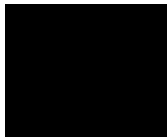


Private & confidential



Our ref

(sent by e-mail)

22 May 2018

Dear 

Sheffield City Council: Audit of accounts for the year ended 31 March 2017 – decision and statement of reasons

We are writing to advise you of our decision on your objection to the accounts of the Sheffield Council for the year ended 31 March 2017.

Your objection

Your objection is set out in your e-mail dated 24 July 2017 and relates to 19 Lender Option Borrower Option (“LOBO”) loans taken out by Sheffield City Council (the “Council”). It specifically asks us to:

- make an application to the Court for a declaration that the related items of account are contrary to law under section 28 of the Local Audit and Accountability Act 2014; and
- issue a public interest report under section 24 of the Local Audit and Accountability Act 2014.

Summary of Decision

Decision not to make an application to the court for a declaration that an item of account is contrary to law.

Section 28 of the Local Audit and Accountability Act 2014 gives auditors the discretion to decide whether or not to apply to the Court for an Order in relation to unlawful items of account. Based on the above considerations and assessments, we are satisfied that the LOBO loans in question were entered into lawfully such that there are no related items of account contrary to law. More specifically we find:

- that the Council had the statutory power to borrow for the permitted purposes, these being so widely drawn that the borrowing by the Council by way of the LOBO loans is likely to be lawful; and

- that the Council took into account all relevant factors including the relevant guidance set out above.
- Having completed our consideration of the information available in relation to the relevant factors (within the areas outlined above) and the Council's approach, actions and decision making, we have not identified any fundamental departures or significant issues that would, in our view, impact on the lawfulness of the LOBO loans. It is our view, based on the information available, that the Council has taken a rational approach in deciding to enter into the LOBO loans referred to in this objection.

As we have not identified any items of account contrary to law, the discretion whether or not to seek a declaration from the court under section 28 of the 2014 Act does not arise.

Decision not to issue a public interest report

We have also decided that we will not issue a public interest report. There is no statutory requirement to provide a reason for this decision, although my reasons are the same as for my decision above and that there is nothing to indicate any lack of prudence in the Council's actions in entering into the loans at the time.

Legal background and relevant guidance

The Council's current powers to borrow are set out in section 1 of the Local Government Finance Act 2003, which states:

- A local authority may borrow money:
 - (a) for any purpose relevant to its functions under any enactment, or
 - (b) for the purposes of the prudent management of its financial affairs.

However, 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) (as amended or re-issued from time to time) is a professional code of practice to support local authorities in taking decisions on capital investments. Key objectives of the Code are to ensure, within a clear framework, that local authorities' capital investment plans are affordable, prudent and sustainable; that treasury management decisions are taken in accordance with good professional practice; and that local strategic planning, asset management planning and proper option appraisal are supported. A local authority is required to determine and keep under review how

much money it can afford to borrow, having regard to the Prudential Code, and it may not borrow money if doing so would result in a breach of any limit it thus determines.

- In carrying out its functions with respect to borrowing, a local authority is also 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. These include suitable treasury management practices ("TMPs") setting out the manner in which the local authority will seek to achieve its policies and objectives and prescribing how it will manage and control those activities. The TM Code states that the content of the policy statement and the TMPs should follow the recommendations in the TM Code (unless the particular circumstances of the authority otherwise require).
- In terms of policy, the TM Code recognises that the priority is to manage and control risk effectively and that, while obtaining value for money is to be encouraged, that should only be within the context of effective risk management. The overriding aim is thus recommended to be the effective identification, monitoring and controlling of risk. As CIPFA's Guidance Notes for Local Authority Treasury Management state, local authorities are financially risk-averse and greatly value revenue budget stability: the volatility of variable interest rate loans can be a major risk to council tax levels, so that local authorities may well be prepared to pay (or accept the risk of) higher interest rates for the certainty of fixed rate loans.
- The TM Code is concerned *inter alia* with both interest rate risk (the risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden against which the local authority has failed to protect itself adequately) and refinancing risk (the risk that borrowing cannot be refinanced on terms that reflect the provisions made to do so or on terms inconsistent with prevailing market conditions at the time).

There are 18 of the Council's LOBO loans – as detailed below – which were taken out after this legislation was enacted. The other loan (agreement entered into before 1 April 2004) relate to periods that pre-date this legislation. This loan which pre dated the LGFA 2003 was bound by and complied with a legislative framework which was set out in the Local Government & Housing Act 1989. This legal framework stipulated that a Council could borrow money for any purpose relevant to their functions under any enactment. It also stipulated that a Local Authority may not, borrow from a lender outside of the UK. The pre 2004 LOBO was for £20m and was taken out with 'Dexia Public Credit - London Branch', which is registered in England and Wales and therefore this criteria was met.

Details of the Council's LOBO loans

We have set out below a summary of the terms of the 19 LOBO loans that the Council has taken out, which we have considered in terms of your objection:

- LOBO loan taken out with Dexia Credit Local, agreement dated 5 December 2003 (and drawn down on 5 December 2003). The value of the loan is £20m. The interest rate was 3.99% and had a fixed period of 5.5 years, such that the lender was unable to exercise their option until 5 June 2009. The lender is able to exercise their option every 6 months after 5 June 2009. The length of the loan is for 45 years;
- LOBO loan taken out with Barclays Bank, agreement dated 7 April 2004 (and drawn down on 22 April 2004). The value of the loan is £30m. The interest rate was 3.85% and had a fixed period of 6.8 years, such that the lender was unable to exercise their option until 22 February 2011. The lender is able to exercise their option every 6 months after 22 February 2011. The length of the loan is for 49.9 years;
- LOBO loan taken out with Dexia Credit Local, agreement dated 7 April 2004 (and drawn down on 27 April 2004). The value of the loan is £20.5m. The interest rate was 3.29% and had a fixed period of 4.8 years, such that the lender was unable to exercise their option until 27 February 2009. The lender is able to exercise their option every 6 months after 27 February 2009. The length of the loan is for 49.9 years;
- LOBO loan taken out with FMS Wert management, agreement dated 8 April 2004 (and drawn down on 26 April 2004). The value of the loan is £17m. The interest rate was 2.85% and had a fixed period of 3.8 years, such that the lender was unable to exercise their option until 26 February 2008. The lender is able to exercise their option every 6 months after 26 February 2008. The length of the loan is for 50 years;
- LOBO loan taken out with Barclays Bank, agreement dated 5 September 2005 (and drawn down on 6 October 2005). The value of the loan is £20m. The interest rate was 4.13%. The lender is unable to exercise their option every 6 months until 8 April 2024. The length of the loan is for 60 years;
- LOBO loan taken out with Barclays Bank, agreement dated 22 November 2005 (and drawn down on 22 March 2006). The value of the loan is £30m. The interest rate was 3.96%. The lender is unable to exercise their option every 6 months until 24 April 2023. The length of the loan is for 60 years;
- LOBO loan taken out with Barclays Bank, agreement dated 28 September 2006 (and drawn down on 23 October 2006). The value of the loan is £15m. The interest rate was 3.9%. The lender is unable to exercise their option every 6 months until 24 January 2022. The length of the loan is for 60 years;
- LOBO loan taken out with Dexia Credit Local, agreement dated 8 November 2006 (and drawn down on 30 November 2006). The value of the loan is £15m. The

interest rate was 3.78%. The lender is unable to exercise their option every 6 months until 4 April 2022. The length of the loan is for 69.9 years;

- LOBO loan taken out with Dexia Credit Local, agreement dated 10 November 2006 (and drawn down on 7 December 2006). The value of the loan is £20m. The interest rate was 3.83%. The lender is unable to exercise their option every 6 months until 9 June 2025. The length of the loan is for 70 years;
- LOBO loan taken out with Barclays Bank, agreement dated 22 January 2007 (and drawn down on 23 January 2007). The value of the loan is £10m. The interest rate was 4.65%. The lender is unable to exercise their option every 6 months until 24 January 2011. The length of the loan is for 70 years;
- LOBO loan taken out with Barclays Bank, agreement dated 22 January 2007 (and drawn down on 29 January 2007). The value of the loan is £8m. The interest rate was 4.65%. The lender is able to exercise their option every 6 months after 31 January 2011. The length of the loan is for 70 years;
- LOBO loan taken out with FMS Wert management, agreement dated 25 January 2007 (and drawn down on 29 January 2007). The value of the loan is £10m. The interest rate was 4.64%. The lender is able to exercise their option every 6 months after 28 January 2011. The length of the loan is for 70 years;
- LOBO loan taken out with Euro hypo SA, agreement dated 11 June 2007 (and drawn down on 11 June 2007). The value of the loan is £18m. The interest rate was 4.80%. The lender is able to exercise their option every 6 months after 28 January 2011. The length of the loan is for 70 years;
- LOBO loan taken out with Dexia Credit Local, agreement dated 26 June 2007 (and drawn down on 4 July 2007). The value of the loan is £10m. The interest rate was 4.64%. The lender is unable to exercise their option every 6 months until 6 July 2020. The length of the loan is for 70 years;
- LOBO loan taken out with FMS Wert management, agreement dated 6 June 2008 (and drawn down on 12 June 2008). The value of the loan is £14.5m. The interest rate was 4.69%. The lender is able to exercise their option every 6 months after 12 June 2008. The length of the loan is for 70 years;
- LOBO loan taken out with Dexia Credit Local, agreement dated 16 September 2008 (and drawn down on 30 September 2008). The value of the loan is £10m. The interest rate was 4%. The lender is able to exercise their option every 6 months after 30 September 2010. The length of the loan is for 50 years;
- LOBO loan taken out with Royal Bank of Scotland, agreement dated 17 February 2009 (and drawn down on 19 March 2009). The value of the loan is £20m. The interest rate was 2.75%. The lender is able to exercise their option annually after 19 March 2012. The length of the loan is for 50.5 years;

- LOBO loan taken out with BAE Systems 2000 Pension Plan Trustees Ltd, agreement dated 14 July 2011 (and drawn down on 1 December 2011). The value of the loan is £7m. The interest rate was 4.15%. The lender is unable to exercise their option monthly until 1 December 2021. The length of the loan is for 35 years; and
- LOBO loan taken out with BAE Systems Pension Funds CIF Trustees Ltd, agreement dated 14 July 2011 (and drawn down on 1 December 2011). The value of the loan is £18m. The interest rate was 4.15%. The lender is unable to exercise their option monthly until 1 December 2021. The length of the loan is for 35 years

The terms of the LOBO loan agreements are similar with regards to the ‘option’ available to the banks, such that on specified dates 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 then:

- 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).

Work carried out

In terms of your objection, whether specifically referred to in this letter or not, we have considered the written submissions of both you and the Council, reviewed documentation provided by the Council and, where appropriate, sought legal advice.

We issued a provision view letter to you and the Council on the 26 March 2018 and have received no representations from either party.

An index to the material documents considered is at Attachment 1.

Approach

Given the age of the loans, it is unsurprising that there is some contemporaneous documentation not available setting out the Council's decision making and what was taken into account. As a result, our approach has been guided by the following.

We have considered first whether there is 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. In considering this we have considered:

- the information that is available, including all bond certificates and council financial outturn reports;
- what is known about the prevailing financial and economic circumstances, both nationally and at the Council at the time; and
- the applicable statutory and Council financial guidance.

As will be apparent from the consideration below, our decision is that there is nothing which indicates that to be the case. Our understanding is that in these circumstances, the Council is entitled to proceed on the basis that the loans were entered into lawfully despite the lack of detailed contemporaneous minuted documentation evidencing the Council's decision making process.

Consideration of lawfulness of LOBO loans: general

We consider that local authorities have the power to borrow and that the permitted purposes (under which borrowing can be undertaken) are widely drawn.

Our decision, following detailed consideration and legal advice, 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 to deciding to enter into the LOBO loans we have considered the particular 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.

We have therefore considered what, in our view, are the relevant factors that would demonstrate whether the Council has entered into the LOBO loans rationally and therefore lawfully. These include consideration of the CIPFA Codes referred to in the 'legal background and relevant guidance' section above, whether the Council has taken into account all relevant matters, left out of account irrelevant matters and also whether the Council has acted reasonably¹.

Despite the passing of time there is only one LOBO where the signed LOBO bond agreement could not be located, all documentation for others was provided by the Council.

¹ In assessing whether the actions of an authority have been unreasonable, the term 'unreasonable' has a special meaning in law. An authority acts 'unreasonably' or 'irrationally' when its actions are so unreasonable that no reasonable person could have made that decision. This is known as the 'Wednesbury unreasonableness principle' (*Associated Provincial Picture Houses Ltd. v Wednesbury Corporation* [1948]). In that case, the court held that it could not intervene to overturn the decision of the defendant simply because the court disagreed with it. Where Parliament has given local authorities a discretion as to their decisions/actions, that discretion may be exercised in different ways according to honestly and reasonably held opinion. It is not the court's job to substitute its own opinion for that of the local authority. This principle applies equally to auditors who are fulfilling their public audit responsibilities.

Our view is that we have sufficient information available from the material documents; discussions with current Council officers (note: that within our provisional view within the work carried out section we enabled both the Council and elector to raise any points regarding this and none were raised); and formal Council / Committee reporting to enable us to form a judgement as regards the objection.

Compliance with relevant requirements and guidance

The Council's Constitution at the relevant times has set out the framework for treasury management, incorporating the Council's borrowing. With regard to this, the Constitution states that the Council has adopted the CIPFA Code of Practice for Treasury Management in the Public Services. Full Council agrees the Treasury Management policy and objectives, and is responsible for setting out how the policies and objectives will be achieved. The treasury management strategy states that it has had regard to and is in accordance with the Prudential Code as required. The Council's Cabinet is responsible for implementing and monitoring the treasury management policies, practices and performance. The Corporate Governance & Audit Committee is responsible for scrutinising the treasury management policies and practices.

Section 1 of the Local Government Finance Act 2003 (the 2003 Act) is wide ranging regarding borrowing as it refers to any purpose relevant to a local authority's functions or for the prudential management of its affairs. The papers that we have seen in our view clearly indicate that the Council's borrowing was for the purpose of financing its capital programme and, as such, we consider that the purpose is within the requirements of Section 1(b) of the 2003 Act.

The Council has asserted that all of its borrowing is currently within its approved borrowing limits and that the interest due is affordable now, and was at the time each of the loans were taken out. The Council has also noted that the starting rate and initial option interest rates for the majority of the LOBO loans were lower than Public Works Loans Board ("PWLB") 50 year rates at the date the Council entered into the loans. (We have set out our commentary on interest rates and projections for each loan below and in Attachment 2.)

The Council has also asserted that it complied and continues to comply with the Prudential Code and that the borrowing undertaken was to finance capital expenditure, as determined by reference to its Capital Financing Requirement. Further, the Council also notes that its Treasury Management Policies refer to the use of LOBO loans as approved instruments. Treasury Management Policies also include the roles and responsibilities of officers and reporting requirements and are approved by the Chief Finance Officer under the Constitution and delegated arrangements and are reported to Council (via the Corporate Governance & Audit Committee and Cabinet) for information. We are not challenged to disagree with these assertions.

We have noted that the annual Treasury Management strategy sets out the Council's consideration of what its boundaries are for borrowing. The strategy is monitored, plus

there is a mid-year review reported to Members as well as an annual out-turn report. The mid-year reviews and out-turn reports have not reported any breaches in respect of the indicators the Council has set.

Reasonableness having regard to the circumstances

It appears from the documents that we have seen that, when the loans were entered into, the Council's expectations were for long term interest rates to increase. We have set out our commentary on interest rates and projections below. The Council considered the LOBO loans against its 'normal' funding options i.e. PWLB interest rates.

It can be seen from some of the documentation that the Council was taking advice from its treasury advisors about the future projections for interest rates before entering into the loans, even though the evidence that still exists for this is incomplete. The Council also asserts that officers considered the Prudential Code and the Treasury Management Code requirements where applicable when discussing the borrowing proposal with treasury advisors, but also comments that some of these officers have left the Council.

The Council has also referred to the annual reporting that takes place with regard to the Treasury Management Code and the Prudential Code. All of the Council's reporting has stated that the Council has had regard to relevant matters/issues and that there have been no breaches reported.

Five of the nineteen LOBO loans taken out included a discounted starting rate of the loan which offered a reduction from the initial interest rate for a period of between 3 and 6.8 years. Thus we consider that, in the short to medium term, the Council was able to plan clearly what the revenue implications would be. After the initial period there is a risk that the Council would have faced a potentially unforeseen increase in interest rates and/or the need to borrow from PWLB at a rate that (at the time the loan was taken out) would be unknown, but would have been an option as the Council would – on the basis of the information provided – remain within its Prudential Code limits (as reported within the treasury management reports). The interest cost of the LOBO loans is covered within the Council's medium term financial plan. In four of the nineteen cases, the PWLB 50 year interest rate at the time the LOBO loan agreement was signed was lower than the starting rate of the Council's LOBO loan (the maximum difference was 0.4% lowering to 0.05) however all of these LOBO loans were taken out for a period of 70 years and therefore there was no PWLB option available over this term, hence it is inappropriate to compare the interest rates to those on offer through a 50 year PWLB.

There is a risk that the lender might request a rate increase on the loan, although the Council considered that the lender was unlikely to increase the interest rate to trigger the borrower option, with Bank of England interest rates now remaining very low. If a rate increase were to be requested, for example, due to increasing long term interest rates, the Council asserts that it would expect to fund the loan repayment (without penalty) by seeking alternative funding (probably through the PWLB).

The LOBO loan agreements are clear in terms of interest rates and dates on which the lender can exercise its option to change the applicable interest rate.

We have also noted that the Council did not expect to have to consider any breakage costs as it did not foresee any circumstances where a LOBO loan would need to be ended outside of the lender exercising its option to increase interest rates. This appears reasonable and in line with similar activity seen within the sector. From discussions with the Council they expected that should a lender exercise their option to increase interest rates then the Council would meet any repayment from internal resources or applying for a loan on terms deemed the best available and ensuring an appropriate fit with the Council's needs/interest rate projections and yield curve, hence appropriately managing any associated risk.

There is a further consideration here with reference to borrowing from the PWLB. Any decision to repay a PWLB loan early is not a 'free' decision. If a local authority were to decide to repay a PWLB loan early there is a formula to calculate whether any premium or discount is payable. Thus any local authority would only decide to repay a PWLB loan early where it has decided it was necessary for the appropriate management of its loan portfolio e.g. by reference to when future loans reach their maturity and, for example, ensuring that a disproportionate element do not mature in the same year.

We also note that the expectation of the TM Code (and associated CIPFA/Government commentary) is that local authorities borrow in relation to needs (either current needs or to meet future plans/strategies); or to ensure that the local authority's loans portfolio remains balanced and in accordance with the TM Code and prudential indicators. Thus there is an expectation that local authorities would borrow to either meet short-term cash flow needs (say overnight up to six months) or to match to capital projects/asset lives (generally these would be of a significant value and expected to be for the long term). We reviewed this and confirmed its lawfulness.

Therefore we would not normally expect a council to take out medium term loans (say 2 to 10 years) with no explicit reference/thought as to the projects/assets being considered or the timeline of its existing loan portfolio and/or when loan repayments/replacements would be needed. In other words local authorities would not normally be expected to be borrowing for periods of time that do not relate to their needs and not in compliance with the TM Code and other relevant requirements, including the Council's own Treasury Management Strategy.

The Council's available papers do not precisely detail the expenditure being funded. However, the majority of the Council's fixed asset additions were funded within the financial years when the LOBO loans were taken out and the Council state that the expenditure is funding these assets of a very long term nature. This is similar activity to what has been seen within the sector.

The Council's key considerations, from the information available, seem to have been the interest costs; and the projected changes in interest rates (both immediate regarding potential discount; and long term PWLB rates and expected increases in medium term). These considerations, in our view, seem to be relevant to management

of borrowing and prudential financial management decisions to be made by the Council.

From the information available, there is nothing to suggest that well-informed choices were not made on the basis of expert advice sought and within the Council's prescribed limits.

Authorised appropriately

Eight of the nineteen LOBO loans were approved by the Council's Deputy Director of Finance in post at that point in time. A further six of the nineteen LOBO loans were approved by the Head of Strategic Finance. Four of the nineteen LOBO loans were approved by a Senior Finance Manager. One of the nineteen LOBO loans were approved by the Section 151 Officer. All of which are in line with the relevant policies in place at the time.

Interest rates and contemporaneous expectations

We have also considered the decisions made in the context of the interest rates at the time and also what the future expectations were at the time the LOBO loans were entered into. The details are contained in Attachment 2. In summary:

- For the nineteen LOBO loans there is evidence of the PWLB interest rates available to local authorities, we have based our assessments on the New Loan Maturity 50 year interest rate.
- In fourteen of the nineteen cases, the PWLB 50 year interest rate at the time the LOBO loan agreement was signed is higher than the starting rate of the Council's LOBO loan.
- In four of the nineteen cases, the PWLB 50 year interest rate at the time the LOBO loan agreement was signed is lower than the starting rate of the Council's LOBO loan.
- In one of the nineteen cases, the PWLB 50 year interest rate at the time the LOBO loan agreement was signed is the same as the starting rate of the Council's LOBO loan.
- The span of time over which the Council took out the LOBO loans is lengthy (December 2003 to December 2011) and hence any assessment of the projection of interest rates by the Bank of England shows a range of increases and decreases over that period, as viewed by the movements in the Bank of England Base Rates. Rates fluctuated from 5.75% in 2007 to 0.5% in 2009. This evidence indicates that the unprecedented reduction in interest rates and subsequent sustained period of low interest rates from late 2007 was not predicted.

Summary of considerations

Having completed our consideration of the information available in relation to the relevant factors (within the areas outlined above) and the Council's approach, actions

and decision making, we have not identified any fundamental departures or significant issues that would, in our view, impact on the lawfulness of the LOBO loans. It is our view, based on the information available, that the Council has taken a rational approach in deciding to enter into the LOBO loans referred to in this objection.

As we have noted, given the passage of time the retained documentation is relatively comprehensive given there is only one LOBO signed bond certificate that cannot be located. The Council has also reported annually its Treasury Management Strategy; Prudential Indicators; and Treasury Management Annual Report which set out compliance with the Prudential Code and Guidance Notes and TM Code and Guidance Notes in the subsequent financial years.

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

In terms of interest rates, we have noted that there was no expectation that interest rates would stay at such a low rate for such a long time, as it later transpired. We have also noted that local authorities should not be borrowing to 'play the markets' as a primary aim. There is nothing to indicate that this was the Council's aim. Instead the indications are that its borrowing was appropriately related to the local authority's position (either as part of the funding needed to meet its capital programme or to ensure its loan portfolio remains balanced as to when loans will reach maturity).

We have not identified any fundamental departures or significant issues from our analysis of the particular circumstances of the LOBOs the Council has entered into.

Consideration of other observations in July 2017 e-mail

Your e-mail refers to several matters, which we do not consider to be formally part of our consideration as to the lawfulness of the Council's LOBO loans, but we have included comments on them below for completeness.

■ *Sheffield Council has 47% of its debt portfolio in callable LOBO loans*

As at 31 March 2017, Sheffield Council had £761.339m of borrowing disclosed in the accounts with a fair value of £1.079bn. We have reviewed the proportion of its borrowing that is in the form of LOBOs and confirm that as at the year-end 31 March 2017 the Council had 26.3% of their loans in LOBOs (excluding PFI arrangements) and 16.8% of loans in LOBOs when including PFI arrangements.

The Council also considers that the costs of repaying any of the LOBO loans (to rebalance its external borrowing portfolio) without a lender exercising their option or imposing breakage costs would be prohibitive, although this has not been formally set out in the Council's Treasury Management Strategy or TMPs. Although the contracts with the various banks do not identify breakage costs it would be highly unlikely to represent value for money for the Council to attempt to extinguish the LOBO loans without the lender recouping foregone interest through breakage costs.

The Council is not required to hold cash balances to meet the LOBO loan call options (annual or bi-annual). At the time the LOBO loans were taken out, the Council agreed varying lengths of time before the lender could consider exercising their option (see details of the Council's LOBO loans set out earlier).

The limited emails and associated reports available relating to the original decisions do not explicitly consider the Council's plans if a lender were to exercise their option (the incompleteness of records is highlighted earlier). Our understanding is that the Council's response would have been to act within the extant approved Treasury Management Strategy and supporting Treasury Management Practices. Also, the Council has noted (in discussions with our staff) that it would have had (and still has) access to PWLB borrowing to replace the LOBO loans if it became prudent to do so i.e. if a lender was to exercise its option the Council would consider the options available and make what it considered to be a prudent decision (note: that within our provisional view within the work carried out section we enabled both the Council and elector to raise any points regarding this and none were raised).

Our understanding from the Council currently is that should a lender exercise their option the Council would consider the position with regards to the Treasury Management Strategy including interest rates offered by the PWLB for various loan lengths and make a decision based on the Council's position at the time. The most likely options would be to either replace the loans via the PWLB (but not necessarily for the same length of time as the LOBO loan) or to extinguish the loans from cash resources available.

The Treasury Management Strategy is agreed annually and sets out the Council's plans and considerations in respect of cash management; loans and investments. The current Treasury Management Strategy is available publicly on the Council's website (as are those from previous years).

- *Butlers received undeclared kickbacks from brokers including ICAP and Tullet Prebon when the Council borrowed from the banks*

As you note in your e-mail, these alleged transactions were not known to the Council and there is insufficient evidence to indicate that anything unlawful with regard to this authority took place, as such this does not warrant further investigation.

If you have concerns in this area we believe the matter should be taken up with the appropriate financial regulators of the entities involved.

Right of appeal

You have a right to appeal our decision not to apply for a declaration under section 28(3) of the Local Audit & Accountability Act 2014. Should you wish to do so, you must issue your appeal to the High Court within a period of 21 days beginning with the day after you receive this statement of written reasons.

Should you wish to appeal this decision, we strongly recommend that you seek legal advice.

We have copied this decision to the Council.

We remind you that Schedule 11 of the Local Audit and Accountability Act 2014 continues to apply. Information relating to this matter is provided solely for the purposes of our audit and for no other purpose. It should not be disclosed to a third party, other than a legal representative, without our consent, or otherwise as permitted by that Schedule 11.

Yours sincerely



Tim Cutler
Partner

For and on behalf of KPMG LLP

Attachment 1

Material evidence to support our decision:

- 1 Annual Review on Treasury Management Strategy 2004/05, 2005/06, 2006/07, 2007/08, 2008/09, 2009/10, 2010/11 and 2011/12
- 2 Public Works Loan Board interest rates as recorded at <https://www.dmo.gov.uk/responsibilities/local-authority-lending-pwlb/interest-rates/nlf-rates/>
- 3 Bank of England base rate as recorded at <https://www.bankofengland.co.uk/-/media/boe/files/monetary-policy/baserate.xls?la=en&hash=EEB8729ABFFF4B947B85C328340AE5155A99AD0F>
- 4 Sheffield Council Constitution (Financial Procedure Rules) as recorded at <http://democracy.sheffield.gov.uk/documents/s28668/Part4RulesofProcedurev154.pdf>



Attachment 2

Summary of interest rates and projections at the time the LOBO loans were agreed/ taken out

We have considered the information and projections available at the time the Council was making its final decisions about the LOBO loans. The information we have used has been drawn from the Bank of England (Monetary Policy Committee (MPC) minutes and quarterly Inflation Reports) and the PWLB historic interest rates for maturity fixed interest loans. All of the information can be obtained from the respective websites of the organisations.

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