
REPORT TO:	FINANCE AND MANAGEMENT COMMITTEE	AGENDA ITEM: 9
DATE OF MEETING:	17th FEBRUARY 2004	CATEGORY: RECOMMENDED
REPORT FROM:	CHIEF FINANCE OFFICER	OPEN
MEMBERS' CONTACT POINT:	KEVIN STACKHOUSE (595811)	DOC: u/ks/loans/finance report
SUBJECT:	REPAYMENT OF PUBLIC WORKS LOAN BOARD DEBT	REF:
WARD(S) AFFECTED:	ALL	TERMS OF REFERENCE: FM08

1.0 Recommendations

- 1.1 That the repayment of all outstanding Public Works Loan Board debt is made before 31st March 2004.
- 1.2 That the timing of the repayment is delegated to the Chief Finance Officer in accordance with the Council's Treasury Management Policy Statement.

2.0 Purpose of Report

- 2.1 To detail options to repay the Council's Public Works Loan Board (PWLB) Debt, using accumulated capital receipts that have been set-aside for such purposes.

3.0 Detail

Introduction

- 3.1 Under the terms of its Treasury Management Policy and Annual Borrowing Strategy, the Council keeps under review the management of its loans and investments.
- 3.2 Loans, mainly from the Government's Public Works Loan Board (PWLB), have been taken out over a long period of time to finance capital spending, for example, improvements to council buildings and construction of council houses. Investments have been built up in recent years from the proceeds of council homes under the Right to Buy Scheme. The Council is required to "set-aside" 75% of these proceeds to repay debt.
- 3.3 As interest rates have been low in recent years, it has not been economic for the Council to repay existing debts taken out at higher rates. This is because lenders will charge a premium to compensate them for the early payment of high rate debt at a time of low interest rates.

- 3.4 The Council has however used the set-aside receipts to replace money that it would have otherwise borrowed to support new capital investment. Effectively, this has kept borrowings at a lower level.

Context

- 3.5 The option of repaying or rescheduling the Council's long term debt has been kept under review over the last 2 to 3 years. A full options appraisal has not previously 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.
- 3.6 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.
- 3.7 As highlighted in the introduction above, the Council has acquired substantial capital receipts over the last 2 years from which 75% has been set-aside for debt repayment. The Council has now effectively accumulated adequate resources to repay all PWLB debt, including the penalty payment.
- 3.8 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.
- 3.9 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.

Current Facts and Figures

- 3.10 The Council currently has the following debt portfolio.

Lender	Amount O/S	Comment
PWLB	£8.04m	<ul style="list-style-type: none"> □ Made up of 20 individual loans maturing at various periods to 2039. □ All loans are at fixed interest rates to maturity. □ The average interest rate is 7.8%, the highest being 14.75% and the lowest at 4.875%. □ Total annual interest is approximately £620,000 per year. □ The total penalty payment for repaying the whole £8m is currently around £2.5m. □ 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	A fixed loan at 4.875%, maturing in 2032 with interest of approximately £48,000 per year. 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.

Bank Deposits

- 3.11 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%.
- 3.12 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.

Set aside Receipts & Changes in Overall Borrowing

- 3.13 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 £19.5m by March 2004, based on current asset sales (mainly council houses). £12m has been generated over the last 4 years alone.
- 3.14 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.
- 3.15 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.
- 3.16 The amount remaining would enable the whole of the PWLB portfolio to be repaid (approximately £10.5m) including the associated penalty payment.

Impact on the Housing Revenue Account (HRA)

- 3.17 The total interest payable on the Council's long term debt (including Money Market) is approximately £668,000 per year. Of this approximately £153,000 (23%) is recharged out to the HRA in accordance with Government guidelines.
- 3.18 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 HRA. The net effect to the Council is therefore approximately £515,000 (£668,000 less £153,000) on the General Fund.

Cost Benefit Analysis

- 3.19 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
 - savings on PWLB debt in the General Fund, by utilising the capital receipts now to redeem that debt.
- 3.20 The analysis covers a period to the year 2039 (which is when all PWLB 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.

3.21 **Appendix 1** details the analysis, and the table below provides a summary.

Years (note 1)	2004/07 (3 years)	2008/10 (3 years)	2011/22 (12 years)	2023/39 (17 years)	TOTAL (35 years)
	£'000	£'000	£'000	£'000	£'000
Savings in PWLB Interest Payments (note 2)	1,844	1,762	6,293	2,041	11,940
Amount lost in Housing Subsidy (note 3)	-146	-146	-585	-828	-1,705
Loss of Deposit Interest (note 4)	-1,089	-1,067	-4,027	-2,965	-9,148
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	1,128	-683	1,478
Average per year	190	155	94	-40	

Note 1 – Analysis of Years

3.22 The years have been split 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.

Note 2 - Savings in PWLB Interest Payments

3.23 These savings would be certain as interest payments are fixed and known over the life of individual loans.

Note 3 - Amount lost in Housing Subsidy

3.24 This amount represents the difference between what would have been transferred to the HRA (and reimbursed via subsidy) and the lower amount with no PWLB 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.

Note 4 - Loss of Deposit Interest

3.25 This represents the **potential** loss of interest on bank deposits, which would reduce considerably if they were used to repay PWLB, including the penalty payment of

around £2.5m. The current average interest rate being earned of 3.46% has been used. This amount on deposit 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.

Note 5 - Net Savings/Cost

3.26 The net effect of items 2 to 4 in **cash** terms.

Note 6 – Net Present Value (NPV)

3.27 This is the accepted methodology used in such circumstances, and has been calculated in accordance with the Government's "Green Book." It compares costs and benefits that occur in different time periods.

3.28 It uses a discount rate (3.5%) to calculate the present value of the differences and produces a NPV. If the total NPV is positive, then the basis of what is being reviewed (in this case repaying debt) is considered to be viable.

3.29 The NPV 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.

Commentary

3.30 The NPV in total of £1.478m is positive. As stated in note 6 above, this makes the option viable as the NPV indicates overall savings.

3.31 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 upto the year 2022.

3.32 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 NPV, which is probably a fairer reflection due to the time period involved, equates to approximately £40,000 per year.

Sensitivity Analysis – Interest Rates

3.33 As previously highlighted, the interest on the PWLB 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.

3.34 The current rate of 3.46% is likely to change. 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 effect of an increase in rates at various levels on the initial calculation.

◆ At an average rate of 4%

Years	2004/07 (3 years)	2008/10 (3 years)	2011/22 (12 years)	2023/39 (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	

3.35 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.

3.36 However, the NPV remains positive, 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)	2008/10 (3 years)	2011/22 (12 years)	2023/39 (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	

3.37 At this level, the NPV 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)	2008/10 (3 years)	2011/22 (12 years)	2023/39 (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

3.38 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.

Risk Analysis

3.39 The table below sets out and assesses the potential risks and implications involved.

Risk	Likelihood	Comments & Effect
Challenge of legally capitalising the penalty payment.	Very Low	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.
Future regulations allow spending of set-aside receipts.	Low	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.
Increase in Interest Rates on <u>short term</u> deposits	High	As per the previous sensitivity analysis.

Risk of Not Repaying?

3.40 Conversely, there could be a risk of not repaying debt, retaining substantial receipts and earning interest. For example, the Council could lose Government grant/capital support from any future changes to funding mechanisms.

Effect on the Council's General Fund Base Budget

3.41 The cost benefit analysis undertaken compared the various cash flows, i.e. the savings in debt interest compared to the **potential return** on short-term deposits over the 35-year period.

3.42 The current 3-year financial forecast contains a budget for interest on deposits as follows:

- 2004/05 - £450,000
- 2005/06 - £400,000
- 2006/07 - £350,000

3.43 This was increased for the current budget round from the previous level of £200,000 per year, to reflect the actual interest being generated. If all PWLB debt were repaid, the effect on the Council's base budget is shown below.

Change to Base Budget	2004/05 £'000	2005/06 £'000	2006/07 £'000
Savings on debt interest to PWLB	624	615	606
Loss of Housing Subsidy	-48	-48	-48
Loss of Deposit Interest (as budgeted)	-450	-400	-350
Overall Savings	-126	-167	-208

- 3.44 Clearly, this represents quite significant on-going savings on the current base budget – over £200,000 from 2006/07 onwards. The loss of deposit interest may not be as great, as some money would still be maintained on deposit. However, it would be reduced considerably, and would not increase to current levels due to the “Pooling” of future capital receipts.
- 3.45 Consequently, depending on the Council’s overall cash flow, short-term borrowing may need to be undertaken at certain times during the year incurring interest payments. Assuming the loss of all deposit interest at this stage would maintain a provision to cover this eventuality.
- 3.46 Furthermore, as highlighted previously, a sustained increase in interest rates on deposits from the current 3.46% to around 4.25%, would generate income in excess of the savings generated by repaying the debt (in the current base budget).

Alternative Options

- 3.47 The Council could use its balance of receipts in other ways, and these are considered below.

Option 1 - Part Repayment of Debt

- 3.48 To maintain some flexibility, whereby some debt could be repaid and the remainder kept on deposit pending a future review or change in circumstances.
- 3.49 **Appendix 2** analyses the NPV of repaying individual loans. This shows that every loan within the portfolio on its own would generate cash and NPV savings. However, except in 1 or 2 cases, the savings are relatively small each year, especially at a net present value level.
- 3.50 A range of scenarios could be modelled and sensitivity analysis applied. However, in attempting to maximise savings, given the Council’s portfolio, it appears more beneficial to repay a group of loans within the overall portfolio.
- 3.51 In essence, the loans that effectively carry the greater cost to the Council are loans 1 to 15. These are at rates of interest substantially higher than current (and in fact predicted) market rates and therefore carry severe penalty payments.
- 3.52 Loans 16 to 20 are at interest rates more in line with current rates and probably represent better value for money in the longer term (this is reflected in the relatively low penalty payments).

3.53 Repaying loans 1 to 15 would repay approximately 50% of the debt (£4.1m), but would still cost around £2.3m in penalty payments.

3.54 The effect of repaying these loans only is detailed in **Appendix 3**, and the table below provides a summary.

<u>Years</u>	2004/07 (3 years)	2008/10 (3 years)	2011/22 (12 years)	2023/30 (8 years)	TOTAL (26 years)
	£'000	£'000	£'000	£'000	£'000
Savings in PWLB Interest Payments	1,233	1,152	3,849	226	6,460
Amount lost in Housing Subsidy	-66	-66	-263	-175	-570
Loss of Deposit Interest	-685	-662	-2,406	-857	-4,610
Net Savings/ Cost (-)	482	424	1,180	-806	1,280
Average per Year	161	141	98	-101	
Net Present Value	452	358	799	-372	1,237
Average per year	151	119	67	-47	

Comparison to Full Repayment

3.55 The overall net savings are around £200,000 greater over 26 years. However, this is due to the "loss period" at the longer end, being 9 years less than that for the full repayment option.

3.56 However, in the medium term, the savings are considerably lower by approximately £3/4m to 2022, compared to the full repayment option.

Option 2 - Charge the Penalty Payment to Revenue

3.57 A fundamental issue to note in the above appraisals is that these show the effect on the Council's Revenue Account (the main General Fund). The penalty payment is effectively outside this, i.e. it is assumed it would be capitalised, to take advantage of the opportunity that closes on 31st March 2004.

3.58 Although it has been included in calculating the loss of deposit interest, it is effectively a "sunk" cost as it is a price of repaying the debt early. However, this money cannot be currently used for other means such as to support spending.

3.59 Penalty payments are usually accounted for through an authority's revenue account, being written off over a maximum of 10 years (in the Council's case £250,000 per year). In addition, an element can be charged to the HRA (23% or £58,000 in the Council's case) and reclaimed through Housing Subsidy.

3.60 The effect of doing this on the full repayment scenario is summarised below.

<u>Years</u>	2004/07 (3 years)	2008/10 (3 years)	2011/22 (12 years)	2023/39 (17 years)	TOTAL (35 years)
	£'000	£'000	£'000	£'000	£'000
Net Savings/Cost (-)	31	-28	912	-1,753	-838
Average per Year	10	-9	76	-103	
Net Present Value	30	-23	554	-683	-122
Average per year	10	-8	46	-40	

- 3.61 It can be seen that overall, there would be a cost on the General Fund of approximately £838,000. Effectively, the cost of the penalty reduces the more significant savings in the short/medium term to 2010 (infact there is a loss in the last 3 years to 2010).
- 3.62 In addition, the Council does run a risk with this option, in that it relies on no changes to housing finance and the subsidy system for the next 10 years, in particular the allowance of charging a proportion of the penalty to the HRA.
- 3.63 Again, the cost benefit analysis undertaken compares the various cash flows, i.e. the savings in debt interest compared to the potential return on short-term deposits. Referring back to the table in **3.43** which shows the savings on the current base budget, it is unlikely that the cost of the premium could be absorbed.

Option 3 - A Managed Investment Fund

- 3.64 Clearly, the Council does not have to repay debt and this analysis shows the effect of maintaining money on deposit. This is assumed to be on a short-term and very little risk basis. Therefore, it may wish to look at alternatives to try and maximise returns.
- 3.65 This could be done by entering into a formal agreement to have some or all of its accumulated receipts managed (for a fee) in an investment fund by a treasury management specialist. Although this **may** generate additional interest compared to that being earned now on the short-term market, it would carry a higher risk.
- 3.66 This is due to the fact that to earn better returns, funds would need to be invested over a longer term without the flexibility of recalling them at short notice. In addition, due to the nature of investments, returns can go up and down – the current situation of local authority pension funds is evidence of this.

4.0 Other Implications

- 4.1 Besides the cash flow and base budget analysis, consideration needs to be given to other issues of a more technical nature. For example, impact on “*Credit Ceilings,*” “*Minimum Revenue Provision,*” the Council’s Balance Sheet, together with the impact of being “*debt free.*”
- 4.2 In addition, due to the significance of the proposals contained in the report, an independent CIPFA consultant was requested to review the cost benefit analysis, to provide advice and guidance on the technical issues and to provide an overall opinion on the best course of action.

- 4.3 The consultant used was Adrian Waite (Independent Consultancy Services) Limited (**AWICS**). He has produced a report that is attached for information as **Appendix 4**. A substantial part of his report repeats the analysis contained above, as he was requested to provide an opinion on this. Some of the pertinent points made have been extracted and are highlighted below.
- *"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."* (1.12.1, page 5)
 - *"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."* (2.3.1, page 11)
 - *"Conversely, the Finance Services Manager considers that there could be a risk of not repaying debt, retaining substantial receipts and earning interest. For example, the Council could lose Government grant/capital investment from any future changes to funding mechanisms. This may prove to be the case."* (2.3.2, page 12)
 - *"It could be considered that regardless of whether the Council decided to charge the premium to the revenue or the capital account, the cost of paying the premium is a real cost to the council. This ought to be taken account of in the appraisal as a cash outflow in the first year."* (2.5.17, page 16)
- 4.4 On this last point, AWICS have then carried out a further calculation to demonstrate the viability of repaying debt, and the conclusions are shown below.
- *"This calculation indicates that it would be in the council's long-term interest to make an early repayment of these loans. The calculation is summarised in Appendix two."* (2.6.3 page 17).
 - *This methodology allows a comparison to be made between the cash flows that arise from the alternative treatment of the loans without including a calculation of the interest that would be foregone on the deposits. The effect on investment income is accounted for by using 3.5% as the discount rate in the calculation of net present value. The conclusions of this analysis support the conclusions that have been reached by the Finance Services Manager."* (2.6.6 page 17).
 - *"My recommendation is that the Chief Financial Officer should consider the early repayment of debt as outlined in the Finance Services Manager's report of 21st November 2003 and this report, and advise the Council accordingly."* (2.7.9 page 18).
- 4.5 The AWICS report goes on to advise on the technical issues (pages 19 to 24). Basically, this confirms that the penalty payment can be capitalised and that the cash currently on deposit can be used in this way.

- 4.6 In addition, during this exercise, Officers were concerned in that although the Council would effectively be repaying all its debt in cash terms, technically it would not become “debt free.” On paper, it would still have a substantial credit ceiling (around **£11m**) which is the measure of debt the Government uses under the present Capital Financing Regulations.
- 4.7 As AWICS point out, Officers looked at this anomaly by reviewing the annual calculation of the Council’s credit ceiling, and found that the initial basis used in 1990, appeared to be incorrect (**3.5.2, page 20**). The credit ceiling is a significant figure in that if it is Nil or negative on 31st March 2004 (and all debt had been repaid), it would mean that the Council is completely and technically “debt free.”
- 4.8 The consequence of this would be that the Council would benefit from the Government’s transitional arrangements for pooling capital receipts from 1st April 2004. As AWICS highlight in **3.8.6 (page 23)** this would mean that the Council would be able to keep around £4m in capital receipts over the next 3 years, rather than paying them over to the Government under the new Pooling arrangements.
- 4.9 The revised calculation based on the revised basis is summarised in the table below.

	£'000
Initial Credit Ceiling (Loans o/s on 1 st April 2004)	16,592
Add : Government Borrowing Approvals (1/4/1990 to 31/3/2004)	15,106
Less:	
Set-aside Capital Receipts (1/4/1990 to 31/3/2004)	-19,626
Loans Repaid as part of Commuting Grants (1992/93)	-8,273
Minimum Revenue Provisions (1/4/1990 to 31/3/2004)	-3,385
European Loans Repaid	-314
Implied Credit Ceiling as at 31 st March 2004 (without debt repayment)	100
Add: Penalty Payment incurred through Debt Repayment	2,500
Implied Credit Ceiling as at 31 st March 2004 (after debt repayment)	2,600

- 4.10 The revised calculation shows that the credit ceiling would still be positive on 31st March, due to the penalty payment being added in. This is the disadvantage of capitalising the penalty payment, as it is effectively classed as a borrowing approval. Therefore, the Council would not become debt free within the time scale allowed.
- 4.11 As highlighted in the option appraisal, charging the penalty payment to Revenue would eliminate the cash flow and base budget savings unless it could be released by other means.

Minimum Revenue Provisions (MRP)

- 4.12 However, due to a higher figure for the credit ceiling being used in the Accounts since 1990, it appears that the Council has been making higher provisions than it should have done for debt repayment from its General Fund.

- 4.13 Although this is not a cost, but a contribution to a capital reserve, it is a charge on the General Fund and therefore reduces spending provision. These higher provisions could amount to quite a substantial figure.

Liaison with the Council's District Auditor

- 4.14 This issue has been raised with the District Auditor on the possibility of restating the Council's credit ceiling and re-crediting the General Fund from the Capital Financing Reserve to an amount equivalent to these "over provisions." In addition, he has been asked to comment on the possibility of debt free status, and in particular the issue of the penalty payment increasing the credit ceiling. An update will be provided at the meeting.

AWICS – Summary and Recommendations

- 4.15 The issues of debt free status and MRP were effectively spin offs from checking the technical aspects of debt repayment. The cost benefit analysis demonstrates the cash flow and base budget savings, and this has been confirmed by AWICS in their overall summary and recommendations.
- *"In summary, there does appear to be a strong business case for repaying the Council's Public Works Loans Board debt. This would reduce a significant liability in the Council's General Fund on an on-going basis. The principal argument for not doing so, would be if there was an expectation that long-term rates of interest would rise above 4.7%." (4.1 page 25).*

5.0 Financial Implications

- 5.1 Clearly, these form an integral part of the report. In addition, the repayment of debt would immediately change one of the Prudential Indicators, which was considered in the Annual Budget Report on this Agenda. Depending on decisions made regarding debt repayment, it is proposed to review this as part of the Treasury Management Strategy that will be reported to the next Committee in March.

6.0 Corporate Implications

- 6.1 As detailed in the report

7.0 Community Implications

- 7.1 As detailed in the report

8.0 Conclusions

- 8.1 Repaying all PWLB debt can produce quite substantial savings on the Council's General Fund in the short and infact longer term (the next 18 years). Although there would be an overall cost from 2022 onwards, this is relatively small on an annual basis. Depending on the Council's financial position in later years, any future financial strategy could include an annual provision to provide for this cost.
- 8.2 For example, after 2010, the Council would have repaid all of its liabilities under existing Covenant arrangements. Savings in annual interest start accruing from 2007/08 onwards, and this could be set-aside as a reserve.

- 8.3 The main risk involved is the potential returns that could be lost by keeping the money on short-term deposit. The average interest rate is currently 3.46% but is steadily rising in accordance with recent base rate changes. On a cash flow basis, the critical rate for this exercise appears to be around 4.7%, where interest earned outweighs the saving from debt repayment.
- 8.4 Clearly, interest rates can fluctuate. It is important not to concentrate on short-term rates as a guide to longer term ones. Infact, an immediate rise in rates would be beneficial, as it would reduce the extent of any premium payable.
- 8.5 Some predictions for interest rates indicate a continuing rise in the shorter term (1 to 2 years). However, as pointed out by AWICS, the Government's Discount rate is 3.5%, representing their view of long term investment returns. In addition, other economists predict lower rates of interest in the longer term, especially if the U.K. adopts the Euro Currency.
- 8.6 Using managed investment funds does carry a higher risk, and although returns could be higher, this is by no means certain.
- 8.7 Clearly, the situation is uncertain for interest rates and events can change the situation overnight. Repaying debt provides more certainty, in that the savings in interest payments on the General Fund are known.
- 8.8 On this point, the Council's Annual Budget Report that has been considered on this Agenda highlights an underlying (and increasing) budget deficit in the medium term to 2006/07. In addition, it also highlights that action will need to be taken well in advance of 2006/07 to align Council spending more closely with projected income. The savings in interest payments would go someway in helping to address this issue.
- 8.9 If debt is repaid, the greatest savings derive from repaying the total portfolio, especially as the Council currently has sufficient set-aside receipts to do so, including the penalty payment. Although this penalty is effectively a "sunk" cost, taking advantage of the opportunity to capitalise it would generate additional revenue resources.
- 8.10 In addition, depending on discussions and the opinion of the Council's District Auditor, there may be other benefits that could generate additional resources for the Council.
- 8.11 In summary, there does appear to be a strong business case for repaying the Council's PWLB debt. This would reduce a significant liability in the Council's General Fund on an on-going basis.

9.0 Background Papers

- The Government's "Green Book"