

NET PRESENT VALUE CALCULATION OF THE REPAYMENT OF PWLB LOANS

APPENDIX 1

Year	INTEREST PAYABLE ON INDIVIDUAL LOANS												TOTAL			DEPOSIT INCOME			NET CASH INFLOW (OUTFLOW)			DR (3.5%)																														
	445014	446866	448679	448545	448546	451916	451917	454131	454132	455794	455795	468435	471691	471692	479505	481013	481014	483087	485381	485382	£	£	£	£	£	£	£	£	£	£	£	£	£	£	£																	
31/03/05	9,656	7,375	14,000	25,231	13,625	16,500	6,136	11,971	25,625	16,125	10,365	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	623,736	366,250	48,711	209,775	0.956	202,681	9,656	7,375	14,000	20,185	13,625	16,500	5,625	11,971	25,625	16,125	10,365	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	614,702	363,323	48,711	202,681	0.954	189,193
31/03/06	9,656	7,375	14,000	20,185	13,625	16,500	5,625	9,976	25,625	16,125	8,885	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	605,668	360,753	48,711	196,205	0.902	176,965	9,656	7,375	14,000	15,139	13,625	16,500	5,114	7,981	25,625	16,125	7,404	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	596,635	358,183	48,711	189,741	0.871	165,348
31/03/07	9,656	7,375	14,000	15,139	13,625	16,500	4,602	5,986	25,625	16,125	5,923	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	587,601	355,163	48,711	183,277	0.842	154,315	9,656	7,375	14,000	10,093	13,625	16,500	4,091	3,960	25,625	16,125	4,442	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	578,568	353,043	48,711	176,814	0.814	143,938
31/03/08	9,656	7,375	14,000	10,093	13,625	16,500	3,580	1,956	25,625	16,125	2,962	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	569,534	350,158	48,711	171,217	0.786	133,924	9,656	7,375	14,000	5,046	13,625	16,500	3,068	2,562	25,625	16,125	1,481	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	560,500	347,219	48,711	165,828	0.759	123,574
31/03/09	9,656	7,375	14,000	5,046	13,625	16,500	2,557	1,068	25,625	16,125	1,481	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	551,466	344,313	48,711	161,885	0.734	116,690	9,656	7,375	14,000	2,045	13,625	16,500	2,045	1,534	25,625	16,125	1,023	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	542,432	341,368	48,711	157,939	0.709	110,307
31/03/10	9,656	7,375	14,000	2,045	13,625	16,500	1,534	511	25,625	16,125	511	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	533,400	338,413	48,711	154,000	0.685	105,327	9,656	7,375	14,000	1,023	13,625	16,500	511	19,307	25,625	16,125	511	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	524,367	335,468	48,711	150,089	0.662	100,944
31/03/11	9,656	7,375	14,000	1,023	13,625	16,500	511	19,307	25,625	16,125	19,307	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	515,334	335,468	48,711	146,151	0.639	91,959	9,656	7,375	14,000	511	13,625	16,500	19,307	25,625	16,125	19,307	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	506,301	332,523	48,711	142,212	0.618	82,910	
31/03/12	9,656	7,375	14,000	511	13,625	16,500	19,307	25,625	16,125	19,307	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	496,268	332,523	48,711	138,277	0.597	75,724	9,656	7,375	14,000	19,307	13,625	16,500	19,307	25,625	16,125	19,307	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	497,234	329,578	48,711	138,277	0.577	64,141		
31/03/13	9,656	7,375	14,000	19,307	13,625	16,500	19,307	25,625	16,125	19,307	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	486,235	332,523	48,711	134,342	0.557	57,435	9,656	7,375	14,000	19,307	13,625	16,500	19,307	25,625	16,125	19,307	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	488,200	329,578	48,711	134,342	0.538	49,402		
31/03/14	9,656	7,375	14,000	511	13,625	16,500	19,307	25,625	16,125	19,307	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	475,196	332,523	48,711	130,413	0.527	50,919	9,656	7,375	14,000	19,307	13,625	16,500	19,307	25,625	16,125	19,307	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	476,162	329,578	48,711	130,413	0.507	42,906		
31/03/15	9,656	7,375	14,000	19,307	13,625	16,500	19,307	25,625	16,125	19,307	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	464,192	332,523	48,711	126,484	0.486	42,906	9,656	7,375	14,000	19,307	13,625	16,500	19,307	25,625	16,125	19,307	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	465,158	329,578	48,711	126,484	0.466	34,893		
31/03/16	9,656	7,375	14,000	511	13,625	16,500	19,307	25,625	16,125	19,307	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	453,200	332,523	48,711	122,555	0.469	32,194	9,656	7,375	14,000	19,307	13,625	16,500	19,307	25,625	16,125	19,307	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	454,166	329,578	48,711	122,555	0.453	24,181		
31/03/17	9,656	7,375	14,000	19,307	13,625	16,500	19,307	25,625	16,125	19,307	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	442,212	332,523	48,711	118,626	0.438	21,485	9,656	7,375	14,000	19,307	13,625	16,500	19,307	25,625	16,125	19,307	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	443,182	329,578	48,711	118,626	0.423	13,472		
31/03/18	9,656	7,375	14,000	511	13,625	16,500	19,307	25,625	16,125	19,307	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	431,228	332,523	48,711	114,700	0.423	13,472	9,656	7,375	14,000	19,307	13,625	16,500	19,307	25,625	16,125	19,307	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	432,198	329,578	48,711	114,700	0.409	5,459		
31/03/19	9,656	7,375	14,000	19,307	13,625	16,500	19,307	25,625	16,125	19,307	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	420,284	332,523	48,711	110,774	0.409	5,459	9,656	7,375	14,000	19,307	13,625	16,500	19,307	25,625	16,125	19,307	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	421,204	329,578	48,711	110,774	0.395	4,446		
31/03/20	9,656	7,375	14,000	511	13,625	16,500	19,307	25,625	16,125	19,307	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	409,340	332,523	48,711	106,848	0.382	4,446	9,656	7,375	14,000	19,307	13,625	16,500	19,307	25,625	16,125	19,307	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	410,356	329,578	48,711	106,848	0.369	4,433		
31/03/21	9,656	7,375	14,000	19,307	13,625	16,500	19,307	25,625	16,125	19,307	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	398,396	332,523	48,711	102,922	0.369	4,433	9,656	7,375	14,000	19,307	13,625	16,500	19,307	25,625	16,125	19,307	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	409,512	329,578	48,711	102,922	0.356	4,420		
31/03/22	9,656	7,375	14,000	511	13,625	16,500	19,307	25,625	16,125	19,307	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	387,446	332,523	48,711	98,996	0.356	4,420	9,656	7,375	14,000	19,307	13,625	16,500	19,307	25,625	16,125	19,307	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	400,628	329,578	48,711	98,996	0.344	4,407		
31/03/23	9,656	7,375	14,000	19,307	13,625	16,500	19,307	25,625	16,125	19,307	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,364	376,499	332,523	48,711	95,070	0.344	4,407	9,656	7,375	14,000	19,307	13,625	16,500	19,307	25,625	16,125	19,307	11,500	178,111	11,889	62,000	29,375	29,375	71,750	70,761	2,								

ANALYSIS OF INDIVIDUAL LOANS

APPENDIX 2

No.	Loan Reference	Years O/S	Loan Rate %	Amount O/S	Penalty Pay't	Total Interest	Deposit Income	HRA	Net Cash Savings	Average Per Year	NPV	Average Per Year
1	101 445014 0	9	12.875%	75,000	45,186	84,525	37,426	3,104	43,996	4,888	32,281	3,587
2	101 446966 0	16	14.750%	50,000	55,214	116,182	58,247	4,266	53,669	3,354	30,951	1,934
3	101 448879 0	17	14.000%	100,000	106,115	234,548	121,237	8,612	104,699	6,159	58,339	3,432
4	101 449545 0	5	13.625%	203,704	47,267	75,694	43,418	2,779	29,497	5,899	24,836	4,967
5	101 449546 0	18	13.625%	100,000	105,470	241,890	127,967	8,882	105,042	5,836	56,551	3,142
6	101 451916 0	19	11.000%	150,000	114,591	309,432	173,942	11,361	124,128	6,533	64,566	3,398
7	101 451917 0	12	11.250%	56,818	19,301	39,887	31,605	1,465	6,817	568	4,512	376
8	101 454131 0	6	10.375%	125,000	21,688	41,899	30,452	1,538	9,908	1,651	8,060	1,343
9	101 454132 0	12	10.250%	250,000	123,589	301,182	155,114	11,059	135,009	11,251	89,347	7,446
10	101 455794 0	21	10.750%	150,000	116,562	334,649	193,684	12,287	128,678	6,128	62,482	2,975
11	101 455795 0	7	11.000%	100,962	21,839	41,462	29,742	1,522	10,197	1,457	8,015	1,145
12	201 468435 0	26	11.500%	100,000	98,297	297,141	178,388	10,910	107,843	4,148	44,090	1,696
13	301 471691 0	19	10.000%	1,781,112	1,127,448	3,280,174	1,912,087	120,439	1,247,648	65,666	648,971	34,156
14	301 471692 0	19	10.000%	118,888	75,256	218,949	127,631	8,039	83,280	4,383	43,318	2,280
15	501 479305 0	14	8.000%	775,000	247,031	842,351	495,072	30,929	316,350	22,596	195,435	13,960
16	101 481013 0	23	5.875%	500,000	70,989	668,382	454,393	24,541	189,448	8,237	85,874	3,734
17	101 481014 0	24	5.875%	500,000	72,612	697,757	475,497	25,620	196,640	8,193	86,120	3,588
18	401 483087 0	35	5.125%	1,400,000	64,898	2,511,250	1,773,992	92,206	645,052	18,430	193,501	5,529
19	301 485381 0	22	4.875%	1,451,506	4,927	1,550,730	1,108,637	56,938	385,155	17,507	180,696	8,213
20	301 485382 0	22	4.875%	48,494	165	51,809	37,039	1,902	12,868	585	5,833	265

ANALYSIS OF PART REPAYMENT

APPENDIX 3

Year	INTEREST PAYABLE ON INDIVIDUAL LOANS												TOTAL INTEREST	DEPOSIT INCOME	HRA	NET CASH INFLOW (OUTFLOW)	DR (3.5%)	NPV				
	443014	446966	448879	449545	449546	451916	451917	454131	454132	455794	455795	468435							471691	471692	479305	
31/03/05	9,656	7,375	14,000	25,231	13,625	16,500	6,136	11,971	25,625	16,125	10,365	11,500	178,111	11,889	62,000	420,111	230,310	21,920	167,881	0.966	162,203	
31/03/06	9,656	7,375	14,000	20,185	13,625	16,500	5,625	9,976	25,625	16,125	8,885	11,500	178,111	11,889	62,000	411,077	228,383	21,920	160,774	0.934	150,085	
31/03/07	9,656	7,375	14,000	15,139	13,625	16,500	5,114	7,981	25,625	16,125	7,404	11,500	178,111	11,889	62,000	402,043	225,813	21,920	154,311	0.902	139,179	
31/03/08	9,656	7,375	14,000	10,093	13,625	16,500	4,602	5,986	25,625	16,125	5,923	11,500	178,111	11,889	62,000	393,010	223,243	21,920	147,847	0.871	128,840	
31/03/09	9,656	7,375	14,000	5,046	13,625	16,500	4,091	3,990	25,625	16,125	4,442	11,500	178,111	11,889	62,000	383,976	220,673	21,920	141,383	0.842	119,041	
31/03/10	9,656	7,375	14,000		13,625	16,500	3,500	1,995	25,625	16,125	2,962	11,500	178,111	11,889	62,000	374,943	218,103	21,920	134,920	0.814	109,757	
31/03/11	9,656	7,375	14,000		13,625	16,500	3,068		25,625	16,125	1,481	11,500	178,111	11,889	62,000	370,955	216,174	21,920	132,861	0.786	104,428	
31/03/12	9,656	7,375	14,000		13,625	16,500	2,557		25,625	16,125		11,500	178,111	11,889	62,000	368,963	215,218	21,920	131,825	0.759	100,109	
31/03/13	7,275	7,375	14,000		13,625	16,500	2,045		25,625	16,125		11,500	178,111	11,889	62,000	366,071	214,828	21,920	129,323	0.734	94,888	
31/03/14		7,375	14,000		13,625	16,500	1,534		25,625	16,125		11,500	178,111	11,889	62,000	358,284	213,373	21,920	122,991	0.709	87,191	
31/03/15		7,375	14,000		13,625	16,500	1,023		25,625	16,125		11,500	178,111	11,889	62,000	357,773	211,918	21,920	123,934	0.685	84,888	
31/03/16		7,375	14,000		13,625	16,500	511		19,307	16,125		11,500	178,111	11,889	62,000	350,943	211,761	21,920	117,262	0.662	77,602	
31/03/17		7,375	14,000		13,625	16,500			16,125	16,125		11,500	178,111	11,889	62,000	331,125	207,279	21,920	101,926	0.639	65,172	
31/03/18		7,375	14,000		13,625	16,500			16,125	16,125		11,500	178,111	11,889	36,351	305,476	202,875	21,920	80,680	0.618	49,843	
31/03/19		7,375	14,000		13,625	16,500			16,125	16,125		11,500	178,111	11,889		289,125	189,468	21,920	57,737	0.597	34,463	
31/03/20		5,557	14,000		13,625	16,500			16,125	16,125		11,500	178,111	11,889		267,307	176,060	21,920	69,326	0.577	39,981	
31/03/21			10,548		13,625	16,500			16,125	16,125		11,500	178,111	11,889		258,288	175,195	21,920	61,183	0.557	34,081	
31/03/22					10,265	16,500			16,125	16,125		11,500	74,172	4,951		244,390	172,600	21,920	49,870	0.538	26,848	
31/03/23						12,432			16,125	16,125		11,500				119,180	169,140	21,920	-71,880	0.520	-37,389	
31/03/24									12,149			11,500				27,625	131,945	21,920	-126,240	0.503	-63,444	
31/03/25												11,500				23,649	96,480	21,920	-84,751	0.486	-46,008	
31/03/26												11,500				11,500	93,885	21,920	-104,305	0.469	-48,935	
31/03/27												11,500				11,500	91,290	21,920	-101,710	0.453	-46,104	
31/03/28												11,500				11,500	91,290	21,920	-101,710	0.438	-44,545	
31/03/29												11,500				11,500	91,290	21,920	-101,710	0.423	-43,038	
31/03/30												9,641				9,641	91,290	21,920	-103,569	0.409	-42,343	
TOTALS	84,525	116,182	234,548	75,694	241,890	309,432	39,887	41,899	301,162	334,649	41,462	297,141	3,280,174	218,949	842,351	6,459,964	4,609,887	569,919	1,280,158			1,236,804



Adrian Waite (Independent Consultancy Services) Limited

**Potential early
repayment of public
works loans board
debt**

**A draft final report for
South Derbyshire
District Council**

January 2004

Contents

1	Introduction	2
2	Appraisal of options based on those outlined in your paper dated 21 st November 2003 to include a sensitivity analysis	6
3	Independent guidance on technical issues including the balance sheet, credit ceilings and the potential effect on the Housing Revenue Account, including:	19
	<ul style="list-style-type: none"> ▪ Clarification of the legality of using the Provision for Credit Liabilities to capitalise the penalty payment. ▪ Whether the Council needs to prove that the Provision for Credit Liabilities (or at least the amount that would be used) is cash backed, and if so how this should be done. ▪ Whether this applies only to the penalty payment or the total debt repayment. ▪ Whether, if the Provision for Credit Liabilities is used the General Fund Credit Ceiling would increase as a result – and whether this would increase Minimum Repayment Provision. ▪ The effect of the whole exercise on credit ceilings (approximately £11m General Fund & £2m Housing Revenue Account). ▪ Whether the Council would still have credit ceilings with effectively no debt. ▪ Whether, in this case, a Minimum Repayment Provision would still be required and the logic of how this would tie in with having no debt. 	
4	Conclusions and Recommendations	25
	Appendices	26
	Appendix One – List of Loans	
	Appendix Two – Comparison of retaining and repaying debt using discounted cash flow at a discount rate of 3.5%.	
	Appendix Three – Comparison of retaining and repaying debt using discounted cash flow at a discount rate of 4.7%.	
	Appendix Four - Comparison of retaining and repaying debt using discounted cash flow at a discount rate of 3.5% - by loan	

1. Introduction

- 1.1 The option of repaying or rescheduling the Council's long term debt has been kept under review by South Derbyshire District Council over the last two to three years. A full options appraisal has not yet taken place, due mainly to the severity of the penalty that would be incurred on repaying any loans early. This generally eliminates any on going cost savings in the General Fund Revenue Account.
- 1.2 However, an opportunity now exists (until 31st March 2004) to capitalise penalty payments. This is ahead of the new prudential system for borrowing and capital finance.
- 1.3 In addition, the Council has acquired substantial capital receipts over the last two years from which, in accordance with regulations, a substantial proportion has been set-aside for debt repayment. The Council has now effectively accumulated adequate resources to repay all Public Works Loan Board debt, including the penalty payment.
- 1.4 These set-aside receipts cannot be used to support spending. Furthermore, the interest currently being earned on these resources is relatively low compared to that being incurred in debt interest, due to the level of current interest rates.
- 1.5 In any event, the existing debt (which is mainly fixed) is a significant cost in the Council's revenue account. Given all of these factors, a more formal appraisal has been undertaken with a view to reducing the Council's liability utilising accumulated resources currently in hand.
- 1.6 The Council has asked me to appraise these options based on those outlined in the paper prepared by the Finance Services Manager dated 21st November 2003 to include a sensitivity analysis; and to give independent guidance on technical issues including the balance sheet, credit ceilings and the potential effect on the Housing Revenue Account. This report is my draft final report.

1.7 Outstanding Long-term debt

1.7.1 The Council currently has the following outstanding long-term debt portfolio.

Lender	Amount O/S (£m)	Comment
Public Works Loans Board	£8.04m	<ul style="list-style-type: none"> <input type="checkbox"/> Made up of 20 individual loans maturing at various periods to 2039. <input type="checkbox"/> All loans are at fixed interest rates to maturity. <input type="checkbox"/> The average interest rate is 7.47%, the highest being 14.75%, and the lowest at 4.875%. <input type="checkbox"/> Total annual interest is approximately £620,000 per year. <input type="checkbox"/> The total penalty payment for repaying the whole £8m is currently around £2.5m. <input type="checkbox"/> However, this reduces as interest rates rise. £2.5m is considered to be the maximum payable given recent increases in the Base Rate. It would be calculated at the date of repayment.
Money Market	£1.0m	<ul style="list-style-type: none"> <input type="checkbox"/> A fixed loan at 4.875%, maturing in 2032. <input type="checkbox"/> Total annual interest is approximately £48,000 per year. <input type="checkbox"/> Potentially, there is a break clause every 6 months. The lender has the option of reviewing the interest rate every 6 months. If they wish to increase it, the Council has the option of repayment. As a result of this, it is considered that this loan may be treated as a short-term loan for the purposes of considering whether South Derbyshire District Council may be considered a 'debt-free' authority should a repayment of the public works loans fund debt be made. It is understood that the Finance Services Manager has confirmed this matter with the external auditors.

1.8 Bank Deposits

1.8.1 The Council currently has around £14m on short-term deposit, placed in accordance with its approved lending list. This has accrued mainly due to substantial asset sales (housing land and council houses) and is currently earning interest at an average rate of 3.46%.

1.8.2 It is important to note that although this level of deposits has been steadily increasing overall since April 2001, it can fluctuate during the year depending on the Council's overall daily cash flow. However, current cash flow projections still point to a balance of around £12m at the end of this financial year.

1.9 Set aside Receipts & Changes in Overall Borrowing

1.9.1 As at the 31st March 2003, the Council had received in total approximately £16.6m in set-aside capital receipts since the inception of the set-aside rules in 1990/91. This is projected to total around £20m by March 2004, based on current asset sales (mainly council houses). £12m has been generated over the last 4 years alone.

1.9.2 Effectively, some of this money has already been used to repay debt, in particular that previously being incurred on a temporary basis. As at April 2000, the Council had temporary loans of just under £8m.

1.9.3 This debt was fully repaid during 2001/02. In addition, the Council has not needed to enter into any form of borrowing over this period, and in accordance with its Treasury Management Strategy, has effectively been able to finance Government borrowing approvals over the last 3 years of approximately £2.5m.

1.9.4 The amount remaining would enable the whole of the Public Works Loans Board portfolio to be repaid including the associated penalty payment (approximately £10.5m).

1.10 Impact on the Housing Revenue Account (Housing Revenue Account)

1.10.1 The total interest payable on the Council's long term debt is approximately £668,000 per year. Of this approximately £153,000 (23%) is recharged out to the Housing Revenue Account in accordance with Government guidelines.

1.10.2 This reflects the amount of estimated debt outstanding in respect of the Housing service. This is reimbursed by the Government through Housing Subsidy and there is generally a neutral effect on the Council's Housing Revenue Account. The net effect to the Council is therefore approximately £515,000 (£668,000 less £153,000) on the General Fund.

1.11 Treasury Management Policy

1.11.1 Sections from South Derbyshire District Council's Treasury Management Policy that appear to be relevant include:

"The Council will manage its exposure to fluctuations in interest rates with a view to containing its interest costs, or securing its interest revenues, in accordance with the amounts provided in its budgetary arrangements." (para. 3.2.2)

Appley Business Centre, Bridge Street, Appley in Westmorland, Cumbria CA16 6QH
Telephone: 017683-52347 or 52165 Mobile: 07971-321863. Fax: 017683-52546.
E-Mail: Adrian.waite@awics.co.uk. Website: www.awics.co.uk.

4

"The Council recognises that future legislative or regulatory changes may impact on its treasury management activities and, so far as it is reasonably able to do so, will seek to minimise the risk of these impacting adversely on the organisation."(para. 3.2.5)

1.12 Calculations carried out by the Finance Services Manager

1.12.1 The Finance Services Manager has calculated the effect of the early redemption of Public Works Loans Board debt on South Derbyshire Council as part of his report of 21st November 2003. Supporting papers to these calculations have been requested and reviewed. Unless otherwise stated I have found no matters within these calculations that I believe could properly have been treated differently.

2. Appraisal of options based on those outlined in your paper dated 21st November 2003 to include a sensitivity analysis

2.1 Introduction

2.1.1 This section reproduces the analysis contained in the paper prepared by the Financial Services Manager, with an appraisal and sensitivity analysis included where appropriate.

2.2 Cost/Benefit Analysis

2.2.1 The starting point comes down to a basic analysis of comparing

- The financial effect of maintaining the set-aside capital receipts on deposit and earning interest for the General Fund, to
- The savings on Public Works Loans Board debt in the General Fund, by utilising the capital receipts now to redeem that debt.

2.2.2 The analysis prepared by the Finance Services Manager covers a period to the year 2039 (which is when all Public Works Loans Board debt would have naturally matured). It assumes that the debt is fully redeemed during the last quarter of 2003/04, and the first full year effect is therefore from 2004/05.

2.2.3 The table below provides a summary.

Years (note 1)	2004/07 (3 years) £'000	2007/10 (3 years) £'000	2010/22 (12 years) £'000	2022/39 (17 years) £'000	TOTAL (35 years) £'000
Savings in Public Works Loans Board Interest Payments (note 2)	1,844	1,762	6,292	2,041	11,939
Amount lost in Housing Subsidy (note 3)	-146	-146	-585	-828	-1,705
Loss of Deposit Interest (note 4)	-1,089	-1,067	-4,026	-2,965	-9,147
Net Savings/ Cost (-) (note 5)	609	549	1,681	-1,752	1,087
Average per Year	203	183	140	-103	
Net Present Value (note 6)	569	464	1,129	-683	1,479
Average per year	190	155	94	-40	

Note 1 – Analysis of Years

The Finance Services Manager has split the years on the following basis:

- 2004/07 - the Council's immediate financial planning period.
- 2008/10 – the following 3-year rolling period.
- 2011/22 – the longer term until the benefit turns into an overall cost.
- 2023/39 – the period when there is an overall cost.

This appears to be an appropriate way in which to regard the 36 year period under consideration.

Note 2 - Savings in Public Works Loans Board Interest Payments

The Finance Services Manager considers that these savings would be certain as interest payments are fixed and known over the life of individual loans. This is an appropriate assumption to make as I understand that there is no facility to switch any of these loans from a fixed rate to a variable rate basis.

Note 3 - Amount lost in Housing Subsidy

The amount included in the Finance Services Manager's calculations represents the difference between what would have been transferred to the Housing Revenue Account (and reimbursed via subsidy) and the lower amount with no Public Works Loans Board debt. This amount is mainly fixed and can be reasonably predicted. It also takes into account the new arrangements from the Prudential System for Capital Finance.

The calculation therefore considers the gross debt of the Council and the gross costs and benefits of early debt repayment – including both General Fund and Housing Revenue Account elements, and nets of these figures the loss of housing subsidy as a result of lower capital financing costs.

Note 4 - Loss of Deposit Interest

The Finance Services Manager has calculated this to represent the potential loss of interest on bank deposits, which would reduce considerably if they were used to repay Public Works Loans Board, including the penalty payment of around £2.5m. The current average interest rate being earned of 3.46% has been used. This amount reduces over the years as it has been assumed that it would be used to repay debt in any case as required over the 35-year period.

The Royal Bank of Scotland publishes a regular 'Interest and Exchange Rate Outlook' the latest of which was published in December 2003. This report states that:

"The Bank of England kept interest rates on hold at 3.75% in December, as we had expected, following last month's rate rise... We... anticipate a series of quarter-point interest rate increases next year – following the MPC meetings on 5th February, 6th May, 5th August and 4th November, which coincide with the committee's quarterly forecasting round – to take UK rates back up to 4.75% by the end of next year. We... expect interest rates to remain on hold throughout 2005."

In the longer-term interest rates in the United Kingdom are likely to be affected by whether the Euro is adopted as the currency. It is generally thought that lower rates of interest would be experienced if the United Kingdom chose to join the Euro.

It is always difficult to project interest rates with accuracy, especially into the longer term and so the use of the current rate of 3.46% could be considered reasonable. However, it is prudent to carry out a sensitivity analysis on variations in interest rates.

Note 5 - Net Savings/Cost

The Finance Services Manager has calculated the net savings or cost as the net effect of items 2 to 4 in cash terms.

Note 6 – Net Present Value

Net Present Value is the accepted methodology used in such circumstances, and the Finance Services Manager states that he has calculated it in accordance with the Government's "Green Book." It compares costs and benefits that occur in different time periods.

It uses a discount rate (3.5%) to calculate the present value of the differences and produces a Net Present Value. If the total Net Present Value is positive, then the basis of what is being reviewed (in this case repaying debt) is considered to be viable. The rate of 3.5% is set by the government and its use is therefore appropriate in this case.

The Net Present Value is effectively taking into account the future value of money, i.e. £1 today will be worth less in say 10 years. This does not have any real effect in the short term, but is more of a guide to future values in the longer term.

2.2.4 Commentary

The Finance Services Manager's calculation of Net Present Value in total is £1.479m and is positive. As stated in note 6 above, this makes the option viable as the Net Present Value indicates overall savings.

Analysing the figures further indicates quite significant cash savings in the short to medium term of approximately £1.1m to 2010. Even at the discounted level, it still equates to over £1m in this period. The savings continue to accrue for a total of 18 years up to the year 2022.

Beyond this, the loss of deposit interest would be greater than the saving in debt payments. This is more acute from 2027, and in cash terms over 17 years amounts to around £103,000 per year. However, the Net Present Value, which is probably a fairer reflection due to the time period involved, equates to approximately £40,000 per year.

2.2.5 Sensitivity Analysis – Interest Rates

As previously highlighted the interest on the Public Works Loans Board debt is fixed and the housing subsidy element is fairly stable and is not considered material here in any case. Effectively, the only variable is the interest rate used for deposit interest.

The current rate of 3.46% is likely to change. As noted above, recent market indications suggest that this will be upwards over at least the next 18 months, possibly hitting around 5% at sometime during 2005. The tables below show the Finance Services Manager's calculation of the effect of an increase in rates at various levels.

◆ At an average rate of 4%

Years	2004/07 (3 years)	2007/10 (3 years)	2010/22 (12 years)	2022/39 (17 years)	TOTAL (35 years)
	£'000	£'000	£'000	£'000	£'000
Net Savings/ Cost (-)	439	383	1,053	-2,215	-340
Average per Year	146	127	88	-130	
Net Present Value	410	323	715	-877	571
Average per year	137	108	60	-52	

This is effectively the break-even point and shows that even with a relatively small increase in interest rates there would be an overall cost over 35 years, as the potential interest on bank deposits outweighs savings on debt interest.

However, the Net Present Value remains positive because the cash advantages are mainly experienced during the beginning of the period, and there would still be quite considerable savings for 18 years, the discounted cost from 2022 onwards being relatively small.

◆ **At an average rate of 4.5%**

Years	2004/07 (3 years)	2007/10 (3 years)	2010/22 (12 years)	2022/39 (17 years)	TOTAL (35 years)
	£'000	£'000	£'000	£'000	£'000
Net Savings/ Cost (-)	281	229	472	-2,644	-1,662
Average per Year	94	76	39	-156	
Net Present Value	263	193	332	-1,057	-269
Average per year	88	64	28	-62	

The Finance Services Manager has calculated that at this level, the Net Present Value becomes negative, which according to the Government's "Green Book" would not make this option viable. However, there would still be savings for 18 years, albeit much lower compared to present rates. The discounted loss value over the later years is still fairly small on average.

◆ **At an average rate of 5.5%**

Years	2004/07 (3 years)	2007/10 (3 years)	2010/22 (12 years)	2022/39 (17 years)	TOTAL (35 years)
	£'000	£'000	£'000	£'000	£'000
Net Cost	-34	-79	-692	-3,501	-4,306
Net Present Value	-31	-66	-434	-1,416	-1,947

This shows that at an average interest rate of 5.5%, the option of repaying debt is not viable from the first year as the potential interest earned on deposits would be more than the savings on debt repayment.

2.3 Risk Analysis

2.3.1 The table below sets out and assesses the potential risks and implications involved that have been identified by the Finance Services Manager.

Risk	Likelihood	Comments & Effect
Challenge of legally capitalising the penalty payment.	Very Low	Finance Services Manager - This has been a "grey area" for sometime. The uncertainty was removed by recent regulations and the Audit Commission has effectively confirmed these. However, the option will be removed when the new Prudential System is introduced on 1 st April 2004. Adrian Waite – This matter is considered in paragraphs 3.1 and 3.3.
Future regulations allow spending of set-aside receipts.	Low	Finance Services Manager - Some authorities have retained receipts in the hope of this. It has been considered previously to boost the economy in times of recession. There are technical and logistical problems around this issue, which is why it has not yet been implemented. Adrian Waite – The Treasury takes account of set-aside receipts when calculating the public sector borrowing requirement, so in macro-economic terms the government considers that this money has already been spent. Government also wishes to see resources allocated on the basis of need rather than on the basis of past levels of capital receipts. It is therefore unlikely that set aside receipts will become available to fund future expenditure.
Increase in Interest Rates on short term deposits	High	Finance Services Manager - As per the previous sensitivity analysis. Although the figures in the model are the potential returns and which are being earned now, the Council's current 3-year financial projection does not yet reflect the full implications. Therefore, there are additional savings compared to the current base budget. This is considered further below. Adrian Waite – My observations are shown below.