LANCASHIRE COMBINED FIRE AUTHORITY
Meeting to be held on 18 December 2017

DEBT RESTRUCTURING

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Executive Summary

At the end of December the Authority will hold £2.0m of debt, having paid off £3.2m of debt in October and with a further £0.3m scheduled for repayment in December. The Authority incurs annual interest charge of £90k on this. Given the change in base rates since this was reported to Resources Committee in September this report provides an updated position in respect of potential early repayment.

Recommendation

The Authority is asked to consider if it wishes to repay its remaining three loans.

Information

A report was submitted to the Resources Committee on 27 September which provided information on the impact of repaying loans. As a result the Committee agreed to pay off all loans that matured in the next 10 years. Subsequently on 5 October loans of £3.184m were repaid which incurred a penalty charge of £0.636m. Therefore the outstanding PWLB balance was reduced to £2.330m. Of this £0.330m is due to mature in December 2017 and was not repaid as PWLB do not normally accept repayments for loans with less than one year to maturity. Therefore the estimated balance at the end of the financial year is £2m. The table below shows the maturity profile and interest rate applicable on these:-

Loan Amount	Maturity Date	Interest rate
£650k	December 2035	4.49%
£650k	June 2036	4.49%
£700k	June 2037	4.48%

Following the change in base rate to 0.5% in November the Resources Committee requested that a revised position should be presented to the Authority meeting.

The level of penalty applicable on early repayment of loans has been reviewed again and now stands at £877k compared with the penalty applicable in September of £971k. (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 £1.684k. Giving a gross saving of £807k.

Penalty incurred	£877k
Savings on interest payable	(£1,684k)
Gross Saving	(£807k)

However as highlighted as part of the Treasury Management Strategy and the previous report to Resources Committee, 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 Updated Base Rate 0.5%

As a starting point we have assumed interest rates remain at their current level, 0.5%. Based on this the anticipated reduction in interest receivable, as a result of the early repayment of loans, is £270k. Hence the net saving by repaying loans early is £537k

Penalty incurred	£877k
Savings on interest payable	(£1,684k)
Reduction in interest receivable	£270k
Net Saving	(£537k)

This shows at current interest rates it would be financially advantages to pay off all loans. However, using 0.5% as an interest rate forecast seems unrealistic, as all forecasts suggest that interest rates will increase in the medium to long term.

Comparison Utilising Current Gilt Rates

As such we have recalculated the net impact based on current investment returns available on Gilts at the end of November, 1.8% for a 20 year gilt. The overall position is summarised below, showing that the anticipated reduction in interest receivable is far more significant, £972k, resulting in a net cost of £165k if all the loans were repaid:-

Penalty incurred	£877k
Savings on interest payable	(£1,684k)
Reduction in interest receivable	£972k
Net Cost	£165k

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. This shows that an average rate of return on investments of 1.49% represents the break-even position, whereby the penalty incurred and the loss of return on investments matches the saving in interest payable on the loan.

Penalty incurred	£877k
Savings on interest payable	(£1,684k)
Reduction in interest receivable	£807k
Net Cost	-

In essence this means that if returns on investments over the next 20 years exceed 1.49% then it is financially disadvantageous to pay off the loans, if interest rate averages less than 1.49% then it is financially advantageous. 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, still having £365k of an earmarked reserve to offset a proportion of any penalty costs associated with this, with any balance being met from either the revenue budget or from a drawdown against the general reserve.

The draft capital budget does not show any additional borrowing being required in the next 5 years, however any major additional item of capital expenditure could impact on that position.

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
Treasury Management Debt Restructuring Report	September 2017	Keith Mattinson
Reason for inclusion in Part II, if appropriate:		