LANCASHIRE COMBINED FIRE AUTHORITY
RESOURCES COMMITTEE
Meeting to be held on 29 September 2021

DEBT RESTRUCTURING

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Table 1Executive Summary and Recommendations

Executive Summary The Authority currently holds £2.0m of debt, incurring annual interest charges of £90k on this. As such the report considers options around early repayment. **Recommendation(s)** The Committee is asked to consider:- • whether to repay the loans; • whether to set up a portfolio of fixed term investment to partly offset interest payments; • whether to leave the debt/investment portfolio as it currently stands and review further if the penalty on early repayment reduces significantly.

Information

The Authority's 2021/22 Treasury Management strategy outlined the following position in respect of existing debt.

The Authority's debt has arisen as a result of prior years' capital investment decisions. It has not taken any new borrowing out since 2007 as it has been utilising cash balances to pay off debt as it matures, or when deemed appropriate with the authority making early payment of debt. The anticipated holding of debt at 31 March 2021 is £2.0m. All the debt is from the Public Works Loans Board (PWLB) and is all at fixed rates of interest and is repayable on maturity. 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%*

(Note, this debt was taken out in 2007 when the base rate was 5.75% and when the Authority was earning 5.84% return on its investments.)

Given the high interest rates payable on these loans, relative to current interest rates, we have again reviewed opportunities for debt repayment/restructuring. The level of penalty applicable on early repayment of loans now stands at £1.180m. (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.)*

Outstanding interest payable between now and maturity is £1.407m.

Penalty incurred	*1.180*
Savings on interest payable	*(1.407)*
Gross Saving	*(0.277)*

However as highlighted previously, 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. It is estimated that if interest rate on investments are at 0.7% over the remaining period of the loan then repaying the loans now will be broadly neutral.

It is also worth noting that the capital budget does allow for additional borrowing within the next 5 years. Current long-term borrowing rates are 1.67% for a 25-year loan and 1.49% for a 50-year loan, both of which exceed the breakeven position noted above. Hence given the penalties it is considered beneficial to retain these loans.

A further update on this position has now been prepared in line with the resolution of the June Resources Committee.

Total debt remains at £2.0m, incurring £0.090m of interest payments each year. Outstanding interest payable between now and maturity totals £1.363m. The penalty payable on early repayment now stands at £1.063m (the penalty changes on a daily basis and therefore actual cost would not be known until request had been made to PWLB).

Savings on interest payable	(1.363)
Penalty incurred	1.063
Gross Saving	(0.300)

However as highlighted previously, any early repayment means that cash balances available for investment will be reduced and hence interest receivable will also be reduced. The extent of this is dependent upon future interest rates, which are unknown hence the following possible scenarios have been calculated: -

	Investment rate	Lost Investment Income
Current Base Rate	0.10%	0.047
Current 5-year Investment rate	1.00%	0.474
Estimated 10-year Investment rate	1.25%	0.592
Estimated 15-year Investment rate	1.50%	0.710

- If interest rate remains at current historically low level of 0.10% throughout the next 15/16 years, which seems very unlikely, and we left the investment in the call account the lost interest receivable £0.047m would not outweigh the net saving from paying off the loan, and hence it would be financially beneficial to pay the loans off.
- The current 5-year investment rate is approx. 1.00%, if we maintained the cash balance in this type of investment throughout the next 15/16 years then

the lost interest receivable £0.474m would outweigh the net saving from paying off the loan, and hence it would not be financially beneficial to pay the loans off.

- Looking at potential 10-year and 15-year investment rates of 1.25% and 1.50% the lost interest is even higher and hence paying off the loan is even less attractive. (It must be recognised that these are estimated interest rates as we would need to use a broker to offer these investments if we were interested in fixing longer term investments.)

The breakeven position occurs at an interest rate of 0.63%, whereby lost interest receivable nets off exactly against the net saving from paying the loan off early.

The position is further complicated by additional borrowing requirements shown in the current draft capital programme 2021/26. This shows new borrowing of £9m being required in 25/26, hence if we paid off the loans now the amount of borrowing required in future years would simply be £2.0m more than currently forecast, £11m as opposed to £9m. The current rate for long-term borrowing is between 1.65% and 1.85%, which again are historically low levels. Even at the lower of these rates the additional £2.0m of borrowing will incur additional interest charges of £0.396m over the next 15 years. These more than offset the gross saving of £0.300m identified earlier, demonstrating that paying off the loans early and re-borrowing due to future capital plans would result in a net additional cost of £0.096m (ignoring any lost investment income), £0.144m if we allow for £0.047m lost investment income.

Summary

The following table summarises the position set out above

	Current 0.10% Investment Income	Breakeven 0.63% Investment Income	Notional 1.00% Investment Income	New Capital Borrowing
Penalty Incurred	1.063	1.063	1.063	1.063
Interest saved on current loans	(1.363)	(1.363)	(1.363)	(1.363)
Lost Investment Income	0.047	0.300	0.474	0.047
Cost of new borrowing required in 25/26				0.396
(Surplus)/Deficit Net Position	(0.252)	-	0.174	0.144

Ultimately any decision regarding early repayment of debt relies on future interest rates and future borrowing requirements. Future interest rates 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 (until such time as additional borrowing is taken out in future years), reducing the pressure on the revenue budget in future years. The Authority has sufficient cash balances to meet any repayments costs, but the penalty costs associated with this will be charged to the revenue budget, which will result in a significant in-year overspend.

However, the over-riding considerations in any decision has to be the net financial impact allowing for either lost interest receivable on investment opportunities and/or additional interest charges on new borrowing. Both of these mean that paying off the debt does not make financial sense, as any net saving is more than offset by either lost interest receivable and/or the additional interest payable on the new borrowing.

Business Risk

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.

Environmental Impact

None

Equality and Diversity Implications

None

HR Implications

None

Financial Implications

As set out in the report.

Local Government (Access to Information) Act 1985
List of Background Papers

Table 2 Details of any background papers

Paper:	
Date:	
Contact:	
Reason for inclusion in Part 2 if appropriate:	