Regeneration and Transport Board **Item 3**
26 March 2009

Local Authority Mutual Fund

Summary

This paper gives details of the work the LGA has done so far to support councils that have explored collaboration in treasury management or the provision of various forms of banking support to their local communities.

Recommendations

This paper is primarily for information. The Board may wish to give a steer on future LGA work in this area.

Action

Work will be taken forward in accordance with the general direction set by the LGA Executive, as noted in paragraph 6.

Contact Officer: Stephen Jones
Phone No: 0207 664 3171
Email: stephen.jones@lga.gov.uk

Background

1. Councils hold considerable amounts of cash in short-term investments. The latest data published by CIPFA showed England and Wales local authority current investments of £25.9bn at 31 March 2007. The majority of this was cash deposited with banks (£15.8bn) and building societies (£7.1bn).

2. Councils' external debt was £53.1bn of which the majority (£40.3bn) was long-term borrowing from the Public Works Loans Board.

3. Councils are free to borrow to fund investment, subject to the prudential code. In practice the key issue can often be not whether councils have the headroom to take out borrowing but whether they can afford the additional interest on the borrowing, which is often not supported by increased government grant.

4. With the substantial falls in interest rates, the collapse of the Icelandic banks and the wider failings in the banking system, councils are looking again at how they use their cash. Questions that are being asked include:
   - Can we make our treasury management more profitable by joining forces with other councils?
   - Could we form a mutual fund to use our own money to support capital investment?
   - Could we support individuals by offering mortgages, or operating mortgage rescue schemes?
   - Could we sponsor new local banks to offer loans and asset-based finance to local businesses?

5. In order to discuss these issues, the LGA convened a round table at the end of January. This was supported by experts from 4ps, Partnerships (UK) and a bank. Members from all the political groups attended. We have also been briefed on work being done by some councils to look at collaboration in treasury management functions. Discussions with the British Bankers' Association, with the New Local Government network on their idea for a local authority mutual fund and with a number of local authority senior finance staff have also improved our understanding of what might be possible.

6. These discussions were reported to the LGA Executive's February meeting at which the Executive agreed to:
   - continue to support councils' own research into these areas by facilitating contact with experts in the banking sector, and with government;
   - work with banks and other institutions prepared to assist the understanding and development of viable propositions in this area that councils may wish to consider;
   - draw out what has been learned, for the benefit of councils generally; and
   - discuss with Government, on the basis of the evidence and learning assembled, what changes to the present arrangements should be made to

improve the working of local economies and enable councils to deliver better value from their financial strength – this may include both detailed technical changes to regulations, and wider issues such as clarity that what councils or groups of councils propose to do is within the scope of the relevant statutory powers

7. Progress since then has included further discussions with financial institutions and with councils that are interested in taking these ideas forward. In relation to work on combined treasury management, a number of councils are pursuing work on the feasibility of collaboration. Going more widely into exploiting opportunities to use councils' funds to invest in infrastructure or support other finance streams such as PFI, a couple of key points have emerged. First, councils' ability to borrow via the Public Works Loan Board gives an ability to access loan finance at competitive rates, and therefore funding is not of itself an issue: the issue is whether the interest can be financed. Secondly, councils generally hold cash on a relatively short term basis and any investment vehicle that held funds collectively but invested long-term would need to be sufficiently liquid to meet calls for repayment of money to the councils that funded it.

8. Nevertheless, a number of councils are now at well advanced stages of introducing various innovative schemes to assist local businesses or residents by supporting lending. On business lending, we are aware that Birmingham City Council and Essex County Council will soon be launching schemes that will support lending to businesses, with the council partnering with a bank or other financial institution to back loans that would not have been made without the council's support. The councils concerned are taking all necessary steps to ensure that the risks involved with this kind of lending are properly managed. It appears that legal issues such as State Aid, and whether the council has the power to act in the desired way are soluble, and in each case the council's intervention is likely to bring significant benefits for businesses in the locality that are currently finding it difficult to raise finance. There will also be benefits for local employment. In addition, benefits are expected from the council's intervention in building stronger relationships than currently exist between the partner bank and its business customers. In each case it is the financial institution, and not the council, that has the lending relationship with the business. The council's investment supports the lending but does not encourage or subsidise imprudent lending, or absolve the lender of risk.

9. Birmingham City Council is also expecting shortly to introduce a scheme that would support a partner financial institution in offering mortgages to purchasers who would not be able to access the financial institution's standard mortgage product because of its requirement for a high deposit. Subject to conditions, for example on the size of the loan, the council would support the offer of higher loan to value mortgage that will be branded to reflect its involvement. Such arrangements have the potential to be extremely valuable in supporting local housing markets and the wider local economy: they depend on the council's preparedness to make an investment to back the scheme and clarity on how risks

are managed.

10. These innovations are being discussed with Government and representations are being made for various technical changes to regulations that will help the schemes to work more effectively.

11. The LGA is exploring whether, to communicate the learning from these ventures, a suitable conference or workshop could be scheduled.

Financial Implications

12. This work is being done within existing budgets

Implications for Wales

None specific.

Contact Officer: Stephen Jones
Phone No: 0207 664 3171
Email: stephen.jones@lga.gov.uk