

REPORT TO CABINET

Title: **RBWM TREASURY MANAGEMENT – ADDITION OF BUILDING SOCIETIES TO APPROVED LENDING LIST**

Date: 22 January 2009

Member Reporting: Councillor Hilton

Contact Officer(s): Andrew Brooker, Head of Finance, 01628 796341

Wards affected: none specifically

1. SUMMARY

- 1.1.1 It is recommended that the remaining fourteen of the top fifteen building societies be added to our list of approved counter-parties, each with a lending limit of £5m.
- 1.1.2 The advantage of having additional building societies on our lending list is that these counter-parties pay better rates than either local authority counter-parties or our call account, where, in accordance with CIPFA guidelines, most of our surplus funds would be deposited
- 1.1.3 By adding these building societies to our list of approved counter-parties we would be able to maintain the potential amount that can be lent out without increasing the level of risk that funds would not be repaid. The building society sector as a whole is as safe, thanks to the availability of government support, as the major UK Banks and the Nationwide, all of which are currently on our list of approved counter-parties.

2. RECOMMENDATION: That:

The number of approved counter-parties that the Royal Borough may lend to be increased, in order to maximise returns achieved on its surplus cash whilst maintaining a low level of risk, as required by the authority's Treasury Management Policy Statement. List at Appendix B identifies Building Societies to be included on new list with immediate effect.

What will be different for residents as a result of this decision?
Residents can be assured that the Council continues to invest its cash reserves cautiously whilst aiming to maximise returns where appropriate.

3. SUPPORTING INFORMATION

3.1 Background

- 3.1.1 In order to manage its cash flow requirements it has always been this authority's policy to lend out surplus funds for fixed periods to approved counter-parties. Suitable counter-parties are chosen in accordance with the Treasury Management Policy Statement. They must meet certain lending criteria, as measured by the

FITCH Credit rating agency, relating to their creditworthiness.

- 3.1.2 In light of the recent liquidity problems within the financial sector it was agreed by cabinet that the list of approved counter-parties be drastically reduced to include only those UK banks and building societies that are covered by the package of financial support offered by the UK government. The list also includes other local authorities (see Appendix A).
- 3.1.3 At the same time it was agreed that the maximum amount that could be lent to any one of these institutions be increased from £5m to £15m for banks and building societies, whilst the maximum amount that could be lent to other local authorities was raised from £3m to £5m.
- 3.1.4 The reasoning behind the change was to reduce the risk of a counter-party defaulting on a fixed term loan, as has happened to those local authorities who had lent funds to certain Icelandic banks. The repayment of funds lent to any of our counter-parties is now ensured, as they are all supported, if required, by the UK government. By increasing the maximum amount that can be lent to any of these counter-parties the authority has maintained the headroom that it previously had, compensating for the loss of names on the list of approved counter-parties.
- 3.1.5 However, CIPFA guidelines for treasury management recommend that no more than 10% of the total loan portfolio be lent out to any one counter-party. As this authority's loan book has averaged £54m for this financial year to the end of November 2008, the maximum amount that could be placed with any one of the counter-parties on our list is £5.4m, which for bank and building society counter-parties is far less than the maximum lending amount as approved by cabinet.
- 3.1.6 Conforming to these CIPFA guidelines would severely restrict the amount that could be lent to those counter-parties from the bank and building society sectors. This will mean that more money will either have to be lent to other local authorities, who pay lower rates than the banks and building societies, or more of the authority's funds will have to be placed onto our call account, which to reflect the fact that it allows us instant access to our funds yields a much lower rate of return than can be achieved by lending funds out for fixed periods.
- 3.1.7 The solution to this problem is to increase the number of potential counter-parties on the authority's lending list whilst at the same time minimising the level of risk involved in lending to these newly appointed counter-parties. It is proposed that this could be achieved by increasing the number of building societies on the list of approved counter-parties from the current total of one (the Nationwide) to fifteen. This could be achieved by reinstating onto the list of approved counter-parties the remaining fourteen of the top fifteen Building Societies as measured by assets under management.
- 3.1.8 An imposed lending limit of £5m for each of these newly approved counter-parties would more than compensate for the loss of lending capacity to the existing list of counter-parties caused by adherence to CIPFA guidelines.
- 3.1.9 Risk would not be increased, as since 8th October 2008 all UK building societies have been eligible for the government's package of financial support, which in effect

makes them as safe as both the major UK banks and the Nationwide, all of whom are approved counter-parties and all of whom are underwritten by this same government guarantee.

- 3.1.10 As of the late November 2008 the FSA declared that the building society sector was adequately capitalised and that no building society was in need of a cash injection from the taxpayer. This reflects the fact that the FSA is satisfied that the building society sector is in a robust position, with societies being subject to the same stress testing on core tier one capital ratios as banks. Where any society was deemed to fall short, the FSA has orchestrated takeovers and capital raisings. Four societies have merged with larger rivals this year – Barnsley, Cheshire, Derbyshire and Scarborough – whilst Nationwide has raised £500m.
- 3.1.11 Building societies have been less exposed to the same problems as banks because, as smaller, more specialist institutions, the regulator requires them to operate with more cautious capital structures. They are also legally restricted from using the wholesale money markets to the same degree as banks. According to the Building Societies Association (BSA), total investments made by building societies in Icelandic banks is less than £200m, the equivalent of .05% of total building society assets.
- 3.1.12 Appendix A shows our current lending list, along with lending limits.
- 3.1.13 Appendix B shows the top fifteen UK building societies, including Nationwide, ranked by assets under management.

4. OPTIONS AVAILABLE AND RISK ASSESSMENT

4.1 Options

	Option	Comments	Financial Implications
1.	Maintain existing list	Cautious option that would lead to large amounts of cash on call (with a single body) failing to optimise returns. The difference between call and one year rates can be as much as 1%.	Revenue - £25m on call potentially losing the Council £250k p.a. in interest. Capital
2.	Agree new list	Safe option that should provide better return on cash invested.	Revenue Capital

4.2 Risk assessment

- 4.2.1 A cautious “better to have money returned than earn a return” approach has been adopted over the last few months. This approach still applies but now that it is clear that the Building Societies can apply for Government support in the unlikely event that they need it the proposed extended list reduces risk by placing money with a wider spread of “safe institutions”.

5. CONSULTATIONS CARRIED OUT

- 5.1.1 No specific consultation, although an external review of our overall Treasury Management Policy has been commissioned.

6. COMMENTS FROM THE OVERVIEW AND SCRUTINY PANEL

- 6.1.1 The Chairman and the Vice-Chairman of the Corporate Services Overview and Scrutiny Panel have been consulted and it is considered that Panel's conclusion last time made it clear that in the current circumstances Cabinet should be paying close attention to the deposit decisions made within the £5m per depository. However, it has been suggested that it may be helpful for Cabinet to be reminded of the Panel's desire for them to pay regular and close attention to all deposits.

7. IMPLICATIONS

- 7.1.1 The following implications have been addressed where indicated below.

Financial	Legal	Human Rights Act	Planning	Sustainable Development	Diversity & Equality
✓	✓	N/A	N/A	N/A	N/A

Background Papers: None