

# LANCASHIRE COMBINED FIRE AUTHORITY

## RESOURCES COMMITTEE

Meeting to be held on 27 September 2017

### DEBT RESTRUCTURING

Contact for further information:

Keith Mattinson - Director of Corporate Services - Telephone Number 01772 866804

#### Executive Summary

The Authority currently holds £5.5m of debt, incurring annual interest charges of £0.25m on this. As such the report considers options around early repayment.

#### Recommendation

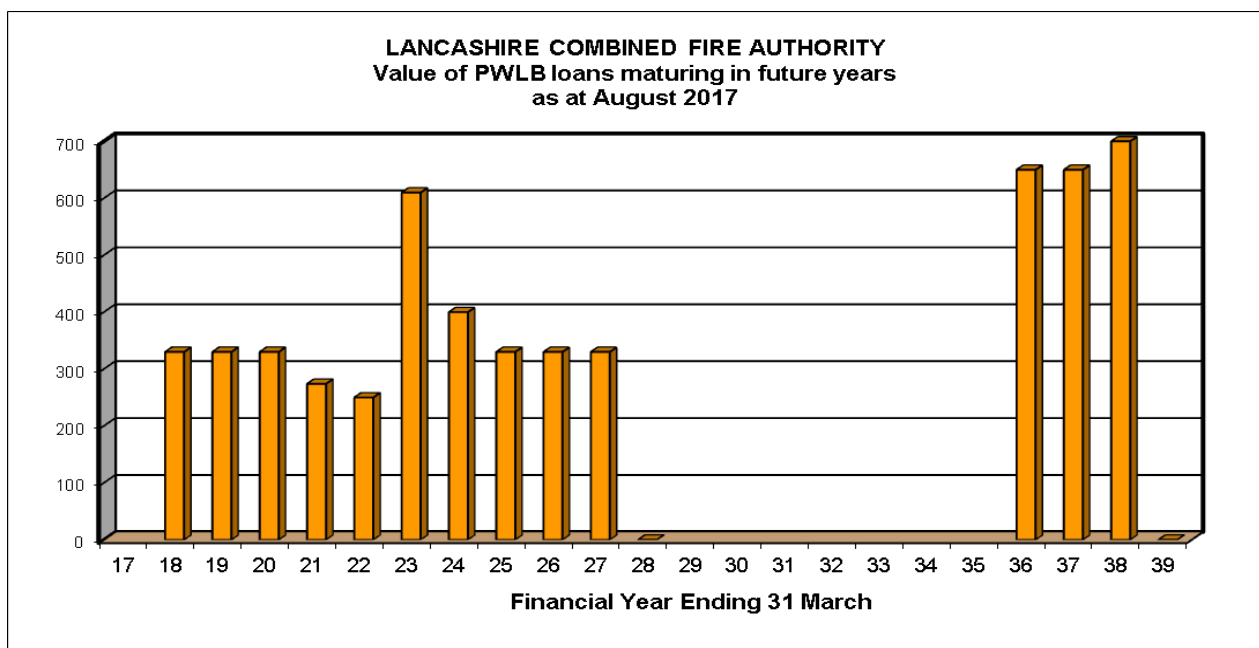
The Committee is asked to consider:-

- Which, if any loans, it wishes to repay;
- Whether it wishes to set up a portfolio of fixed term investment to mirror its debt profile and offset interest payments;
- Whether to leave the debt/investment portfolio as it currently stands and review further as part of next year's Treasury Management Strategy.

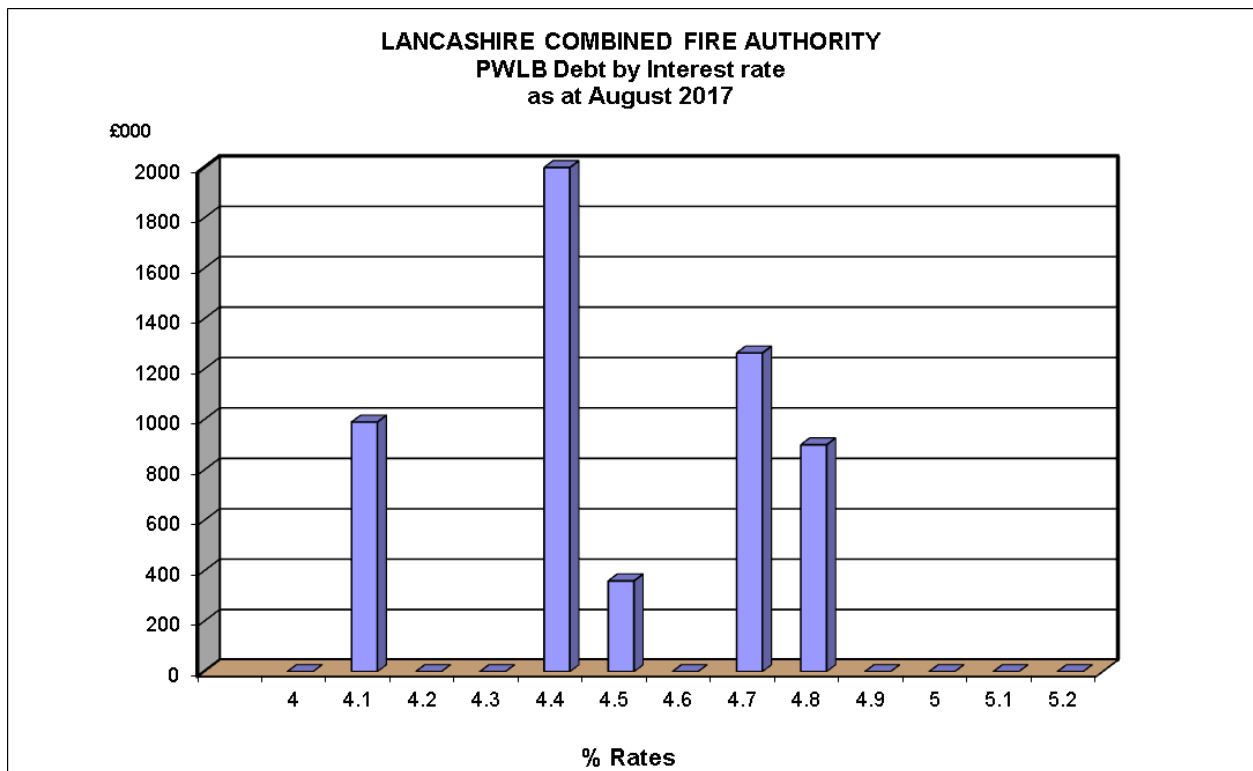
#### Information

##### Current Debt Portfolio

Currently the Authority has £5.5m of existing debt, repayable over the next 20 years, as shown in the chart below:-



All borrowing is at fixed rates, ranging between 4.10% and 4.88%, as shown in the chart below



As a result of this the Authority incurs annual interest charges of £0.25m.

### **2017/18 Treasury Management Strategy**

As part of the 2017/18 Treasury Management Strategy, presented to Members in February, a review of debt restructuring opportunities was undertaken which identified that the cost of repaying the loans in the year would be in the region of £1.6m. This would result in lower interest payments over the period of the loans of £2.7m, a net gain over the period of the loans of £1.1m. However, paying the loans early would result in a loss of investment income, and allowing for future interest rate forecasts, once this was taken into consideration then it is estimated that the repayment of the loans would cost rather than save the Authority money. Hence it was recommended that debt restructuring was not undertaken at that time, but that the situation would be reviewed again as part of the mid-year update.

### **Mid-Year Update**

A loan for £330k matures on 31 December 2017, and as such is excluded from the review as this will be repaid at that time.

The level of penalty applicable on early repayment of loans has been reviewed again and now stands at £1.7m. (As previously reported the level of penalty is dependent upon two factors, the difference between the interest chargeable on the loan and current interest rates, the greater this difference the greater the penalty, and the length to maturity, the greater the remaining time of the loan the greater the penalty. Hence as interest rates increase or as loans get closer to maturity the level of penalty will reduce.)

This compares with the outstanding interest payable between now and maturity of £2.6m. Giving a gross saving of £0.9m.

Penalty incurred	£1.7m
Savings on interest payable	(£2.6m)
Net Saving	(£0.9m)

However as highlighted as part of the strategy, and referred to above, any early repayment means that cash balances available for investment will be reduced and hence interest receivable will also be reduced. The extent of which is dependent upon future interest rates.

### Comparison Utilising Base Rate 0.25%

As a starting point we have assumed interest rates remain at their current level, 0.25%:-

Based on this the anticipated reduction in interest receivable, as a result of the early repayment of loans, is £0.2m. Hence the net saving by repaying loans early is £0.7m

Penalty incurred	£1.7m
Savings on interest payable	(£2.6m)
Reduction in interest receivable	£0.2m
Net Saving	(£0.7m)

This overall position can be broken down into a loan by loan analysis as follows:-

Loan Number	Loan Amount	Loan Rate	Loan Maturity	Penalty Incurred	Savings On Interest Payable	Interest Receivable Rate	Reduction In Interest Receivable	Net (Saving) /Cost
490220	330,000	4.10%	31/12/2018	17,988	(20,337)	0.25%	1,089	(1,260)
490221	330,000	4.10%	31/12/2019	31,401	(33,857)	0.25%	2,033	(423)
484844	274,000	4.75%	31/12/2020	42,482	(45,610)	0.25%	2,573	(555)
485770	250,000	4.88%	31/12/2021	50,636	(54,890)	0.25%	3,196	(1,058)
485771	250,000	4.88%	31/12/2022	60,613	(67,069)	0.25%	4,078	(2,378)
486102	360,000	4.50%	31/12/2022	80,144	(89,150)	0.25%	5,778	(3,227)
485934	400,000	4.88%	31/12/2023	111,247	(126,797)	0.25%	7,989	(7,561)
486869	330,000	4.75%	31/12/2024	99,475	(117,632)	0.25%	7,787	(10,370)
486870	330,000	4.75%	31/12/2025	108,940	(133,297)	0.25%	9,055	(15,302)
486871	330,000	4.75%	31/12/2026	116,996	(148,961)	0.25%	10,338	(21,627)
494102	650,000	4.49%	31/12/2035	309,176	(539,992)	0.25%	43,764	(187,052)
494101	650,000	4.49%	30/06/2036	315,122	(554,535)	0.25%	45,237	(194,176)
494100	700,000	4.48%	30/06/2037	347,508	(627,200)	0.25%	51,716	(227,976)
	5,184,000			1,691,728	(2,566,142)		194,633	(672,965)

This shows at current interest rates it would be financially advantageous to pay off all loans. However, using 0.25% as an interest rate forecast seems unrealistic, as all forecasts suggest that interest rates will increase in future years.

## Comparison Utilising Forecast Increase in Base Rate to 0.50%

The latest indications from the Bank of England are that base rates are likely to rise to 0.50% earlier than previously anticipated; hence the calculations have been re-run utilising that. Based on this the anticipated reduction in interest receivable, as a result of the early repayment of loans, increases to £0.4m, hence the net saving by repaying loans early falls to £0.5m:-

Penalty incurred	£1.7m
Savings on interest payable	(£2.6m)
Reduction in interest receivable	£0.4m
Net Saving	(£0.5m)

This overall position can be broken down into a loan by loan analysis as follows:-

Loan Number	Loan Amount	Loan Rate	Loan Maturity	Penalty Incurred	Savings On Interest Payable	Interest Receivable Rate	Reduction In Interest Receivable	Net (Saving) /Cost
490220	330,000	4.10%	31/12/2018	17,988	(20,337)	0.50%	2,177	(172)
490221	330,000	4.10%	31/12/2019	31,401	(33,857)	0.50%	4,067	1,610
484844	274,000	4.75%	31/12/2020	42,482	(45,610)	0.50%	5,147	2,018
485770	250,000	4.88%	31/12/2021	50,636	(54,890)	0.50%	6,391	2,138
485771	250,000	4.88%	31/12/2022	60,613	(67,069)	0.50%	8,155	1,700
486102	360,000	4.50%	31/12/2022	80,144	(89,150)	0.50%	11,556	2,551
485934	400,000	4.88%	31/12/2023	111,247	(126,797)	0.50%	15,978	428
486869	330,000	4.75%	31/12/2024	99,475	(117,632)	0.50%	15,574	(2,583)
486870	330,000	4.75%	31/12/2025	108,940	(133,297)	0.50%	18,110	(6,246)
486871	330,000	4.75%	31/12/2026	116,996	(148,961)	0.50%	20,676	(11,289)
494102	650,000	4.49%	31/12/2035	309,176	(539,992)	0.50%	87,527	(143,289)
494101	650,000	4.49%	30/06/2036	315,122	(554,535)	0.50%	90,474	(148,939)
494100	700,000	4.48%	30/06/2037	347,508	(627,200)	0.50%	103,432	(176,261)
	5,184,000			1,691,728	(2,566,142)		389,265	(478,333)

This shows at a revised base rate of 0.50% it would be beneficial to pay off the longer term loans, but not those that mature in the next 6 years. However, even using an updated base rate of 0.50% as an interest rate forecast throughout the period seems unrealistic, as all forecasts suggest that interest rates will increase further in future years.

## Comparison Utilising Current Gilt Rates

As such we have recalculated the net impact based on current investment returns on Gilts, available mid-September. The overall position is summarised below, showing that the anticipated reduction in interest receivable is far more significant, £1.2m, resulting in a net cost of £0.3m if all the loans were repaid:-

Penalty incurred	£1.7m
Savings on interest payable	(£2.6m)
Reduction in interest receivable	£1.2m
Net Cost	£0.3m

The position on loans maturing within the next 10 years is fairly cost neutral, a net loss of £40k, it is the longer term loans where the majority of losses would be incurred:-

Loan Number	Loan Amount	Loan Rate	Loan Maturity	Penalty Incurred	Savings On Interest Payable	Interest Receivable Rate	Reduction In Interest Receivable	Net (Saving) /Cost
490220	330,000	4.10%	31/12/2018	17,988	(20,337)	0.40%	1,729	(620)
490221	330,000	4.10%	31/12/2019	31,401	(33,857)	0.45%	3,684	1,228
484844	274,000	4.75%	31/12/2020	42,482	(45,610)	0.45%	4,663	1,535
485770	250,000	4.88%	31/12/2021	50,636	(54,890)	0.45%	5,791	1,537
485771	250,000	4.88%	31/12/2022	60,613	(67,069)	0.52%	8,400	1,945
486102	360,000	4.50%	31/12/2022	80,144	(89,150)	0.52%	11,903	2,898
485934	400,000	4.88%	31/12/2023	111,247	(126,797)	0.52%	16,457	907
486869	330,000	4.75%	31/12/2024	99,475	(117,632)	0.98%	30,525	12,368
486870	330,000	4.75%	31/12/2025	108,940	(133,297)	0.98%	35,496	11,140
486871	330,000	4.75%	31/12/2026	116,996	(148,961)	0.98%	40,525	8,560
494102	650,000	4.49%	31/12/2035	309,176	(539,992)	1.89%	330,328	99,512
494101	650,000	4.49%	30/06/2036	315,122	(554,535)	1.89%	341,450	102,037
494100	700,000	4.48%	30/06/2037	347,508	(627,200)	1.89%	390,351	110,658
	5,184,000			1,691,728	(2,566,142)		1,221,303	353,705

### Comparison Utilising Current Gilt Rates

Whilst Gilts represent the safest investment, as they are backed by the Government, inter-authority fixed term investments offer a greater return, albeit they are marginally more risky, which would result in a greater net cost in early repayment, £0.7m:-

Loan Number	Loan Amount	Loan Rate	Loan Maturity	Penalty Incurred	Savings On Interest Payable	Interest Receivable Rate	Reduction In Interest Receivable	Net (Saving) /Cost
490220	330,000	4.10%	31/12/2018	17,988	(20,337)	0.95%	4,136	1,788
490221	330,000	4.10%	31/12/2019	31,401	(33,857)	0.95%	7,727	5,270
484844	274,000	4.75%	31/12/2020	42,482	(45,610)	1.00%	10,294	7,165
485770	250,000	4.88%	31/12/2021	50,636	(54,890)	1.00%	12,783	8,529
485771	250,000	4.88%	31/12/2022	60,613	(67,069)	1.25%	20,389	13,933
486102	360,000	4.50%	31/12/2022	80,144	(89,150)	1.25%	28,891	19,886
485934	400,000	4.88%	31/12/2023	111,247	(126,797)	1.25%	39,944	24,395
486869	330,000	4.75%	31/12/2024	99,475	(117,632)	1.25%	38,935	20,778
486870	330,000	4.75%	31/12/2025	108,940	(133,297)	1.25%	45,276	20,919
486871	330,000	4.75%	31/12/2026	116,996	(148,961)	1.25%	51,691	19,725
494102	650,000	4.49%	31/12/2035	309,176	(539,992)	2.37%	415,580	184,764
494101	650,000	4.49%	30/06/2036	315,122	(554,535)	2.37%	429,572	190,159
494100	700,000	4.48%	30/06/2037	347,508	(627,200)	2.37%	491,093	211,401
	5,184,000			1,691,728	(2,566,142)		1,596,310	728,712

### Comparison Demonstrating Breakeven Position

As a final comparator we have calculated a breakeven position in terms of the average interest rate that would be required over the remaining life of each loan in order for early repayment costs to be fully offset:-

Loan Number	Loan Amount	Loan Rate	Loan Maturity	Penalty Incurred	Savings On Interest Payable	Interest Receivable Rate	Reduction In Interest Receivable	Net (Saving) /Cost
490220	330,000	4.10%	31/12/2018	17,988	(20,337)	0.54%	2,349	0
490221	330,000	4.10%	31/12/2019	31,401	(33,857)	0.30%	2,457	0
484844	274,000	4.75%	31/12/2020	42,482	(45,610)	0.30%	3,129	0
485770	250,000	4.88%	31/12/2021	50,636	(54,890)	0.33%	4,254	0
485771	250,000	4.88%	31/12/2022	60,613	(67,069)	0.40%	6,455	0
486102	360,000	4.50%	31/12/2022	80,144	(89,150)	0.39%	9,005	0
485934	400,000	4.88%	31/12/2023	111,247	(126,797)	0.49%	15,550	0
486869	330,000	4.75%	31/12/2024	99,475	(117,632)	0.58%	18,157	0
486870	330,000	4.75%	31/12/2025	108,940	(133,297)	0.67%	24,357	0
486871	330,000	4.75%	31/12/2026	116,996	(148,961)	0.77%	31,965	0
494102	650,000	4.49%	31/12/2035	309,176	(539,992)	1.32%	230,816	0
494101	650,000	4.49%	30/06/2036	315,122	(554,535)	1.32%	239,413	0
494100	700,000	4.48%	30/06/2037	347,508	(627,200)	1.35%	279,692	0
	5,184,000			1,691,728	(2,566,142)		867,598	0

If average interest rates throughout the remaining life of each loan are lower than the breakeven interest rates shown then it is financially advantageous to pay off the loan, if they are greater then it will cost more to pay off the loan than the net saving on interest. As an example if we look at the longest loan we have, loan 494100 maturing in 2037, interest rates would need to average less than 1.35% throughout the remaining life of the loan, i.e. the next 20 years, for it to be financially advantageous to pay this off now and incur the penalty charge. It is worth noting that other than during the current financial crisis interest rates have never been at such a low rate. If, as seems likely, interest rates prove to be higher than this then the early repayment of debt results in a worse overall financial position.

Ultimately any decision re early repayment of debt relies on future interest rates which cannot be known with any degree of certainty, hence there is always a risk that any decision will be incorrect. Paying off the debt early gives you certainty, it enables all the costs to be met in the current year, and eliminates the interest payable budget in future years, reducing the pressure on the revenue budget. The Authority has sufficient cash balances to meet any repayments costs, having set aside an earmarked reserve of £1.0m to offset a proportion of any penalty costs associated with this, with any balance being met in year.

As an alternative a series of fixed term investments could be established to mirror our debt portfolio with investment returns offsetting interest payments. Utilising Gilts in this way would generate £1.0m of interest receivable over the life of the loans, compared with interest payable of £2.5m, a shortfall of £1.5m. This is still less than the penalty being charged on early repayment, £1.7m, and is considered a risk free strategy as it is based on Government investment. An earmarked reserve could be established to offset any in year shortfall over the life of the debt, i.e. £1.5m over the next 20 years. Given we have already established a reserve of £1.0m to meet potential penalty costs associated with early repayment, we would need to transfer a further £0.5m into this reserve in order to completely offset future net interest payments. Whilst this is a viable option, the level of returns on Gilts still appears to be extremely low and hence it is still not

considered an ideal solution at the present time, albeit it is still more attractive than repayment of all debt and the associated penalty.

### **Financial Implications**

As set out in the report

### **Human Resource Implications**

None

### **Equality and Diversity Implications**

None

### **Environmental Impact**

None

### **Business Risk Implications**

As highlighted in the report the risk associated with any decision surrounding early repayment of debt is that the interest rate forecast on which it is based prove to be inaccurate. Ultimately this cannot be known at the time of any decision. However the risk of this has been mitigated by reviewing the latest forecasts and basing comparators on rates achievable at the present time.

### **Local Government (Access to Information) Act 1985**

#### **List of Background Papers**

Paper	Date	Contact
CIPFA Treasury Management Code of Practice and Guidance	November 2011	Keith Mattinson
The Department of Communities and Local Government (CLG) guidance on local authority investments	March 2010	Keith Mattinson
Treasury Management in the Public Services: Code of Practice 2011 Edition.	November 2011	Keith Mattinson
Treasury Management Strategy 2017/18	February 2017	Keith Mattinson
Reason for inclusion in Part II, if appropriate:		