Finance and Resources Committee

10.00am, Friday, 14 February 2020

Loans Fund Review

Executive/routine	**Executive**
Wards	
Council Commitments	

1. Recommendations

1.1 The Finance and Resources Committee is asked to:

1.1.1 Note the proposal for an amendment to the methodology of calculating loans fund advance repayments for pre-March 2019 advances;

1.1.2 Note the proposal for an investment of £2m per annum of Loans Fund savings in infrastructure maintenance;

1.1.3 Refer the report to Council as part of the 2020-23 budget considerations.

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Report

Loans Fund Review

2. Executive Summary

2.1 The purpose of this report is to seek Members' approval to revise the Loans Fund debt charge repayment periods, based on a prudent financial management strategy.

3. Background

3.1 The Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016 *(the 2016 Regulations)* came into force on 1 April 2016. These regulations replaced the statutory provisions for local authority borrowing, lending and loans fund, as set out in Schedule 3 of the Local Authority (Scotland) Act 1975.

3.2 From 1 April 2016, the statutory purpose of the loans fund was simplified, with details set out in Appendix 1.

3.3 Regulation 14 requires a local authority to determine for each loans fund advance the period over which the advance is to be repaid to the loans fund, and the amount of repayment to be made to the loans fund in each financial year in that period.

3.4 Regulation 14(2) allows a local authority to subsequently vary either the period or the amount of the repayment (or both) if it considers it prudent to do so.

3.5 The 2016 Regulations do not define prudent repayment, but the statutory guidance explains that it is a repayment which is reasonably commensurate with the period and pattern of benefits provided to the community from the capital expenditure. The statutory guidance also sets out a number of options that are considered to be prudent.

3.6 It has been confirmed by Audit Scotland that the existing Regulations permit pre-2016 advances to be reprofiled, if it is considered prudent to do so.

3.7 Paragraph 31 of the Guidance identifies that the broad aim of prudent repayment is to ensure that the repayment of a loans fund advance, in relation to the repayment period and each year's repayment amount, are reasonably commensurate with the period and pattern of the benefits provided to the community from capital expenditure. It is for each Authority to manage this appropriately and to determine prudent repayments based on its own individual circumstances.

4. Main report

4.1 Following the introduction of the new regulations, and subsequent clarification on their application to pre-2016 advances, a review of the Council's Loans Fund repayment has been undertaken by Link Asset Services (LAS), with the objective to explore options which can re-profile loans fund repayments in order to assist with delivery of a prudent, sustainable and deliverable medium-term revenue budget strategy, whilst ensuring that the provision remains prudent and appropriate to the benefits that are provided to the community from the associated expenditure.

4.2 It is recommended that Members consider the proposed option, which incorporates officers' views for a preferred outcome that is specific to the Council's financial position and is consistent with the prudential framework.

4.3 The repayment of loans fund advances is based on two elements:

- The period set for which each advance is to be repaid to the loans fund; and
- The annuity interest rate.

4.4 Statutory guidance identifies that the broad aim of a prudent repayment is to ensure that the repayments of a loans fund advance, in relation to the repayment period and each year's repayment amount are reasonably commensurate with the period and pattern of the benefits provided by the capital expenditure.

4.5 The method considered most appropriate for the Council is a simplified annuity method that uses an average repayment period for all loans fund advances. Following the general accounting principles of matching and consistency, it is considered appropriate that the asset life used in the repayment calculation reflects the useful economic life (UEL) used when calculating depreciation in the statutory annual accounts, unless it is considered imprudent to do so. Depreciation bases are set out in Appendix 2.

4.6 The depreciation policy of the Council has generally set a higher useful life period than the average loan repayment periods, which repaid the advances over a shorter period than the actual use of the asset. It is recommended to use an average life of 30 years for General Fund repayments which is more in line with the depreciation policy. For the Housing Revenue Account (HRA) it is recommended to use an average life of 30 years for non-component spend. Component spend will remain on an average 20-year life, due to the nature of the expenditure, e.g. replacement of kitchens, bathrooms, heating systems, etc.

4.7 The Council has set out a repairs and maintenance programme for operational buildings and in increasing the useful life of other infrastructure (roads, bridges, etc), it would be appropriate to increase the repairs budget for those assets. It is therefore recommended that £2m of the annual saving is accordingly earmarked.

Annuity Interest rate

4.8 The Council has applied the average loans pool rate each year to calculate loan repayments for historic debt based on interest incurred and loans fund advances made. This ranges from 10% in 1996/97 to 4.63% in 2018/19. Taking into account the level of expenditure in each year, the average loans fund borrowing rate over this period is 5.8% and it is recommended that this interest rate is used to calculate loans fund charges for advances made during this period. Going forward, for new advances, the pool rate for the year will be used.

Variation of prior year repayments

4.9 Section 14 of the 2016 Regulations stipulates that a local authority may subsequently vary either the period of the amount of repayment (or both), if it considers it prudent to do so. Given the outcome of the review, it is considered appropriate to amend the repayment period for previous loans fund advances to 30 years, based on the average historic loans fund interest rate of 5.8%.

5. Next Steps

5.1 If the report recommendations are approved, the revised methodology will be applied to loans fund advance repayments from the 2020/21 financial year.

6. Financial impact

6.1 Revised repayments have been calculated for the General Fund and HRA based on the repayment periods set out in 4.6 and annuity rate set out in 4.8 above.

6.2 The result of this calculation produces an excess provision up to 2018/19, based on the increase in asset life, which could be taken to reduce charges in future years.

Loans Fund Repayments	General Fund £m	HRA £m	Total £m
Actual charge to 31/03/2019	324	119	443
Revised charge to 31/03/2019	180	74	254
Excess to be adjusted for in future years	144	45	189

6.3 It is recommended that the recalculation adjustment is spread to reduce the impact upon loans fund repayments in later years and apply a prudent approach specific to the Council's financial position as follows, based on implementation from 2020/21.

6.3.1 General Fund

- Gross savings of £12m for the next five years

- Smoothing the remaining savings in order that it does not create a significant spike in charges in later years
- Ensuring the recalculation adjustment does not result in a cost in net present value (NPV) terms over the useful life of the asset.

6.3.2 Housing Revenue Account

- Smoothing the recalculation adjustment in order to give a reduced cost but remaining affordable in terms of the housing capital strategy.

6.4 The table below shows the whole life impact both in nominal and NPV terms in order to take into account the time value of money and assess the whole life impact of this proposal. The NPV uses a discount rate of 3.5% as suggested by the Treasury Green Book

	General Fund		**HRA**	
	Nominal £m	NPV £m	Nominal £m	NPV £m
2019/20	0.0	0.0	0.0	0.0
Years 2 – 5	(48.0)	(42.6)	(29.2)	(25.7)
Years 6 – 10	(47.0)	(36.2)	(47.2)	(36.2)
Years 11-25	72.0	36.2	62.4	28.8
Years 26 – 31	23.0	8.9	14.0	5.5
Total	0.0	(33.7)	0.0	(27.6)

6.5 The revised General Fund payment profile is set out in Appendix 3.

7. Stakeholder/Community Impact

7.1 There is no direct relevance to the report's contents.

8. Background reading/external references

8.1 Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016

8.2 Audit Scotland Technical Guidance Note 2018/10(LG)

9. Appendices

Appendix 1 – Additional background information

Appendix 2 – Depreciation bases

Appendix 3 – Revised General Fund charges

Additional Background Information

The repeal of the Schedule 3 provisions is set out in The Local Government etc. (Scotland) Act 1994 (Commencement No. 9) Order 2016. Finance Circular 29/1975 is only applicable to loans fund advances made before 1 April 2016.

The 2016 Regulations require the statutory loans fund to be administered in accordance with the Regulations, proper accounting practice and prudent financial management.

From 1 April 2016 the statutory purpose of the loans fund is simplified as follows:

- to recognise, by making advances from the loans fund, the expenditure incurred, or loans made to third parties, by the authority, which a local authority has determined are to be financed by borrowing;

- to record transactions – opening balances each year, new advances, repayments charged to revenue (statutory repayment of debt), and a closing position balance at each financial year end, being the value of the loans fund advances still to be repaid/ charged to revenue;

- for each loans fund advance made, to record the annual repayment to be made to revenue. This will provide an authority with a profile of annual charges representing the amount of statutory repayment of debt to be charged to the General Fund/Housing Revenue Account in any financial year.

Regulation 14 requires a local authority to determine for each loans fund advance:

- the period over which the advance is to be repaid to the loans fund;

- the amount of repayment to be made to the loans fund in each financial year in that period.

Technical bulletin 2019/1 was issued by Audit Scotland in December 2018 and stated that Authorities could not subsequently vary the loans fund advances once set, i.e. pre-2016 loans.

Following representations made to the Scottish Government by Finance Directors, the Scottish Cabinet Secretary for Finance, Economy and Fair Work, Derek Mackay MSP, issued a letter on 31st January 2019. This set out the Stage 1 agreement on the Local Government Settlement and also provided confirmation of the intention to bring forward changes to the guidance to clarify and confirm that Councils can vary loans fund repayments for advances made before 1st April 2016.

In May 2019 Audit Scotland received Counsel opinion that accords with legal advice ascertained by a number of some Scottish Councils which confirms:

“Local Authorities do have the power to vary repayments of pre-April 2016 advances under the 2016 regs.”

Audit Scotland has subsequently issued further clarification in Technical Guidance Note 2018/10(LG) published on 5 June 2019. Module 3 Financial Instruments confirms:

"…the 2016 Regulations can be applied to pre-April 2016 advances. Specifically, this includes Regulation 14(2) which permits a local government body to vary the period and amount of the repayment if it considers it prudent to do so."

It also confirms that:

"While the ultimate judgement rests with each appointed auditor, in Professional Support's view, any local government body wishing to vary the amount and/or period of loans fund repayment of pre-April 2016 advances in 2018/19 has the statutory power to do so subject to the repayment being considered prudent. Similarly, the councils which varied repayment in 2017/18 had the power to so and therefore no restatement in 2018/19 is necessary, again subject to the repayment being considered prudent**.**

Depreciation bases and current repayment periods

The Council's statutory annual accounts depreciation policy calculates depreciation on the following bases:

Buildings (assets not subject to component accounting)	50 years
Buildings – structural	50 years
Buildings – non-traditional roofing	35 years
Buildings – finishes	25 years
Buildings – mechanical and electrical	20 years
Buildings – fittings and furnishings	15 years
Infrastructure assets	20 years
Vehicles, plant and equipment	5 – 30 years

Loans Fund

Loans fund advances are currently repaid over the following periods:

General Fund	Major infrastructure projects	30 years
	Vehicles, plant and equipment	5 – 20 years
	Other expenditure	20 years

Repayment profile for loans fund advances to the General Fund

	Original Repayment £m	Revised Repayment £m	Difference £m
2020/21	49.203	37.203	-12.000
2021/22	50.371	38.371	-12.000
2022/23	51.450	39.450	-12.000
2023/24	51.401	39.401	-12.000
2024/25	51.939	39.939	-12.000
2025/26	52.519	40.519	-12.000
2026/27	47.693	38.693	-9.000
2027/28	45.961	37.961	-8.000
2028/29	43.881	37.881	-6.000
2029/30	39.951	37.951	-2.000
2030/31	33.022	36.022	3.000
2031/32	31.758	34.758	3.000
2032/33	29.672	32.672	3.000
2033/34	29.061	32.061	3.000
2034/35	27.633	30.633	3.000
2035/36	28.133	30.133	2.000
2036/37	29.341	30.341	1.000
2037/38	20.859	29.891	9.032
2038/39	19.306	29.306	10.000
2039/40	17.180	26.180	9.000
2040/41	17.907	25.907	8.000
2041/42	18.386	24.386	6.000
2042/43	12.205	19.205	7.000
2043/44	3.867	10.867	7.000
2044/45	0.880	7.348	6.468
2045/46	0.597	6.097	5.500
2046/47	0.582	6.582	6.000
2047/48	0.592	3.592	3.000
2048/49	0.515	2.655	2.140
2049/20	0.140	0	-0.140
	806.005	806.005	0.000