarantee would only need to be called upon where the contribution arrangements have failed to fill any shortfall under UK MBA's underlying borrowing facilities. However, where more than one LA has defaulted under its obligations under the Framework Agreement and the contribution arrangements are insufficient to cover the shortfall, the remaining non-defaulting LAs shall be liable to make payments under the Guarantees.

3.5 Instructing Solicitors draw Counsel's attention to the following features of the Framework Agreement that (among others) mitigate the risks identified at 3.4 above:

- (a) UK MBA's robust credit checks carried out on acceding LAs and its internal due diligence policies, as well as the comprehensive representation and warranties packages contained within the Framework Agreement;
- (b) the maintenance of UK MBA's liquidity facilities and reserves;
- (c) diversification of borrowing through the imposition of concentration limits to ensure that LAs do not have to take credit risk against a small number of LAs with large outstanding borrowings;
- (d) the contractual timing for payment of amounts due under the Loans ensure that UK MBA are in funds before payment of amounts are due to underlying lenders (subject to any potential default by an LA); and
- (e) the power of at least 50 per cent. of LAs (both by number and also by reference to those LAs' borrowings from UK MBA against the total outstanding borrowings from UK MBA) to restrict UK MBA from borrowing further funds from underlying lenders.

3.6 Counsel is asked to confirm that an LA that decides to enter into the Framework Agreement and a Guarantee on the basis of the Documents Package (assuming that it has (i) properly read and understood its contents, (ii) duly evaluated the risks identified (including, but not limited to, those identified at 3.4 above) as well as the relevant mitigants thereto, and (iii) followed all appropriate

internal procedural requirements) would be acting in accordance with the requirements of *Wednesbury* reasonableness.

- 3.7 Instructing Solicitors refer to the "*Guide to the Framework Agreement*" contained at appendix 1 to the Introductory Guide (as defined in the Schedule to these instructions). It is Instructing Solicitors' view that this appendix (with a suitable disclaimer that precedence should be given to the Framework Agreement itself) is helpful for LAs in considering whether to enter into the Framework Agreement. However, a concern has been raised by UK MBA that this appendix may be counter-productive given that there is a risk that LA officers may place reliance on this summary as opposed to the detail of the Framework Agreement itself. Counsel is asked to confirm that he agrees with Instructing Solicitors' view on the merits of including the "*Guide to the Framework Agreement*" as an appendix to the Introductory Guide.

#### **4. Other considerations**

- 4.1 Instructing Solicitors note that the Follow-up Memorandum (as defined in the Schedule to these instructions) and Counsel's Opinion will be capable of being relied upon by individual LAs. However, individual LAs are not able to rely upon the provisions of the Accounting Report (as defined in the Schedule to these instructions), which is being provided to them for information purposes only. It is Instructing Solicitors' view that this in itself would not mean that an LA was not acting in accordance with *Wednesbury* reasonableness requirements, so long as it considered whether it should take its own accounting advice as to the accounting implications of the Guarantees and the Loans, separate to the Accounting Report. Does Counsel agree?
- 4.2 Counsel is asked to advise as to any further risks that should be taken into account by an LA considering entering into the Framework Agreement in its decision making process, other than those identified in the Documents Package.
- 4.3 Counsel is also asked to advise on any further evidential requirements that an LA considering entering into the Framework Agreement could or should impose upon itself in order to eliminate the risk of its decision to enter into the Framework Agreement being challenged, either in the context of its General Power to do so or on the basis that the decision was not made in accordance with the requirements of *Wednesbury* reasonableness.

Counsel is asked to provide his advice in writing addressed to Birmingham City Council, Reading Borough Council and Southwark Borough Council (with an acknowledgement that his opinion (a) will be included in the Documents Package and (b) may be relied upon by each LA wishing to enter into the Framework Agreement and borrow from UK MBA) and Instructing Solicitors by 23 October, 2015 and, in the meantime,

to contact Geoff Fuller ([geoff.fuller@allenoverly.com](mailto:geoff.fuller@allenoverly.com)) of Instructing Solicitors should he have any questions about these Instructions or require any clarifications.

Allen & Overy LLP

9 October, 2015

**DOCUMENT SIX**

**ACCOUNTING ADVICE**  
**(prepared by Grant Thornton)**



Christian Wall  
Portfolio Manager  
UK Municipal Bonds Agency  
5-8 The Sanctuary  
UK Municipal Bonds Agency  
London  
SW1P 3JS

Telephone: 020 3837 9963  
Mobile: 07974 355034

22 October 2015

Dear All,

**Accounting Advice Relating to Borrowing from the UK Municipal Bonds Agency:**

Further to our recent conversations concerning borrowing from the UK Municipal Bonds Agency (the **Agency**), please find enclosed a paper prepared by Grant Thornton UK LLP (**Grant Thornton**) which highlights issues relating to the accounting requirements including refinancing.

Grant Thornton is one of the leading accounting, tax and advisory firms in the country with a significant share of the local authority audit market. It therefore has an excellent understanding of the technical and practical issues that need to be considered.

The advice has been prepared for the Agency itself and is being released to you for information purposes only. Coupled with the standard terms and conditions common to any advice and guidance prepared by a professional firm, this does mean that there are some matters that need to be drawn to your attention:

- The advice has been prepared solely in relation to the UK Municipal Bonds Agency and it cannot be used for any other purpose.
- Any reliance you place on the information in the paper will be entirely at your own risk. Each local authority remains responsible for its own accounts and there is no warranty provided either by the Agency or Grant Thornton, either explicit or implicit, in relation to the advice.

- The advice cannot be passed to third parties.
- No local authority has any right of recourse to Grant Thornton or the Agency in relation to the advice. This also means that if you have a query concerning the advice you should contact me and not contact Grant Thornton directly.

If you have any questions or queries, do get in touch.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'CW', with a stylized flourish at the end.

Christian Wall  
Portfolio Manager



**Grant Thornton**

*An instinct for growth*<sup>TM</sup>

*Local Authority Accounting for borrowing via the  
Municipal Bonds Agency*

**Advice to the Municipal Bonds Agency**



# Grant Thornton

An instinct for growth™

Our Ref MBA20151013  
Your Ref

Municipal Bonds Agency  
Ground Floor  
5-8 The Sanctuary  
LONDON  
SW1P 3JS

For the attention of Christian Wall

14 October 2015

Dear Christian

**Advice in connection with local authority accounting requirements  
in relation to the Municipal Bonds Agency**

Grant Thornton UK LLP is the largest supplier of audit and related services to the local government sector in the UK. As a practice we have significant sector expertise including the specific requirements of UK local authority accounting. I am the firm's Head of Local Government, lead our public sector assurance team in London and the South East and am the partner responsible for public sector financial reporting.

Further to the letter of engagement dated 22 June 2015, I am pleased to present our report to you on the accounting implications for local authorities in relation to their borrowing via the Municipal Bonds Agency.

Please do not hesitate to contact me should you wish to discuss any aspect of this report or if you require assistance with any other matter.

Yours sincerely

Paul Dossett  
Partner  
For Grant Thornton UK LLP

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# 1 Terms used in this report

<b>Term</b>	<b>Definition</b>
CIES	Comprehensive Income and Expenditure Statement
CIPFA	Chartered Institute of Public Finance and Accountancy
Code	Code of Practice on Local Authority Accounting in the United Kingdom
EIR	Effective Interest Rate
Grant Thornton	Grant Thornton UK LLP
IAS	International Accounting Standards
IFRS	International Financial Reporting Standards
MBA	Municipal Bonds Agency
PWLB	Public Works Loan Board
Us/We	Grant Thornton UK LLP
You	The Municipal Bonds Agency

## 2 Important context

### Introduction

- 2.1 Grant Thornton has been engaged by the Municipal Bonds Agency (MBA) to provide this advice under the terms as set out in the letter of engagement dated 22 June 2015.
- 2.2 This section sets out the context of this report, the basis of its preparation and its appropriate uses. It is important that the rest of this report is considered in the context of the information in this section.

### Context

- 2.3 MBA wish to support local authorities investing in, and borrowing via, MBA in preparing their statutory financial statements.
- 2.4 As part of this, MBA has requested independent advice on the accounting implications for local authorities of investing in, and borrowing via, MBA under the Code of Practice for Local Authority Accounting in the UK and the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended) ("the Project"). The work will be completed in two phases.
- 2.5 MBA will seek to circulate our reports to local authority shareholders and borrowers and potential shareholders and borrowers to promote knowledge of the financial reporting requirements and consistency.

### Scope of engagement

- 2.6 As part of our work, we will assess documentation provided by MBA including:
- background information provided in the Credit Agency Presentation March 2015 and Shareholder and Borrower Update March 2015 (Phase I and II)
  - articles of association (Phase I)
  - draft framework agreement (Phase II)
  - draft joint and several guarantee (Phase II)
  - a summary of the consideration by the MBA in relation to risks of local authority default (Phase II).
- 2.7 We will consider:
- the accounting requirements for local authority shareholders in relation to their investment in the MBA (Phase I)
  - the Minimum Revenue Provision implications for local authority shareholders in relation to their investment in the MBA (Phase I)

- the accounting requirements for local authority borrowers in relation to:
    - the joint and several guarantee
    - loans taken out via the MBA (Phase II)
- 2.8 This report provides the results of our work in relation to Phase II, summarising the local authority accounting requirements for local authority guarantees and borrowing via the MBA. Our report sets out the key requirements and options/ methodologies available under the Code of Practice for Local Authority Accounting in the UK in preparing statutory financial statements and is not a substitute for detailed advice required by individual borrowers or the judgements required by Directors of Finance.

### **Limitation of liability**

- 2.9 Our liability in connection with this engagement shall be limited, on the basis set out in Appendix 1 "Additional terms and conditions of engagement" of our letter of engagement, to a maximum aggregate amount of £2 million and, subject to that cap, to that part of any loss suffered which is proportional to our responsibility.

### **Forms of report**

- 2.10 For your convenience, this report may have been made available to you in electronic as well as hard copy format, multiple copies and versions of this report may therefore exist in different media and in the case of any discrepancy the final signed hard copy should be regarded as definitive.

### **Confidentiality and reliance**

- 2.11 Our reports will be addressed to the MBA. Our reports and other communications are prepared for the MBA only. Subject to paragraph 2.12 below, they should not be used, reproduced or circulated for any other purpose, whether in whole or in part without our prior written consent. We agree that MBA may disclose our reports to its employees, officers, directors, insurers and professional advisers in connection with the Project, or as required by law or regulation, the rules or order of a stock exchange, court or supervisory, regulatory, governmental or judicial authority without our prior written consent but in each case strictly on the basis that we owe no duties to any such persons.
- 2.12 MBA have informed us that onward distribution of our reports to local authority shareholders and borrowers and potential shareholders and borrowers ("Permitted Disclosees") will be required as part of this engagement. In these circumstances, we consent to the circulation of our reports strictly to those Permitted Disclosees to whom it is necessary to release them on the basis that you notify each recipient that they are being released to them for information purposes only and that any reliance they place on them will be at their own risk. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the MBA for our work, for our reports and other communications, or for the opinions which we shall form.
- 2.13 To the fullest extent permitted by law, we do not accept any responsibility for any loss or damage arising out of the use of the reports or other communications by the MBA for any purpose other than in connection with the Project.

## 3 Executive Summary

### Introduction

- 3.1 This report sets out our advice relating to local authority accounting implications and requirements for borrowing via the MBA. It is based on our review of requirements in the 2015/16 Code of Practice on Local Authority Accounting in the United Kingdom and specific statutory requirements relevant to borrowing, where relevant.

### Key messages

- 3.2 Local authorities entering into the joint and several guarantee as part of the Local Authority Financing Framework Agreement will enter into a financial guarantee contract. The financial guarantee contract is a financial instrument. This should be classified as financial liabilities at amortised cost, recognised at fair value and subsequently held at the higher of carrying value and a best estimate of the amount to settle the obligation when a payment under the guarantee becomes probable. Local authorities will need to consider assumptions and use judgement in determining fair value on initial recognition and subsequent measurement. Local authorities will also need to consider disclosure requirements in relation to the financial guarantee liability taking into account materiality (both quantitative and qualitative).
- 3.3 Local authority loan agreements with the MBA are financial instruments. These should be classified as financial liabilities at amortised cost and initially recognised at fair value less transaction costs (unless a local authority chooses to write these off immediately). These should be measured subsequently at amortised cost. Local authorities will need to consider assumptions and use judgement in determining fair value on initial recognition. Local authorities will also need to consider disclosure requirements in relation to the borrowing taking into account materiality (both quantitative and qualitative).
- 3.4 Local authorities making contributions to the MBA as part of the Local Authority Financing Framework Agreement will be providing loans to the MBA. The contribution loan agreement is a financial instrument. This should generally be classified as financial asset classified as loans and receivables, recognised at fair value and subsequently held at amortised cost. Local authorities will need to consider assumptions and use judgement in determining fair value on initial recognition and in considering impairment. Local authorities will also need to consider disclosure requirements such as fair value and credit risk of the contribution loans taking into account materiality (both quantitative and qualitative).
- 3.5 Where a local authority takes out borrowing from the MBA to refinance existing debt with other lenders, premia for early redemption may become payable. Whilst these will be chargeable immediately to the Surplus or Deficit on Provision of Services in the Comprehensive Income and Expenditure Statement, statutory adjustments allow local authorities to spread the impact of these to the General Fund in line with statutory provisions.

### Conclusions

- 3.6 Whilst the report provides a summary of the key accounting requirements for local authorities, local authorities will remain responsible for the preparation of their financial statements. Issues requiring judgement have therefore been set out in the report and highlighted above for local authorities to consider in the preparation of their financial statements.

## 4 Accounting requirements

### Introduction

- 4.1 In this section we set out the advice relating to local authority accounting implications and requirements in relation to borrowing from the MBA.

### Background

- 4.2 Over 50 local authorities have invested in establishment of the MBA through two capital raises. This allows shareholders priority for borrowing from MBA, with non-shareholders charged a premium to borrow. All local authority borrowers agree, through the framework agreement, that they will enter into a joint and several guarantee.
- 4.3 The Local Authority Financing Framework Agreement between MBA and authorities borrowing from the MBA set out the arrangements and requirements relating to local authority borrowing from the MBA. Provisions relevant to accounting for this agreement are summarised below.

#### Joint and several guarantee

- 4.4 The draft Local Authority Financing Framework Agreement v11 sets out that:

*To facilitate the issuance of Notes by the Company and borrowing from other lenders and/or investors, the Authorities have agreed to guarantee the payment of all sums expressed to be payable from time to time by the Company in respect of the Notes, the Trust Deed and certain other loan agreements or other borrowing arrangements that the Company may enter into from time to time.*

- 4.5 It further provides details of the guarantee as follows:

*The Guarantor irrevocably and unconditionally:*

*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) 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 liability; and*

*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 obligation or 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.*

#### Local authority borrowing from the MBA

- 4.6 The MBA will borrow funds and lend on those funds to local authorities. The draft Local Authority Financing Framework Agreement v11 sets out arrangements in respect of borrowing from the MBA as follows:

*The Company and any Authority may from time to time agree terms upon which the Company will make an Authority Loan to such Authority. The Company and such Authority will either (i) execute a Loan Confirmation in order to document such terms, which shall incorporate the Loan Standard Terms, save as modified or supplemented by the relevant Loan Confirmation or (ii) execute an agreement in such other form as may be agreed between the Company and such Authority.*

- 4.7 These loans will be subject to a separate agreement.

**Local authority contribution loans**

- 4.8 Section 3 of the draft Local Authority Financing Framework Agreement v11 sets out arrangements in the event of default by a local authority. These are designed to prevent a call under the joint and several guarantee by providing the MBA with sufficient funds to meet interest payments/ principal repayments through local authority contribution loans, if necessary. The agreement states that:

*If:*

*at 11 a.m. on the date falling 4 Business Days (or, in respect of principal and unless otherwise agreed between the Company and the relevant Authority, 8 Business Days) prior to a day on which a payment is due under the Finance Documents, the Company has been unable to obtain sufficient funds from (i) one or more Liquidity Facility Providers under Liquidity Facility Agreement(s) or (ii) one or more Lending Authorities or lenders or other providers of financial accommodation, in each case, under Finance Document(s), in each case to enable it to pay such amounts falling due under the Finance Documents, the Company shall; or*

*at any other time the Company expects to be unable to pay, or does fail to pay, any amount when due under the Finance Documents, the Company shall; or*

*on any date after the Funding Date on which an amount due by an Authority pursuant to Clause 3.3.1 above remains unpaid by the relevant Authority (notwithstanding that the Company has sufficient funds to enable it to make all payments of amounts due under the Finance Documents), the Company may,*

*notify each Authority (other than any Defaulting Authority) thereof as soon as reasonably practicable (or, in the case of paragraph (a) above, by 5 p.m. on such date). Such notice (a "Contribution Notice") shall specify the Shortfall Amount and shall set out the Authority Contribution required from each Authority which is not a Defaulting Authority (including specifying where, in relation to any Authority, the Authority Contribution is zero).*

*If the Company does so issue Contribution Notices, it may also initiate discussions with any Authority which is not a Defaulting Authority with a view to such Authority agreeing to be issued with an Individual Authority Contribution Notice pursuant to Clause 3.3.5(b).*

- 4.9 The agreement further confirms that these contributions will be repaid to local authorities with interest following any enforcement action by the MBA as follows:

*All amounts received by the Company from an Authority pursuant to a Contribution Notice, Further Contribution Notice or Individual Authority Contribution Notice shall be treated as Contribution Loans made by the relevant Authority to the Company, the repayment of which, and the payment of any interest thereon, shall be made in accordance with Clause 3.9 (Order of application of proceeds) and shall be due and payable only at the times and to the extent that the Company has funds available to make such payments in accordance with Clause 3.9 (Order of application of proceeds). Interest on Contribution Loans ("Contribution Interest") shall accrue at an interest rate equal to the higher of (i) the interest rate payable by the Defaulting Authority under the relevant Authority Loan, and (ii) the prevailing rate offered by the Public Works Loan Board (or any*

*replacement agency) in respect of loans having the same maturity and interest basis under the relevant Authority Loan (and to the extent (ii) applies, the relevant Defaulting Authority shall be required to indemnify the Company in respect of such cost pursuant to the Loan Standard Terms). Such interest, if unpaid, will be compounded with the amount due under the relevant Contribution Loan on the date falling 6 months after the relevant Contribution Loan is made and at 6-monthly intervals thereafter, but will remain immediately due and payable subject to availability of funds to make such payments in accordance with Clause 3.9 (Order of application of proceeds).*

- 4.10 This section of the report sets out the accounting requirements for local authorities for entering into the joint and several guarantee, borrowing from the MBA and local authority contribution loans in the event of default by another local authority. Further details on the precise details and mechanisms in relation to the joint and several guarantee, local authority borrowing and local authority contribution loans are included within the draft Local Authority Financing Framework Agreement v11. Local authorities should ensure that they are familiar with the detailed provisions in the final agreement in preparing their financial statements and in forming any accounting judgements.

### **Accounting framework and requirements**

- 4.11 Local authorities in the United Kingdom are required to prepare their statutory financial statements in line with the Code of Practice on Local Authority Accounting in the United Kingdom (the Code) which is based International Financial Reporting Standards (IFRS), except where these are inconsistent with specific statutory requirements.
- 4.12 This report sets out our consideration of the accounting issues based on the Code of Practice on Local Authority Accounting in the United Kingdom 2015/16 and any relevant statutory provisions in force at the date of the report. The MBA intends to focus initially on English local authorities. The report therefore will focus on the regulations applicable in England, however similar provisions exist in Wales and Scotland; there are no relevant equivalent statutory provisions in Northern Ireland.

### **Accounting for financial instruments**

#### **Financial instruments**

##### *Requirements*

- 4.13 The Code and IAS 32 Financial Instruments: Presentation defines a financial instrument as *any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.*
- 4.14 IAS 32 defines financial assets as *any asset that is:*
- (a) cash;*
  - (b) an equity instrument of another entity;*
  - (c) a contractual right:*
    - (i) to receive cash or another financial asset from another entity; or*
    - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or*
  - (d) a contract that will or may be settled in the entity's own equity instruments...*



4.15 IAS 32 further defines financial liabilities as *any liability that is:*

*(a) a contractual obligation:*

*(i) to deliver cash or another financial asset to another entity; or*

*(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or*

*(b) a contract that will or may be settled in the entity's own equity instruments...*

*Joint and several guarantee*

4.16 Based on our understanding of the form of guarantee entered into by local authorities as set out in the draft Local Authority Financing Framework Agreement v11, the local authorities guarantee payments of MBA's liabilities to relevant beneficiaries in the event MBA cannot meet its obligations.

4.17 In such cases, a local authority will have a contractual obligation to deliver cash to the relevant beneficiaries any unpaid balances of the MBA and as such the guarantee will be a financial liability.

*Local authority borrowing from MBA*

4.18 Based on our understanding of local authorities' borrowing from the MBA as set out in the draft Local Authority Financing Framework Agreement v11 the MBA will make loans to local authorities in line with standards terms and the relevant Loan Confirmation or any other such agreement.

4.19 In such cases, a local authority will have a contractual obligation to deliver cash (the repayment and interest) to the MBA and as such the borrowing will be a financial liability.

*Local authority contribution loans*

4.20 Based on our understanding of arrangements for local authority contribution loans as set out in the draft Local Authority Financing Framework Agreement v11, in certain circumstances, a local authority may be required to make contributions to MBA. In these circumstances it is expected that these are repaid with interest by the MBA.

4.21 In such cases, the MBA will have a contractual obligation to deliver cash (the repayment and interest) to the local authority and as such the loan will be a financial asset.

## **Financial instrument classification**

*Requirements*

4.22 Local authorities are required to account for financial instruments in accordance with IAS 39 Financial Instruments: Recognition and Measurement, except where adaptations, or interpretations, to fit the public sector are detailed in the Code or where there are statutory accounting requirements. Whilst all financial instruments are measured initially on the basis of fair value, subsequent measurement depends on the classification of an instrument.

- 4.23 Local authorities are required to classify their financial liabilities in one of two classes as follows:
- 1) fair value through profit and loss, where the financial liability is held for trading; or
  - 2) amortised cost, financial liabilities which are not held for trading.
- 4.24 Local authorities are required to classify their financial assets in one of three classes as follows
- 1) fair value through profit and loss, where the financial asset is held for trading
  - 2) loans and receivables, where the asset has fixed or determinable payments and are not quoted on an active market
  - 3) available for sale, those assets not classified as fair value through the profit or loss or loans and receivables.
- 4.25 Although IAS39 permits designation of a financial instrument to a different category to the one to which it would inherently belong, this is not permitted by the Code. For example, held to maturity assets permitted under IAS 39 are not permitted under the Code.

*Joint and several guarantee*

- 4.26 Based on our understanding of the reasons for local authorities entering into the guarantee, considering the draft Local Authority Financing Framework Agreement v11 which does not allow a local authority to transfer its obligations other than to a statutory successor, these could not be held for trading. The guarantee should therefore be classified as a Financial Guarantee Contract which is classified as amortised cost, unless a local authority has entered the agreement for the purpose of trading.

*Local authority borrowing from MBA*

- 4.27 Based on our understanding of local authorities' borrowing from the MBA and considering the draft Local Authority Financing Framework Agreement v11 which does not allow a local authority to transfer its obligations other than to a statutory successor, it is unlikely that this will be held for trading. The borrowing should therefore be classified as Borrowings classified as amortised cost, unless a local authority has borrowed principally for the purpose of trading.

*Local authority contribution loans*

- 4.28 Based on our understanding of arrangements for local authority contribution loans as set out in the draft Local Authority Financing Framework Agreement v11, contributions are expected to be repaid with interest specified within the agreement. Under these circumstances it is expected that payments would be fixed or determinable. The contribution loans should therefore be classified as debtors classified as loans and receivables.

## **Initial recognition and measurement**

*Requirements*

- 4.29 A financial asset or liability shall be recognised when an authority becomes party to the contractual provisions of the instrument. In the case of a financial liability, local authorities will

not become party to the contractual provisions of the financial liability unless one of the parties has performed under the agreement, such as the advance of cash under a loan agreement.

- 4.30 IAS 39 requires that *When a financial asset or financial liability is recognised initially, an entity shall measure it at its fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability. However, if the fair value of the financial asset or financial liability at initial recognition differs from the transaction price, an entity shall apply paragraph AG76 .*
- 4.31 IFRS 13 Fair Value defines fair value as *the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.*
- 4.32 IAS 39 considers that, *the best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price (ie the fair value of the consideration given or received).* However, transaction prices may not always equal fair value under IFRS 13 which is based on an exit price concept. Local authorities will therefore need to consider the fair value of the financial instrument on initial recognition.
- 4.33 Local authorities will need to consider whether the transaction is at arms-length, is not taking place under duress (that is they are willing to enter into the transaction, they are motivated but not forced or otherwise compelled to do so), and takes place in the principal market (the market with the greatest volume and level of activity for the asset or liability). Where a transaction was is not at arm's-length a valuation technique should be used to establish fair value.
- 4.34 However, IAS 39 also requires that unless fair value is evidenced by a quoted price or a valuation technique using data from observable markets the financial liability shall be recognised at transaction price. In the case of liabilities, there is less likely to be an active market due to contractual and other restrictions on liability transfers. In cases where a transfer price is unavailable but the instrument is held by another party as an asset, the liability should be measured from the asset holder's perspective.
- 4.35 The effect of adjusting the fair value of a financial liability for transactions costs is to amortise those transaction costs over the life of the instrument. The Code adapts IAS 39 to provide an option to write off transactions costs immediately to Surplus or Deficit on the Provision of Services rather than adjust the initial recognition amount where they are considered immaterial.
- 4.36 In relation to financial asset loans, local authorities need to consider whether loans are made at below prevailing market rates (soft loans). Statutory accounting requirements under the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended) with regards to soft loans (loans below prevailing interest rates) advanced by a local authority provide that the impact on the General Fund in relation to soft loans is the contractual interest receivable. Any difference between the amount credited to Surplus or Deficit on the Provision of Services in accordance with the Code and interest income under the regulations credited to the General Fund will be adjusted via the Financial Instruments Adjustment Account so that the General Fund reflects only the amounts required by the regulations (contractual interest receivable).

#### *Joint and several guarantee*

- 4.37 Authorities will be required to recognise the liability at the time of entering into the guarantee, when they become party to the contractual provisions.

- 4.38 The financial guarantee will be initially recognised at fair value. Based on our understanding of the guarantee, transactions are at arm's-length (although borrowers may be MBA shareholders they will not have control or significant influence over the MBA, as considered in our Phase I report) but no premium is payable for taking on the risk of the guarantee.
- 4.39 As no premium is received, the fair value at inception should be considered by local authorities and will require the use of an estimation technique. One such estimation technique might be the expected losses under guarantee, although authorities might consider other estimation techniques provide a more reliable estimate of fair value such as the price for an equivalent credit insurance policy (if such a policy were available).
- 4.40 In considering, expected losses under guarantee, local authorities would consider the probability of the guarantee being called and the likely amount payable. In doing so, local authorities might take into account the provisions in the draft Local Authority Financing Framework Agreement v11 intended to avoid the guarantee being called including:
- payment requirements and timetables set out in the Local Authority Financing Framework Agreement
  - availability of any MBA liquidity facility
  - the local authority contribution arrangements set out in the Local Authority Financing Framework Agreement.
- 4.41 Further considerations might include:
- the overall governance framework of the MBA including risk management and controls
  - MBA lending policies
  - the history of local authority default
  - local authority access to PWLB funds as a lender of last resort
  - the wider local authority legislative framework.

MBA may also be able to provide further documentary evidence of the history of local authority default.

- 4.42 In considering the matters in 4.40 and 4.41 above, particularly the terms of the Local Authority Financing Framework Agreement and the system of contribution loans alongside any other relevant information, local authorities may conclude that the expected losses are negligible. This will be a judgement for each local authority based on the information available to it at the time. The treatment of potential contribution loans is set out from 4.47 below. In recognising any financial guarantee any loss will be charged to the Surplus or Deficit on the Provision of Services. There are no statutory provisions for guarantees entered into on or after 9 November 2007 which would mitigate the impact on the General Fund.
- 4.43 The intention of IAS39 is to recognise a financial liabilities under financial guarantee contracts. It is not expected that an authority would account separately for any benefits as a result of entering into the guarantee, any benefits such as the ability to borrow at favourable rates which would be considered under accounting for the initial recognition of any borrowing from the MBA at fair value covered below.

#### *Local authority borrowing from MBA*

- 4.44 Local authority borrowing from the MBA will only be recognised by local authorities when the cash is received rather than at the date of the loan agreement (if different). The borrowing will

be measured initially at fair value less transaction costs directly attributable to the issue of the financial instrument.

- 4.45 Based on our understanding of the borrowing from the MBA, transactions are at arm's-length (although borrowers may be MBA shareholders they will not have control or significant influence over the MBA, as considered in our Phase I report). Transaction price (the receipt of the loan advance) is therefore likely to provide the best evidence of fair value and therefore used for initial recognition.
- 4.46 However, at initial measurement local authorities should consider whether the transaction price does provide the best evidence of fair value, and if not whether fair value can be evidenced by a quoted price or a valuation technique using data from observable markets. Where this is the case the borrowing should be recognised at fair value (with the gain or loss recognised in the Surplus or Deficit on the Provision of Services), otherwise it should be measured at transaction price.
- 4.47 On initial recognition transaction costs should be deducted from the fair value of the liability. However, the Code does provide an option for immediate write off to Surplus or Deficit on the Provision of Services where these are immaterial. Where local authorities consider that transactions are immaterial, on initial recognition of the borrowing they could either:
- deduct transaction costs from the fair value of the liability or
  - write off transactions costs to Surplus or Deficit on the Provision of Services.

*Local authority contribution loans*

- 4.48 The contribution loan will be recognised when the authority becomes party to the contractual provisions of the contribution loan agreement and when the authority takes on the legal right to repayment/ payment of interest. This is likely to be on providing the financial contribution/ loan to MBA. The loan will be measured initially at fair value.
- 4.49 Local authorities will need to consider fair value at recognition as the draft Local Authority Financing Framework Agreement v11 sets out the interest rate payable being *the higher of (i) the interest rate payable by the Defaulting Authority Loan, and (ii) the prevailing rate offered by the Public Works Loan Board (PWLb) (or any replacement agency) in respect of loans have the same maturity and interest basis under the relevant Authority Loan*. As this is likely to be based on the PWLB rate, it is likely that local authorities will consider that the interest rate reflects the market rates at the time the contribution loans are advanced.
- 4.50 Given the interest rates set out in the Local Authority Financing Framework Agreement it is unlikely that contribution loans will be provided at less than contribution rates. If, in the circumstances, bearing materiality in mind, where local authorities consider that contribution loans to the MBA are at less than market rate the fair value should be estimated as the present value of cash receipts discounted at the prevailing market rate of interest (for a similar organisation with a similar credit rating) with the sum by which the amount lent exceeds the fair value of the loan charged to Surplus or Deficit on Provision of Services. In applying the statutory regulations the impact on the Surplus Deficit on Provision of Services is reversed and replaced with the actual interest receivable. In considering the prevailing market rate of interest in calculating fair value, the Code confirms that it is acceptable to base the prevailing interest rate on the authority's borrowing cost plus an allowance for credit risk. The Code requires that the PWLB rate shall be used to estimate the prevailing market rate unless the authority can provide reliable evidence it would be able to borrow at a lower rate.

- 4.51 Whilst fair value on initial recognition should be adjusted for transaction costs, it is not expected that there will be transaction costs relating to these contributions loans.

*Future considerations*

- 4.52 Local authorities are required to apply the measurement and disclosure requirements of IFRS 13 fair value prospectively from 2015/16. There are no adaptations to IFRS 13 for the public sector context. However, it is likely that CIPFA will issue further application guidance in relation to local authority liabilities, particularly in relation to liabilities that cannot be transferred, therefore local authorities will need to consider any subsequent guidance issued by CIPFA in assessing fair value.

**Subsequent measurement**

*Requirements*

- 4.53 Subsequent treatment of a financial instrument depends on its classification. Under the Code, financial liabilities classified as amortised cost and financial assets classified as loans and receivables are measured subsequent to initial recognition at amortised costs.
- 4.54 In relation to financial guarantee contracts, following initial recognition, these are carried at the original amount at recognition, less any cumulative amortisation to match any expected changes in exposure, unless payment under the guarantee becomes probable at which point the amount of the liability should be determined as the higher of the carrying amount or the amount determined in accordance with IAS 37 Provisions, Contingent Liabilities and Assets, less any cumulative amortisation. IAS 37 requires provisions to be measured at the *best estimate of the expenditure required to settle the present obligation at the end of the reporting period*.
- 4.55 Any movements in the carrying amount of a financial guarantee liability will be made through the Surplus or Deficit on Provision of Services. As set out in 4.42, there are no statutory provisions which will mitigate any impact.
- 4.56 The amortised cost model requires accounting for a financial liability by applying a calculated single effective interest rate (EIR)<sup>1</sup> over the expected life of the instrument, rather than accounting for the cash flows within the contract to reflect the underlying substance of the instrument. The profile of interest charges under the EIR and contractual cashflows may be the same where loans are at fixed rates or variable rates linked to base rates, however these will be different where there are significant transaction costs.
- 4.57 Each year the carrying amount of the liability is increased for the interest calculated under the effective interest rate (charged to the Surplus or Deficit on Provision of Services in the Comprehensive Income and Expenditure Statement (CIES)) and reduced by any cash outflows (being interest and principal payments made under the contractual terms).
- 4.58 However, where judged immaterial, transaction costs may be charged immediately to the Surplus or Deficit on Provision of Services.
- 4.59 Where financial liabilities are measured at amortised costs there are no fair value revaluations following initial recognition.

<sup>1</sup> The effective interest rate is the rate of interest that will discount all cashflows throughout the life of the instrument down to the fair value of the liability calculated at initial measurement (fair value less transaction costs).

- 4.60 In relation to financial assets, financial assets are impaired and impairment losses incurred when there is objective evidence as a result of a past event that occurred subsequent to initial recognition. The Code, in 7.3.3.1, sets out events that provide objective evidence of impairment including significant financial difficulty of the creditor, breach of contract or probability that the borrower will enter into bankruptcy or financial reorganisation. Local authorities need to assess whether there is objective evidence of impairment at each balance sheet date.
- 4.61 Where objective evidence of impairment is identified local authorities need to consider whether the carrying amount exceeds the estimated recoverable amount (present value of expected future cash flows discounted at the original effective interest rate). Where this is the case the carrying amount shall be reduced and loss included in the Surplus or Deficit on the Provision of Services.

*Joint and several guarantee*

- 4.62 Following initial recognition of a financial guarantee liability, if any such liability is recognised, it is expected that this will continue to be held at carrying value less any cumulative amortisation.
- 4.63 Annually, local authorities would need to consider whether the payment under the guarantee becomes probable, and if so measure the guarantee as the higher of the carrying amount or in line with measurement of a provision in accordance with IAS 37.
- 4.64 In considering whether or not payment under the guarantee is probable, local authorities should consider whether there had been any local authority defaults and resulting local authority contribution loans under the Local Authority Financing Framework Agreement and might further consider whether the MBA had been able to recover money from defaulting authorities. For example, in the circumstances that a local authority default has occurred and the MBA has been unable to recover monies from defaulting authorities or that recovery is not probable, local authorities are likely to consider it probable that payments will be required under the guarantee. However this will be a local authority judgement.
- 4.65 In relation to the measurement of the guarantee, the measurement provisions of IAS 37 apply. IAS 37 requires measurement as *The best estimate of the expenditure required to settle the present obligation being the amount that an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time. Further The estimates of outcome and financial effect are determined by the judgement of the management of the entity, supplemented by experience of similar transactions and, in some cases, reports from independent experts. The evidence considered includes any additional evidence provided by events after the reporting period.*
- 4.66 The standard recognises that there may be uncertainties around the amount and suggests that the individual most likely outcome may be the best estimate although authorities may need to consider other possible outcomes.
- 4.67 Where payment under the guarantee is probable, it is likely that the default amounts will be known or estimated. In these circumstances, local authorities should be able to calculate the best estimate of any payments under the guarantee based on information on their proportion of borrowing which would be available from the MBA.
- 4.68 Whilst it is possible that, following payments under the guarantee, local authorities obtain rights to recover funds, IAS 37 requires that *where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement shall be recognised when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation.* In the event of any guarantee payments, local authorities would be expected to obtain their own legal advice as to further rights to recover funds from defaulting authorities and for that advice to be reflected in

the financial statements. A local authority would therefore need to record the liability irrespective of any further rights to reimbursement with the reimbursement asset only recognised if recovery was virtually certain.

*Local authority borrowing from MBA*

- 4.69 Following initial recognition of borrowing it is expected that this will continue to be held at carrying value plus the interest calculated under the amortised cost model, less contractual cash outflows. The relevant accounting entries being:

Dr CIES – Financing and Investment Expenditure (Interest based on amortised cost)  
Cr Cash (contractual cash payments of interest and principal)  
Cr Borrowing (balancing amount)

- 4.70 The carrying value will not be re-valued following initial recognition as these are held at amortised cost.

*Local authority contribution loans*

- 4.71 Subsequent to initial recognition, the contribution loans should be held at amortised cost being the amount at initial recognition plus interest (based on the amortised cost multiplied by the interest rate used on recognition) minus any cash receipts (interest and principal repayments).
- 4.72 At the balance sheet date local authorities will need to consider whether there is objective evidence of impairment and where applicable record any loss in the Surplus or Deficit on the Provision of Services as set out in 4.72. In doing so local authorities might consider whether or not the MBA has failed to recover money from defaulting authorities and availability of MBA equity in considering whether MBA were in significant financial difficulty.
- 4.73 Where objective evidence of impairment is identified, local authorities need to consider whether the carrying amount exceeds the estimated recoverable amount (present value of expected future cash flows discounted at the original effective interest rate). Where this is the case the carrying amount shall be reduced and loss included in the Surplus or Deficit on the Provision of Services.

## **Disclosure**

*Requirements*

- 4.74 In considering the disclosures required in the financial statements a local authority will need to consider whether or not the financial instruments are either qualitatively or quantitatively material. Where material a local authority will need to consider the disclosure requirements specific to loans and receivables and financial liabilities held at amortised cost required in the Code which include:
- 7.4.2.2 the carrying amounts of loans and receivables (including where material separate disclosure and details of soft loans) and financial liabilities at amortised cost
  - 7.4.2.9 net gains or net losses on loans and receivables and financial liabilities at amortised cost, total interest income and expense for financial assets and financial liabilities that are not at fair value through profit or loss, interest income on impaired assets and the amount of any impairment loss.
- 4.75 Other financial instrument disclosure Code requirements that may need to be tailored to reflect the relevant financial liabilities include:



- 7.4.2.10 accounting policies for the recognition and measurement
  - 7.4.11 fair value in comparison to carrying value disclosures
  - 7.4.2.13 the methods and assumptions applied in determining fair value
  - 7.4.2.14 where a local authority does not recognise a gain or loss on initial recognition because the fair value is not evidenced by a quoted price in an active market for an identical liability nor based on a valuation technique on data from observable markets, additional disclosures providing additional information.
- 4.76 Local authorities will also need to consider relevant disclosures in relation to the nature and extent of risks arising from financial instruments.

*Joint and several guarantee*

- 4.77 Local authorities will need to consider the materiality of the financial guarantee contracts in considering the extent of disclosures. Local authorities might expect to include details of the nature of the guarantee within financial instrument disclosures providing details as set out in the Local Authority Financing Framework agreement.
- 4.78 The joint and several guarantee will need to be reflected in financial instrument disclosures relating to financial liabilities, accounting policies and judgements with regards to fair value measurements. In doing so, local authorities will need to ensure that judgements and estimation such as the those judgements made in relation to estimating expected losses under the guarantee or other techniques to estimate fair value on recognition.

*Local authority borrowing from MBA*

- 4.79 Local authorities will need to consider the materiality of their borrowing from the MBA in considering the extent of disclosures.
- 4.80 The borrowing will need to be reflected in financial instrument disclosures relating to financial liabilities, accounting policies and judgements with regards to fair value measurements.

*Local authority contribution loans*

- 4.81 Local authorities will need to consider the materiality of their contribution loans to the MBA in considering the extent of disclosures.
- 4.82 The contribution loans will need to be reflected in financial instrument disclosures relating to loans and receivables financial assets, accounting policies and judgements with regards to fair value measurements. Local authorities will also need to consider disclosures with regards to credit risk in the nature and extent of risks arising from financial instruments. Where the contribution loans are considered to be soft loans, local authorities will need to consider specific disclosure requirements relating to soft loans.

**Re-financing with the MBA**

*Requirements*

- 4.83 A financial liability is derecognised when the obligation in the contract is discharged or cancelled or expires. Under IAS 39, the difference between the carrying amount of a financial liability extinguished or transferred (if any) and the consideration paid is recognised in the Surplus or Deficit on Provision of Services. Differences are will arise when loans are repaid early and premiums become payable or discounts receivable.

- 4.84 At this point it is not expected that local authorities will derecognise borrowing from the MBA in the short/ medium term, therefore this report does not consider the de-recognition of borrowing from the MBA. However local authorities may consider re-financing current borrowing from other lenders with the MBA.
- 4.85 Specific statutory provisions are in place with regards to premiums arising on the early repayment of loans which allows local authorities to amortise the charge to the General Fund where this has been charged to the Surplus or Deficit on the Provision of Services. This will be an important factor in the considerations of Directors of Finance when considering any re-financing options.
- 4.86 In particular, the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended) provide specific statutory accounting requirements relating to accounting for premiums on the early redemption of debt. In cases where the statutory adjustments are applicable, the Surplus or Deficit on the Provision of Services shall reflect total premium incurred and the application of the regulations shall be accounted for through the Movement on Reserves Statement with the double entry going to the Financial Instruments Adjustment Account. As a result the impact of the premium on the General Fund can be spread.
- 4.87 The regulations allow for premiums to be funded by capital receipts (in full or in part).
- 4.88 In relation to the early repayment of loans after 1 April 2007 the charge to the General Fund should be calculated in line with the statutory formula. The formula is  $(D-E)/F$  where D is the amount of premium; E is the any amounts of the premium charged to the General Fund before the current year plus any capital receipts used to pay any part of the premium; and F is the number of financial years from the current year to the final year (where the final year is the later of the financial year in which the original loan would have been due to be repaid or, the financial year in which the replacement loan is due to be repaid).
- 4.89 Local authorities may amortise the premium over a shorter period.

*Refinancing via MBA borrowing*

- 4.90 In the case of refinancing with the MBA, local authorities will derecognise borrowing with other lenders when the obligation is discharged ie when the principal, outstanding interest and any premium is repaid.
- 4.91 Where a premium is payable a local authority will need to recognise this immediately in the Surplus or Deficit in the Provision of Services (Financing and Investment and Expenditure). However, the impact of the premium on the General Fund is reversed out and replaced with an annual charge managed via the Financial Instruments Adjustment Account or funded by capital receipts.
- 4.92 The annual charge to the General Fund will be calculated as the remaining un-financed premium balance over the remaining life of the original or replacement loan (whichever is later) or a shorter period as a local authority might choose.

## **Summary: accounting for the joint and several guarantee**

### **Classification**

Local authorities shall account for the joint and several guarantee as a financial liability at amortised cost.

### **Initial recognition**

The joint and several guarantee shall be initially recognised as a financial guarantee liability at fair value. As no premium will be payable local authorities will need to use judgement to estimate fair value which might include consideration of expected losses under the guarantee.

Where a financial guarantee is recognised, any loss will be charged to the Surplus or Deficit on the Provision of Services.

### **Subsequent measurement**

Annually local authorities will need to consider whether payment under the guarantee is probable. The financial guarantee liability will be subsequently measured of the higher of the carrying amount and, where payment under the guarantee becomes probable, the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.

Losses will be recognised in Surplus or Deficit on the Provision of Services.

### **Disclosure**

Local authorities will need to consider the materiality of the financial guarantee liability in providing details of the guarantee and considering the extent of disclosures and will need to consider the impact on financial instrument disclosures relating to financial liabilities at amortised cost, accounting policies and judgements with regards to fair value measurements.

## **Summary: accounting for borrowing from the MBA**

### **Classification**

Local authorities shall account for borrowing from the MBA as a financial liability at amortised cost.

### **Initial recognition**

The borrowing shall be initially recognised as borrowing at fair value. The transaction price (the receipt of the loan advance) is likely to provide the best evidence of fair value and therefore used for initial recognition, however local authorities will need to consider whether fair value is different.

On initial recognition transaction costs should be deducted from the fair value of the liability unless local authorities chooses to write these off immediately to the Surplus or Deficit on the Provision of Services where these are immaterial.

### **Subsequent measurement**

Following initial recognition of borrowing, the carrying amount will be adjusted as the opening carrying value plus the interest calculated under the amortised cost model, less contractual cash outflows. The relevant accounting entries being:

Dr CIES – Financing and Investment Expenditure (Interest based on amortised cost)  
Cr Cash (contractual cash payments of interest and principal)  
Cr Borrowing (balancing amount)

The carrying value will not be re-valued following initial recognition.

### **Disclosure**

Local authorities will need to consider the materiality of the borrowing in considering the extent of disclosures and will need to consider the impact on financial instrument disclosures relating to financial liabilities at amortised cost, accounting policies and judgements with regards to fair value measurements.

## **Summary: accounting for local authority contribution loans**

### **Classification**

Local authorities shall account for contribution loans under the Local Authority Financing Framework Agreement as a loan debtor (financial asset) classified as loans and receivables.

### **Initial recognition**

The loans shall be initially recognised as loan debtors at fair value. In doing so local authorities will need to consider whether the contribution loans are at the prevailing market rate of interest and whether the loans should be treated as soft loans. Where the loans are not considered to be at fair value the profit or loss will be recognised in the Surplus or Deficit on Provision of Services.

In the case of soft loans, the impact of any loss will be reversed out of the General Fund to the Financial Instruments Adjustment account.

### **Subsequent measurement**

Following initial recognition of the loan debtor, the carrying amount will be adjusted as the opening carrying value plus the interest calculated using the original effective interest rate, less contractual cash inflows. The relevant accounting entries being:

Dr Cash (contractual cash receipts of interest and principal)  
Dr/ Cr Loan debtor (balancing amount)  
Cr CIES – Financing and Investment Income (Interest based on effective interest rate)

The carrying value will not be re-valued following initial recognition however at each balance sheet date local authorities will need to consider whether there is any objective evidence of impairment. Impairment losses will be identified where the carrying value is in excess of the recoverable amount the excess and will be recognised in the Surplus or Deficit on the Provision of Services.

### **Disclosure**

Local authorities will need to consider the materiality of the contribution loans in considering the extent of disclosures and will need to consider the impact on financial instrument disclosures relating to loans and receivables, accounting policies and judgements with regards to fair value measurements.

## **Summary: accounting for re-financing**

### **De-recognition of old loans**

In the case of re-financing with the MBA, local authorities will derecognise borrowing with other lenders when the obligation is discharged ie when the principal, outstanding interest and any premium is repaid.

Where a premium is payable, a local authority will need to recognise this immediately in the Surplus or Deficit in the Provision of Services (Financing and Investment and Expenditure). However, the impact of the premium on the General Fund is reversed out and replaced with an annual charge managed via the Financial Instruments Adjustment Account or funded by capital receipts.

### **Initial recognition, subsequent measurement and disclosure of new loans**

In recognising the new borrowing with the MBA, local authorities should consider the summary: accounting for borrowing from the MBA above.

### **Disclosure**

Local authorities will need to consider the materiality of the re-financing in considering the extent of disclosures and will need to consider the impact on financial instrument disclosures relating to financial liabilities at amortised cost, accounting policies and judgements with regards to fair value measurements.



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## **DOCUMENT SEVEN**

### **STANDARD CONFIRMATION OF LA'S AUTHORITY TO BORROW FROM UK MBA AND EXECUTE A GUARANTEE (prepared by UK MBA)**



**Standard confirmation of LA's authority to borrow from UK MBA and execute a Guarantee**

To: UK Municipal Bonds Agency PLC  
[Address]

Date: [●]

Dear Sirs,

Certificate of Approval - UK Municipal Bonds Agency PLC (the **Company**)

With reference to the Framework Agreement [to be entered into / dated [insert date]] between the Company and various UK local authorities and as annexed hereto as Annex 1 (the **Framework Agreement**) and the form of guarantee attached as Schedule 2 to the Framework Agreement (the **Guarantee**), we hereby confirm that:

- (a) the Authority has the necessary power to enable it to enter into the Framework Agreement and the Guarantee, and perform its obligations thereunder;
- (b) the Authority has approved the entering into of the Framework Agreement and the Guarantee; and
- (c) all necessary authorisations have been obtained, and all appropriate and applicable decision-making procedures have been followed and completed, to enable it to enter into this Agreement and the Guarantee.

[Attached hereto / Available at the weblinks specified below] are copies of documentation required to evidence the chain of authority from the council to the relevant signatories on behalf of such Authority, as follows:

[Annex 2 / [insert weblink]] - *[Set out all delegations of power from constitutional documents to signatory of the documents, referring to specific sections of documents where relevant. Such documents may include standing orders, Annual Treasury Management Strategy, delegations to committees, and should include minutes of meetings specifically approving the Framework Agreement and the Guarantee]*

Signed by: [name]

Chief Finance Officer (appointed pursuant to s151 of the Local Government Act 1972)

.....

Signed by: [name]

Monitoring Officer (appointed pursuant to section 5 of the Local Government and Housing Act 1992, as amended by Schedule 5 paragraph 24 of the Local Government Act 2000)

.....