

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.

