

EXETER CITY COUNCIL

SCRUTINY COMMITTEE – RESOURCES 24 MARCH 2010

**EXECUTIVE
13 APRIL 2010**

ICELANDIC BANKS – FINANCIAL UPDATE

1. PURPOSE OF THE PAPER

- 1.1 To update Members on the latest financial position regarding the money deposited with the Icelandic banks and the implications that this has on the Council's overall revenue budget.

2. BACKGROUND

- 2.1 Members will recall that at the time of the collapse of the Icelandic banking system in October 2008, the Council had money on deposit with 2 of the banks directly affected. It had an investment of £3 million with Landsbanki on a short term deposit that was due to mature on 3 November 2008 and also another £2 million deposit with Glitnir Bank due to mature in early December 2008. Both of these investments were made about a year before the collapse and when the credit ratings of both banks were high. Once the full impact of the potential loss of Icelandic deposits was established, the Local Government Association (LGA) together with its legal advisers has been acting on behalf of all the affected local authorities seeking recovery of the deposited sums.
- 2.2 Up until very recently the LGA had advised that the eventual payout from both banks would be in the 80% to 100% range. Although this identified a potential loss regarding the Council's Icelandic investments, the Government had allowed all local authorities to relax normal accounting rules so that any potential loss could be deferred from 2008/09 and 2009/10 until future years. In October 2009 Communities and Local Government (CLG) announced that this deferral of normal accounting requirements would end after 2010/11 and therefore this would mean that the potential loss on investments would have to be reflected in the accounts for 2010/11. At the same time CLG also advised affected local authorities that applications could be made to capitalise the potential losses during the current (2009/10) financial year. Capitalisation would allow for the loss to be spread over a number of years rather than having being charged to the revenue account all in one go. The deadline for applications to capitalise expenditure was 15 December 2009.
- 2.3 On 7 December the Council applied for capitalisation of £332,000 in respect of a potential loss on our Landsbanki investment. At the time of this application we were still expecting to recover 100% of the £2 million that was held on deposit with Glitnir bank. This was based upon the most recent advice given by the LGA and their legal advisers. On 10 December we were advised that the Winding-Up Board of Glitnir had reversed their previous decision to grant preferential creditor status to UK local authorities. This came as a great surprise and disappointment to the LGA and everyone involved, particularly as this decision was contrary to an earlier decision made by the Winding-Up Board for Landsbanki where preferential status was confirmed for UK local authorities. However, the impact of this decision upon the Council was such that it was suddenly exposed to a potentially significant loss in respect of its Glitnir deposit. As a result, the Council submitted another application for capitalisation for an additional £1.5 million bringing our total claim to £1.832 million for potential losses. In conjunction with this claim, the Council also submitted a request to capitalise £500,000 of revenue expenditure in respect of potential statutory redundancy payments.

- 2.4 In order for CLG to grant approval for capitalisation they must be satisfied that each submission meets certain set criteria including the "exceptional financial difficulties test". At the time we made our submission we were and remain satisfied that we met all the criteria laid down by CLG. On 1 February 2010 the Council received a refusal letter from CLG in respect of our application to capitalise £1,832 million in respect of our potential Icelandic bank losses. It has also since become apparent that whilst some other local authorities have been successful with similar applications a significant number like us have been refused. We have not yet received any specific detail as to why we were unsuccessful with our submission. The Council was however successful in its request to capitalise statutory redundancy expenditure of £500,000.
- 2.5 The impact of the refusal by CLG upon the Council's revenue finances is severe. The Council is now faced with the likelihood of having to account for the potential loss of £1.832 million during the 2010/11 financial year. A medium term financial plan showing the full impact of the loss is shown in Appendix 1. This shows that based upon the Council's current budget proposals, the level of the general fund balance would reduce to £1 million at the end of 2010/11, and reduce even further in the subsequent two years. This is not a sustainable financial position for the Council and will therefore require robust action to ensure financial stability for the future. Over the medium term the level of the general fund balance will need to be reinstated to the minimum level of £2 million in accordance with the Council's current budget strategy.

3. THE NEXT STEPS

- 3.1 The Council strongly believes that the decision taken by CLG on this matter is unsound and that it has failed to appreciate the extreme financial hardship that will be caused by refusing this capitalisation request. Despite extensive lobbying by the Council it is now apparent that CLG is unwilling to reverse its original decision. The Council is however continuing to work with other interested parties in seeking a positive capitalisation decision from CLG. However ultimately, if the Council is unable to capitalise the Icelandic losses then it will have to have a financial strategy to restore financial stability as a matter of extreme urgency.
- 3.2 As indicated above, the medium term financial plan shows that the Council's balances will reduce to £1 million at the end of next year if no action is taken. Whilst in the short term the Council could function with this low level of balances, in the medium term it will be necessary to identify further one-off savings of £1.832 million in order to restore balances to the prudent level that is required. This will be in addition to the £1.741 million of base budget reductions that have yet to be identified after 2010/11. Having already struggled to identify cuts of £1 million for the 2010/11 budget it is unfortunately inevitable that the cuts and savings now required will have a huge impact upon services.

4. OPTIONS TO CLOSE THE FUNDING GAP

- 4.1 As indicated above, the Council was successful in being able to capitalise statutory redundancy payments made during 2009/10, up to a total limit of £500,000. It is therefore recommended that the Council utilises this capitalisation option to reduce revenue expenditure in 2009/10 by £500,000 and thus replenish the General Fund Balance. Similarly, the revenue budget for 2010/11 currently contains a budget provision of £500,000 towards the cost of potential redundancy payments. It is anticipated that the Council will again be able to seek approval from CLG to capitalise the redundancy payments for 2010/11. Both of these capitalisation measures would 'save' expenditure in the short term by spreading the cost of redundancy over a longer period of 'say' 5 years. The potential savings are indicated in the table below showing that the Council will 'save' £500,000 in 2009/10, £400,000 in 2010/11, but thereafter until 2015/16, there will be an additional cost to take into account.

	2009/10 £	2010/11 £	2011/12 £	2012/13 £	2013/14 £	2014/15 £	2015/16 £
Redundancy	500,000	500,000					
Capitalisation	0	100,000	200,000	200,000	200,000	200,000	100,000
Saving/(Loss)	500,000	400,000	(200,000)	(200,000)	(200,000)	(200,000)	(100,000)

- 4.2 A revised medium term financial plan that takes into account the use of capitalisation of redundancy is shown in Appendix 2. This indicates that the general fund balance would be £1.9 million by the end of 2010/11 but would fall well below the prudent level in the following 2 years. The Council will therefore need to consider further budgetary measures to restore balances to a more prudent level after 2010/11. It is therefore recommended that the Council capitalises all of its proposed statutory redundancy payments regardless of the eventual outcome of any final decision made regarding the capitalisation of Icelandic impairment losses.
- 4.3 The Council currently has a number of earmarked reserves that have been set aside for specific purposes. It is proposed that they are fully reviewed at end of the current financial year (2009/10) and any that are deemed to be no longer required will be transferred instead to the Council's general fund working balance.
- 4.4 The final measure to be considered will be to temporarily reduce or suspend spending of part of the Council's revenue budget. This could for example be a temporary suspension of part of the Asset Improvement and Maintenance (AIM) budget or the continuation of measures to review the appointment to vacant posts.

5. RECOMMENDATION

It is recommended that Members of Scrutiny Committee Resources note the report and that Executive approves that:

- 5.1 the Council capitalises its statutory redundancy payments for 2009/10 and 2010/11;
- 5.2 if a positive decision on capitalising the Icelandic impairment is not forthcoming then further measures to reduce the revenue budget outlined in this report are adopted.

HEAD OF TREASURY SERVICES

CORPORATE SERVICES DIRECTORATE

Local Government (Access to Information) Act 1985 (as amended)

Background papers used in compiling this report:

None