Melbourne councils caught in debt squeeze

Mathew Dunckley

A quartet of inner-Melbourne councils has admitted investing in complex debt products that have fallen in value amid the global credit crunch, sparking calls for tougher investment rules for Victorian councils.

Banyule, Boroondara, Yarra and Glen Eira have all confirmed they invested in the Grange Securities Enhanced Cash Fund, despite Victoria having the toughest laws in the country governing council investments.

The fund invested in a range of products including collateralised debt obligations (CDOs), which were promoted by the Lehman Brothers-owned Grange Securities.

Councils in NSW and Western Australia have had millions wiped from the value of their investments as falling credit markets hit CDOs, which are bundles of loans and bonds.

Returns in the Enhanced Cash Fund went backwards by 1.7 per cent in July, according to material on its website, and the state's peak body for councils, the Municipal Association of Victoria, said the rules needed to be reviewed.

"We thought no Victorian council would be involved. We have got the most stringent set of rules in Australia but it is clear these things can still happen . . . it would be useful now to look at the rules," chief executive Rob Spence said.

He said it was unlikely Victorian councils would have the same quantities to invest as their counterparts in other states because they did not receive developer contributions as cash. Instead, developers built community infrastructure as an in-kind contribution, he said.

Banyule director of corporate services Keith Yeo said the council had invested $6.675 million in the fund and, on its most recent figures, had booked a paper loss of about $67,000.

Victoria has the toughest laws governing council investments, but the state's peak body for councils says these should be reviewed. Photo: PAUL HARRIS

Mr Yeo said he was hopeful that recent market buoyancy might improve that position but refused to comment when asked if he thought the investment had been a good one for ratepayers. The Local Government Act required council investments to have a minimum of an AAf rating from Standard and Poor's and the Grange fund met that standard, he said.

Glen Eira and Boroondara have both cashed out their investments without loss on their initial capital.

Yarra Council confirmed the council had invested in the fund but did not answer further questions by deadline.

Local Government Minister Dick Wynne, said in a statement: "At this stage we have no plans for a review but we are monitoring the situation to ensure the intent of the existing legislation continues to be met."

In a statement, Grange Securities spokeswoman Sinead Taylor played down the risks to investors in the fund from the turbulence in American credit markets.

"The fund has no exposure to the US sub-prime housing sector in any of its underlying investments," she said. "In its mortgage and asset backed sector, the fund is predominantly invested in Australian residential mortgage-backed securities."

Meanwhile, industry group NSW Urban Taskforce warned yesterday that millions of dollars of community amenities might never be built in NSW because of risky investments made by the state's councils.

Chief executive Aaron Gadiel said NSW councils should use developer contributions, paid to cover the cost of amenities for residents of new housing developments, to build facilities straight away, rather than investing the money.

with Jonathan Barrett