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Contact Jon Brown

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Dear Aidan

Weymouth and Portland Borough Council: Objection to the accounts for the year ended 31 March 2017 relating to LOBO loans

Further to the completion of our work regarding the above objection, I said I would try and summarise the objection and process in order for you to report to 'those charged with governance', i.e. the Audit Committee.

I have set out a brief summary in appendix 1 and 2.

Yours sincerely

Jonathan Brown
Partner

Appendix 1: Summary of objection and conclusion

Weymouth and Portland Borough Council: Objection to the accounts for the year ended 31 March 2017 relating to LOBO loans

The objection

An objection to the accounts for the year ended 31 March 2017 was made by a Local Government elector (LGE) in 9 August 2017 relating to Lender Option Borrower Option ("LOBO") loans taken out by Weymouth and Portland Borough Council (the "Council") with a total value of £27 million¹. The objection specifically asked the auditor to issue a public interest report in relation to the LOBO loans taken out by the Council.

Having reviewed the history of the Council's LOBO loans, the auditor identified that the three original LOBO loans were taken out separately during 2002 and 2003. All three of the LOBO loans were rescheduled in 2006.

Summary of auditor's decision

Decision not to issue a public interest report

The auditor decided not to issue a public interest report on the grounds that he was satisfied that the LOBO loans in question were entered into appropriately and reasonably and:

- that the Council had the statutory power to borrow for the permitted purposes, these powers being so widely drawn that the borrowing by the Council by way of LOBO loans is likely to be lawful and reasonable;
- that the Council took into account all relevant factors including the relevant guidance set out in this decision letter; and
- there is nothing to indicate any lack of prudence in the Council's actions in entering into the LOBO loans at the time.

Legal background and relevant guidance

Whilst the powers to borrow are widely drawn, to be lawful any borrowing must nonetheless comply with certain limitations; only be undertaken having had regard to certain matters; be such that a reasonable authority could undertake in the circumstances at the time; and be properly authorised.

These requirements / limitations are guided by two Codes that have been developed by the Chartered Institute of Public Finance and Accountancy (CIPFA) to assist authorities in their decision making, including when they are undertaking borrowing.

- *The Prudential Code for Capital Finance in Local Authorities* (the Prudential Code) is a professional code of practice to support local authorities in taking decisions on capital investments, which the Council is required to have regard to.

¹ The key details for the loans and the effect of the rescheduling are summarised in appendix 2.

- In carrying out its functions with respect to borrowing, a local authority is required to have regard to CIPFA's code of practice contained in *Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes* (as amended or reissued from time to time) (the "TM Code"). The TM Code states that the local authority should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.

Approach and consideration of lawfulness of LOBO loans

Given the age of the loans (and the normal deletion policies of local authorities), it was unsurprising that there was limited contemporaneous documentation available setting out the Council's decision making and what was taken into account. As a result, the auditor's approach has been guided by the following.

The auditor considered first whether, on the basis of the information that had been located by the Council, what was known about the prevailing financial and economic circumstances, both nationally and at the Council at the time and taking into account the applicable statutory and Council financial guidance, there was anything to indicate that entering into a long term loan on the LOBO terms would be considered irrational or in some other way outside the Council's powers.

The auditor's view, following detailed consideration and legal advice, is that LOBO loans are not inherently unlawful and borrowing by a local authority under a LOBO loan is capable of being lawful provided the local authority has taken a rational approach in making a decision about any borrowing.

In terms of assessing whether the Council has taken a rational approach in deciding to enter into LOBO loans the auditor needed to consider the circumstances of each case. In particular any borrowing must:

- comply with relevant requirements and guidance;
- be such that a reasonable authority could undertake in the circumstances; and
- be properly authorised.

The Council's Treasury Management reporting was clear that each of the initial LOBO loans (i.e. those commencing in 2002 and 2003) was taken out as part of restructuring its loan portfolio through the redemption of existing Public Works Loans Board loans. The aim of restructuring the LOBO loans in 2006 was to produce revenue savings for the Council (in exchange for the length of the LOBO loans being extended).

The Council's reporting at the time refers to advice being sought from the Council's dedicated Treasury Management Advisor, although details of what advice was sought and obtained specifically relating to LOBO loans is not specified and the evidence is no longer available.

Whilst the lack of contemporaneous documentation is regrettable, the auditor's view was that, on balance, he had sufficient information available from the material

documents; discussions with current Council officers; and formal Council / Committee reporting to enable him to form a judgement on the objection.

Summary of considerations

The auditor considered what would be the relevant factors that would demonstrate whether the Council had entered into LOBO loans rationally and therefore lawfully. These included consideration of the CIPFA Codes referred to above, whether the Council has taken into account all relevant matters, left out of account irrelevant matters and whether the Council had acted reasonably.

Having considered the information available in relation to the relevant factors and the Council's approach, actions and decision making, the auditor did not identify any fundamental departures or significant issues that would, in his view, impact on the lawfulness of the LOBO loans. The auditor's view, based on the information available, that the Council had taken a rational approach in deciding to enter into the LOBO loans (and to undertake the subsequent restructuring) referred to in the objection.

In some areas the documentation was not comprehensive. However, the Council had reported annually its Treasury Management Strategy; Prudential Indicators; and Treasury Management Out-turn which set out compliance with the Prudential Code and Guidance Notes for the earlier financial years and TM Code and Guidance Notes in the later financial years.

There is nothing to indicate that the approach taken by Council officers and the formal reporting to Members was inconsistent with what the auditor would expect to see for a local authority when making its Treasury Management decisions.

The auditor's understanding is that in these circumstances, the Council was and continued to be entitled to proceed on the basis that the loans were entered into lawfully despite the limited contemporaneous documentation evidencing the process and decision making.

Appendix 2: Details of the Council's LOBO loans

Below is a summary of the terms of the three LOBO loans that the Council has taken out (including rescheduling), which were considered in terms of the objection.

Initial loans

The original loans were taken out in 2002 and 2003 and in summary their terms were:

- LOBO loan taken out from 4 July 2002 with Barclays Bank plc for £10 million. There was an initial fixed period of 18 months with a low initial interest rate of 2.2%, so the lender was not able to exercise their option until 2 January 2004. The interest rate from 2 January 2004 was 5%. The lender is able to exercise their option every 6 months from 2 January 2004. The loan was for 40 years, with a scheduled end date of 2 July 2042.²
- LOBO loan taken out from 5 December 2002 with Bayerische Landesbank/Dresdner for £11 million. Initial fixed period of 16 months with a low initial interest rate of 1.8%, so the lender was not able to exercise their option until 6 April 2004. Interest rate from 6 April 2004 was 4.8%. The lender is able to exercise their option every 6 months from 6 April 2004. The loan was for 40 years, with a scheduled end date of 5 December 2042.
- LOBO loan taken out from 27 May 2003 with Dresdner Kleinwort for £6 million. There was an initial fixed period of 1 year with a zero rate initial interest rate, so the lender was not able to exercise their option until 27 May 2004. The interest rate from 27 May 2004 was 4.40%. The lender is able to exercise their option every 6 months from 27 May 2004. The loan was for 40 years, with a scheduled end date of 27 May 2043.

Rescheduled loans

The Council completed a rescheduling exercise in November 2006. This involved all three of the LOBO loans and the following is a summary of the changes made:

- LOBO Loan with Barclays Bank plc for £10 million. The new interest rate was 4.79% (previously 5.00%). The lender remains able to exercise their option every 6 months from 14 May 2007. The length of the loan was extended to 2076.
- LOBO loan with Bayerische Landesbank for £11 million. The new interest rate was 4.59% (previously 4.80%). The lender remains able to exercise their option every 6 months from 14 May 2007. The length of the loan was extended to 2076.³

² In 2016, Barclays unilaterally decided to amend all of its LOBO loans with local authorities to fixed interest rate loans, by permanently waiving its 'lender option' to amend the interest rate at given periods.

³ The LOBO loan was moved to KBC Bank on 8 May 2007, but the terms were unchanged, so this is not considered to be a new or rescheduled LOBO loan in 2007.

- Loan with Dresdner Bank for £6 million. The new interest rate was 4.22% (previously 4.40%). The lender remains able to exercise their option every 6 months from 27 May 2007. The length of the loan was extended to 2066.

The terms of the LOBO loan agreements are similar with regards to the 'option' available to the banks such that every 6 months the bank may exercise its option to increase the interest rate of the LOBO loan. Once the option has been exercised by the bank, the Council can:

- accept the increase (and pay the new increased interest rate for the remaining LOBO loan period, or until the bank exercises its option again); or
- not accept the increase and repay the LOBO loan in full within a specified period (a minimum of two working days from receiving the notification to increase the interest rate).