Report to Haslemere Town Council Finance & Governance Committee
10th March 20121

DRAFT: Recommendation on Town Hall loan Sinking Fund payments

Introduction

The Council has an outstanding loan which was taken out to fund improvements to the town hall. The loan is for £230,000, interest is payable at a fixed rate of 4.3% per annum, and the principal is repayable at the end of March 2035.

To ensure that the Council is able to repay the loan a sinking fund has been set up, and a schedule of annual payments to the fund was agreed in 2011. The fund currently stands at £79, 225, which is some £12,000 above the projected level of £67,112. This includes the payment due for March of this year.

The purpose of this report is to consider why the sinking fund is at a higher level than projected and to consider whether this means that the schedule of payments should be amended.

Recommendation

Given the analysis below, I do not recommend any change to the contribution schedule for the next five years. However, I suggest that the planned rate of increase in contributions over time is lowered.

Analysis of current position

The projected sinking fund and schedule of contributions set out in 2011 are reproduced in the table below.

Planned sinking fund contributions and projected balance – 2011 calculation

Date	Planned Contribution	Projected Balance	Date	Planned Contribution	Projected Balance
31-Mar-11		21,992	31-Mar-24	8,000	91,112
31-Mar-12	2,120	24,112	31-Mar-25	8,000	99,112
31-Mar-13	**2,500**	26,612	31-Mar-26	**11,000**	110,112
31-Mar-14	2,500	29,112	31-Mar-27	11,000	121,112
31-Mar-15	2,500	31,612	31-Mar-28	11,000	132,112
31-Mar-16	**5,500**	37,112	31-Mar-29	11,000	143,112
31-Mar-17	5,500	42,612	31-Mar-30	11,000	154,112
31-Mar-18	5,500	48,112	31-Mar-31	**15,000**	169,112
31-Mar-19	5,500	53,612	31-Mar-32	15,000	184,112
31-Mar-20	5,500	59,112	31-Mar-33	15,000	199,112
31-Mar-21	**8,000**	67,112	31-Mar-34	15,000	214,112
31-Mar-22	8,000	75,112	31-Mar-35	15,888	230,000
31-Mar-23	8,000	83,112			

The fund is currently higher than projected for 2021 for three reasons.

First, the projection of the sinking fund balance doesn't allow for any interest earned, but in practice the sinking fund is held in a bank account and does earn interest. This interest is kept within the fund rather than treated as income for the Council more broadly, and so acts to increase the sinking fund balance over time. This will continue in future, although the level of interest is likely to be lower than in the past.

Second, a one-off payment of some £7,500 was made into the fund by mistake several years ago following an unexpected VAT refund. It was decided at the time to leave this in the fund, which has increased the balance. This is unlikely to occur again.

Third, the contribution for this year has been made at the lower rate of £5,500 rather than the planned rate of £8,000, which partially offsets the two items above.

Analysis of future payments

On the face of it, as the fund is currently some £12,000 higher than expected there is an argument to take contribution holiday, or at least lower next year's contribution. However, it is worth considering the path of future contributions before doing so. This is discussed below and leads to the recommendation to leave the current schedule unchanged.

The aim of the original contribution schedule appears to have been to keep contributions at a broadly constant proportion of the precept (approximately 1.5%), although to simplify administration it was decided to keep contributions fixed for five years at a time, so the proportion would vary slightly from year to year. To do this an assumption was required as to the growth rate of the precept, and a contribution schedule was adopted that would meet this aim if the growth rate was around the 8% level.

In retrospect precepts have not grown at this rate, as inflation has fallen significantly over recent years. The current precept is £366,932, some 15% below the level that the repayment schedule assumed (6% actual growth rather than 8%), and this year has increased by just under 5%. To keep future contribution rates at their previously suggested level will therefore lead to a significant increase in the contributions as a percentage of the precept in future years.

To give some context, if future increases in the precept remain at 5%, the repayments set out in the current schedule will grow as a proportion of the precept, from 1.5% today to 2.5% in 2031. A 3% precept growth rate would leave to the contributions reaching 3% of precept in 2031. This suggests that it would be more prudent to use the excess in the sinking fund to allow a lower future contribution rate rather than take an immediate payment holiday.

Two illustrations are shown for information below. The first assumes the precept grows at 4% in future but ignores any interest income on the sinking fund. The second includes an allowance for 1% interest per annum. They both start from the current precept and sinking fund and maintain the original idea of a stepped increase in contributions that maintains a broadly constant contribution as a proportion of the precept.

(A 4% growth rate is broadly in line with the expected nominal growth rate of the economy as a whole (real long-term growth of 1.5-2.0%, although higher over the next year or so post COVID, and CPI of 2.0%). However, a percent either way would not make much difference over the next five years.)

The first three columns show that if we continue to ignore interest but assume a 4% long term growth in precept from the current position, we should consider increasing the planned contribution for the next five years from £8,000 to £8,500 per annum, and then allow the contributions to grow at a slower rate into the future. The second three columns show that, if we allow for interest, the planned increase to £8,000 is sufficient, and also allows a slower increase in contributions into the future.

As we do in fact receive interest, it seems reasonable to allow for it in our calculations.

While it is impossible to accurately predict the future of inflation or interest rates, this analysis suggests that it would be reasonable to leave the planned contributions unchanged for the next five years. At the end of this period the contribution will need to be reviewed again, but it should be possible to maintain the contribution rates at a broadly level percentage of the precept, i.e., at a lower rate than currently assumed.

Projected sinking fund contributions and projected balance – current calculation

No interest			Allowing for interest at 1%.			
Date	Planned Contribution	Projected Balance	Date	Planned Contribution	Expected Interest	Projected Balance
31-Mar-21	**5,500**	79,225	31-Mar-21	**5,500**		79,225
31-Mar-22	8,500	87,725	31-Mar-22	8,000	792	88,017
31-Mar-23	8,500	96,225	31-Mar-23	8,000	880	96,897
31-Mar-24	8,500	104,725	31-Mar-24	8,000	969	105,866
31-Mar-25	8,500	113,225	31-Mar-25	8,000	1,059	114,925
31-Mar-26	**10,500**	123,725	31-Mar-26	**9,500**	1,149	125,574
31-Mar-27	10,500	134,225	31-Mar-27	9,500	1,256	136,330
31-Mar-28	10,500	144,725	31-Mar-28	9,500	1,363	147,193
31-Mar-29	10,500	155,225	31-Mar-29	9,500	1,472	158,165
31-Mar-30	10,500	165,725	31-Mar-30	9,500	1,582	169,247
31-Mar-31	**12,500**	178,225	31-Mar-31	**11,000**	1,692	181,939
31-Mar-32	12,500	190,725	31-Mar-32	11,000	1,819	194,759
31-Mar-33	12,500	203,225	31-Mar-33	11,000	1,948	207,706
31-Mar-34	12,500	215,725	31-Mar-34	11,000	2,077	220,783
31-Mar-35	14,275	230,000	31-Mar-35	7,009	2,208	230,000

Another approach would be to consider the sum of the sinking fund contributions and of the annual interest payments made on the loan, and to keep this total a fixed proportion of the precept. On this basis the shape of the current schedule of increases would remain appropriate but there would be some scope for an across-the-board reduction of future contributions of about 8%, or some £600 next year.

I have not recommended this as it seems counter to the original approach, which I presume was discussed and agreed before it was adopted, and because it seems prudent to leave headroom for the Council in case any future funding requirements arise.