Report to Audit & Governance Committee

Date:	23rd November 2022
Reference number:	N/A
Title:	**Treasury Management Loans to Other Local Authorities**
Cabinet Member(s):	John Chilver, Cabinet Member for Accessible Housing and Resources and Cllr Tim Butcher - Deputy Cabinet Member for Accessible Housing and Resources
Contact officer:	Mark Preston, Assistant Director of Finance (Pensions, Procurement and Revenues)
Ward(s) affected:	None specific
Recommendations:	**That the Treasury Management Strategy being developed for 2023/24 will take into account the new range of government interventions and not just capitalisation directives and S114 notices as per the Audit and Governance Committee actions from the meeting of 27th September 2022. In the meantime, additional controls have been implemented for loans to other Local Authorities.**
Reason for decision:	To reduce the reputational risk to the Council of making loans to local authorities who are experiencing financial difficulties or where concerns exist about their financial status.

1. Executive summary

1.1 The Council generates an income from interest it receives from the investment of the cash balances it holds. The Treasury Management Strategy sets out the parameters within which cash balances can be invested. Included in the Treasury

Management Strategy is the ability to loan up to £10m for 5 years with any individual local authority up to a total of £150m being placed with local authorities at any one time. The number of local authorities who are experiencing financial difficulties has increased significantly over recent years resulting in s114 notices, Best Value reports and Public Interest reports, applications for Capitalisation Directives, as well as reports of general financial pressures being experienced by councils.

1.2 This report looks to reassure the Council that there is no risk to the funds that are loaned to other local authorities, even when they are facing significant financial pressures, and explain why the council needs to loan money to other local authorities. Recognising that there is a lot of press coverage of local authorities suffering financial pressures outside of formal notices and reports, the report also looks at the options for further consideration before agreeing loans to other local authorities.

2. Content of report

Lender Protections

2.1 Local Authorities are considered to be quasi government risk. In addition, there is also specific protection under the Local Government Act 2003, which sets out that no local authority can offer security to a lender, however there is specific regulation on loans to local authorities which makes clear that all loans are secured on future revenues and this includes the ability to take legal action if any debts are not repaid.

2.2 The relevant sections of the Local Government Act are Section 6 (Protection of lenders) and Section 13 (Security for money borrowed etc). Section 6 provides that *'a person lending money to a local authority shall not be bound to enquire whether the authority has power to borrow the money and shall not be prejudiced by the absence of any such power'*.

2.3 However, it is Section 6 that sets out the specific security provided on any loans made to local authorities. In particular:

13 (3) All money borrowed by a local authority (whether before or after the coming into force of this section), together with any interest on the money borrowed, shall be charged indifferently on all the revenues of the authority.

13 (5) The High Court may appoint a receiver on application by a person entitled to principal or interest due in respect of any borrowing by a local authority if the amount due remains unpaid for a period of two months after demand in writing.

13 (7) The High Court may confer on a receiver appointed under subsection (5) any powers which the local authority has in relation to—

(a) collecting, receiving or recovering the revenues of the local authority,

(b) issuing levies or precepts, or

(c) setting, collecting or recovering council tax.

2.4 The above protections would enable the recovery of any outstanding debt with a local authority.

2.5 In addition, the CIPFA Code of Practice on Local Authority Accounting also makes clear that a local authority is not expected to default, so you make no 'Expected Credit Loss' in your accounts on any investment made with another local authority.

2.6 The maintenance of the 'Watch List' of local authorities where public announcements of financial difficulties have been made is a valid internal measure to put in place as a means of managing reputational risk. However, even where we have loaned money to local authorities that subsequently present with financial issues, there is no tangible financial risk to the Council.

Treasury Management

2.7 The level of cash balances that the Council currently holds is largely because of the healthy level of reserves that the Council has set aside. This has enabled the Council to undertake internal borrowing rather than having to borrow and incur additional revenue borrowing costs, however the level of cash balances the Council currently has is approximately £220m. The Council's Treasury Management Strategy sets out the parameters within which it can loan money to generate revenue income from interest received. The Council can loan up to £10m for up to 5 years with a single local authority, up to a maximum limit of £150m with local authorities at any one time.

2.8 Although the commercial market is improving with recent interest rate rises, the opportunities are intermittent and sometimes the counterparties do not conform to our Treasury Management Strategy in terms of loan amount being sought or duration required. The Treasury team use a mixture of Money Market Funds, Commercial Bank and Building Societies as well as local authorities to place its cash to maximise returns without risking the loan value given. There are sometimes good deals available with other local authorities, which would be better than interest that could be gained through the government Debt Management Office (DMO).

Local Authorities Lending

2.9 The advice from Link, the Council's treasury management advisers, is not to exclude local authorities from our lending list as they are the safest counterparties and using other counterparties increases credit risk. Although there is no specific security against a loan, the statutory protections described at 2.1-2.3 provide for the ability to place a charge against a local authority's future revenues. This has never had to be tested, as historically no local authority has ever defaulted on a loan.

2.10 Despite this, the Treasury Management Strategy, that was agreed at Council in February, recognised that there were a number of local authorities that were issuing s114 notices or requesting capitalisation directives due to financial pressures being experienced and therefore the following section was added to the Treasury Management Strategy:

Other Local Authorities

The Council will invest with other local authorities. However, where a local authority has issued a section 114 notice or has been granted permissions to use capital to help with their revenue budgets the investment can only be placed with the prior approval of the Service Director – Corporate Finance and Section 151 Officer in consultation with the Cabinet Member for Finance, Resources, Property and Assets. If a local authority that the Council has invested in subsequently issues a section 114 or is given a capitalisation directive, then this will be reported to the Audit and Governance Committee at the earliest opportunity.

2.11 There was a recent LGC article published on 16th September 2022, about the scale of borrowing by Thurrock from other local authorities. Buckinghamshire Council was one of a large number of authorities named, due to a £10m 1 year loan given to Thurrock Council in January 2022. Although there is no section 114 notice or capitalisation directive, in September 2022 the government announced that it was appointing Essex County Council as commissioners to oversee Thurrock's finance and governance functions. The existing Treasury Management Strategy makes no formal requirement to report this loan to Regulatory and Audit, as there is no s114 notice or capitalisation directive in place, however this needs to be reviewed considering the potential reputational risk that such a loan poses to the Council.

2.12 The Interim s151 Officer of Thurrock Council has subsequently written to the Leader of Council to give assurance that the £10m will be repaid on 6th January 2023 as they have agreed a refinancing packing of their short-term loans through the PWLB with the Department for Levelling Up, Housing and Communities and the Treasury.

2.13 Although the formal strategy states that the Council should not loan to Councils with a section 114 notice or capitalisation directive in place, the Treasury Management watch list includes those authorities that have requested capitalisation directives or where commissioners have been appointed regardless of any formal notices or directives.

2.14 In the current macroeconomic context and the known pressures on local authority finances, there is a realistic probability that more councils will find themselves in an adverse funding scenario and that this could emerge without any notice.

2.15 It is being recommended that before any local authority loan is made, a thorough due diligence review is undertaken to ensure that there are no financial issues that have been raised regarding that local authority. In year budget pressures and Medium-Term Financial Planning funding gaps are commonplace in many local authorities and are regularly reported, but this does not necessarily mean there is any risk in making loans to those Councils. Therefore, following that review, a loan will only be placed with another local authority once it has been signed off by the s151 Officer, the Chief Executive and the Leader of the Council.

2.16 The Council had made a £10m loan to Spelthorne BC on 13th January 2022. This loan was repaid on 14th November 2022. Again, although there is no s114 notice or capitalisation directive in place or requested, Spelthorne has featured prominently in the press due to the significant level of investments it has made in Commercial Property. Under the new proposal this loan could not be made without getting s151 Officer, Chief Executive and Leader of the Council sign off first.

3. Other options considered

3.1 An analysis of a local authority's balance sheets and CIPFA data could be undertaken before a loan is issued. However, this analysis would only be backward looking and couldn't be future proofed. It would also be highly resource intensive and couldn't be carried out in sufficient time given that there is often a short window of opportunity to accept any deal and there wouldn't be sufficient time to undertake the analysis on a case-by-case basis.

4. Legal and financial implications

4.1 The statutory underwrite under the Local Government Act 2003 is explained in the report, which protects any loan made to another local authority.

5. Corporate implications

5.1 There are no other significant corporate implications not already covered in the report.

6. Next steps and review

6.1 The Treasury Management Strategy 2023/24 will be updated to reflect the actions from the 27th September 2022 Audit & Governance Committee meeting before coming to the 1st February 2023 Audit & Governance Committee for review.

7. Background papers

Treasury Management Strategy 2022/23