Finance and Resources Committee

10.00 a.m., Tuesday, 7 February 2023

Accounting for Service Concessions

Executive/routine
Wards
Council Commitments

1. Recommendations

1.1 The Finance and Resources Committee is asked to note the content of this report and refer it to Council to approve the following recommendations:

1.1.1 The Council exercises flexibility on accounting for Service Concessions, effective from 1 April 2023, as permitted under Finance Circular 10/2022;

1.1.2 The retrospective benefit of £95.208m to the end of 2022/23 is transferred into the General Fund, from the Capital Adjustment Account, and its use considered as part of the budget setting process;

1.1.3 Notes that adoption of the guidance will extend the repayment period over a longer timeframe, past the date when government grant support will cease;and

1.1.4 Agrees, for this reason, that future benefits which will accrue under the revised accounting arrangements are ring-fenced to help towards future years' costs.

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Report

Accounting for Service Concessions

2. Executive Summary

2.1 The report sets out the outcome of the review of accounting for the Council's service concession arrangements in light of financial flexibilities introduced by the Scottish Government. Adoption of the opportunities available under these financial flexibilities is subject to approval at a meeting of the Council. The report will be considered by Council at its meeting on 9th February. Use of retrospective benefits arising from the proposed changes, if approved, will be considered at the Council's budget meeting on 23rd February 2023.

3. Background

3.1 The Revenue Budget 2022/27 Framework: progress update report to the Finance and Resources Committee on 16th June 2022 updated members on the progress with the request from local government for a service concession financial flexibility. The request sought to allow, in accounting terms, the principal element of debt repayments to be spread over the (longer) life of the asset and not the contract term, with the effective "credit" from prior years being treated as overpayments to be made available to fund expenditure.

3.2 The report advised that the Scottish Government had confirmed that the flexibility would be made available to councils. Use of these flexibilities is subject to both (i) robust local consideration to ensure such use is prudent, sustainable and affordable over the life of the asset and (ii) explicit approval by Council. The flexibilities may only be applied to existing concession arrangements. The Scottish Government issued Finance Circular 10/2022 setting out further details.

3.3 The Council has five service concessions that fall within scope for consideration, noting the flexibilities, if adopted, must be applied to all concessions in scope. The Council cannot choose to apply the flexibilities to some schemes and not others.

3.4 The five service concessions within scope are detailed in Appendix 1. Under the accounting arrangements for these service concessions, the Council added £337m of assets to its balance sheet, creating a lease liability of the same value. This amount excludes capital contributions that the Council made as part of the contractual arrangements.

3.5 The unitary charge, or contractual payment, made to the providers comprises three elements – payment for services provided, repayment of debt and interest payable. The element relating to repayment of debt is used to write down the lease liabilities over the contract term(s).

3.6 At the end of the contract period, the lease liabilities will be fully repaid and the assets are transferred into Council ownership.

3.7 As at 31 March 2023, the Council expects to have outstanding lease liabilities of circa £221m arising from these contracts.

3.8 Advice and support has been sourced from Link Asset Services for the work undertaken on service concessions.

4. Main report

4.1 The Council has four service concession arrangements for the provision of education services, as detailed in Appendix 1. The current arrangements provide for repairs and maintenance to be carried out during the life of the contracts and the assets are expected to be in a good condition when ownership transfers to the Council at the end of the contractual periods in compliance with contract conditions.

4.2 Under the new guidance issued by the Scottish Government, councils now have the option to account for the payment for the assets over their useful life, rather than over their contractual period. Other education buildings funded through the capital programme have an asset life of 50 years. It is therefore proposed to extend the repayment period for each of the education service concessions to 50 years, on a consistency basis.

4.3 Furthermore, had these assets been provided through the capital programme at the time of construction, the debt repayments would have been calculated on an annuity basis. For consistency purposes, it is also proposed to adopt an annuity repayment method for these assets

4.4 The Council is not proposing to change the asset life for the waste facility at Millerhill due to this being an operational asset subject to technology and legislative risk but is proposing, on a consistent accounting basis, to adopt the annuity repayment method.

4.5 Members are asked to note that this proposal does not change the amount that will be paid to the service concession providers each year, nor the contract term over which these payments will be made.

4.6 Details of the current and proposed repayment profiles are set out in Appendix 2.

4.7 The guidance provides councils with the opportunity to apply these changes retrospectively. This allows the Council to revisit the repayments that have been made and restate them over the revised useful life, on the annuity basis proposed. This creates an overpayment situation, which currently sits in unusable reserves *(Capital Adjustment Account)*. The Council is permitted to move the overpayment from unusable reserves to its General Fund balance.

4.8 Adopting the Scottish Government guidance provides the Council with a retrospective gain of £95.208m as at 31st March 2023. Council will be asked to approve the release of this retrospective gain into the General Fund and to subsequently consider its use as part of the budget setting process.

4.9 Members should note that the level of reserves held, and the use thereof, is considered as part of the capital financing requirements and inform the Council's Treasury Strategy.

4.10 Further savings will be generated in future years through the use of extended asset lives, and the adoption of annuity-based repayments. Extension of asset lives, however, will require the Council to budget for repayments after the end of the service concession contractual periods as the Level Playing Field Support funding provided by the Scottish Government towards debt and interest costs will cease at the end of the contractual periods. The Council's longer financial planning will require to provide for repayments as they fall due. For this reason, it would be prudent for the Council to ring fence and set aside future savings as they arise to help mitigate these costs and anticipated increased repairs and maintenance expenditure in future years.

4.11 Members are advised that the Service Director: Finance and Procurement, in his capacity as s95 officer, confirms that the proposals set out in this report, including the set-aside of future years' savings to mitigate increased costs, is consistent with the requirements for the proposal to be prudent, sustainable and affordable. Use of the retrospective gain of £95m should be applied on a prudent basis, recognising the significant incremental funding gaps over the full period of the framework. As reported to members on 10 November 2022, a five-year period for application of the flexibility is considered appropriate.

5. Next Steps

5.1 Subject to the agreement of the Committee, the report will be referred to Council for approval, as required under the Scottish Government guidance.

5.2 Should approval be given, the Council will adopt the accounting changes set out in this report as part of its revenue budget strategy.

5.3 The Council's Annual Treasury Strategy will consider any impact on the Capital Financing Requirement.

5.4 The applicable accounting policies will be updated in the Financial Statements from financial year 2023/24 onwards.

6. Financial impact

6.1 Adopting the Scottish Government guidance by extending the asset lives of the educational schemes assets and using an annuity repayment basis results in a retrospective gain of £95.208m as at 31 March 2023, together with further savings in future years until the end of the current PPP service concession contracts, as noted in 4.10 above.

6.2 Extending the asset lives will result in repayments being due after the end of the contractual periods when Level Playing Field Support will also cease. These costs will require to be included in the Council's revenue budget framework as they fall due.

6.3 The retrospective benefit is on an accounting basis. Using this retrospective gain as part of the revenue budget framework will increase the Council's Capital Financing Requirement (CFR). Funding the CFR is considered as part of the Council's Annual Treasury Strategy which is reported in March each year to the Council.

6.4 Use of the retrospective gain will have an opportunity cost in terms of interest earned on credit balances. For example, use of £20m of gain in 2023/24 would result in foregone interest of £0.6m, assuming an interest rate of 3%. This loss of interest earned on credit balances will be managed within the overall loan charges / investment income budget included in the financial framework.

6.5 Level Playing Field Support (LPFS) provided by the Scottish Government towards contractual debt repayments and interest costs will cease at the end of the original contractual period. The Council receives circa £20m of LPFS funding per annum.

6.6 The current and proposed repayment position is summarised in the following table, with tables on a concession-by-concession basis shown in Appendix 2.

Year	Current repayment £m	Revised repayment £m	(Reduction) / cost £m	NPV at 3.5% £m
Pre 2023/24	115.566	20.358	(95.208)	(95.208)
Due within one year	9.009	2.374	(6.635)	(6.411)
Due within 2 – 5 years	41.728	11.429	(30.299)	(26.825)
Due within 6 – 10 years	64.528	20.065	(44.463)	(33.772)
Due within 11 – 25 years	106.023	131.066	25.043	5.386
Due within 26 – 40 years	-	135.225	135.225	46.446
Due within 41 – 50 years	-	16.337	16.337	3.641
Total	**336.854**	**336.854**	**-**	**(106.743)**

6.7 Council is required to demonstrate that implementing these changes is sustainable and prudent. Retention of future years' savings, as noted in 4.10 above will provide funding towards costs arising after the contractual repayment periods end. Adopting an annuity basis for repayment matches the costs of repaying debt to the useful life of the asset and is an approved repayment basis in line with accounting standards.

6.8 At the end of the original contract period, the existing budget, less the LPFS funding, will become available to the Council to meet future costs of school facilities and maintenance that were provided under the PPP contracts and costs arising from the change in accounting treatment proposed.

7. Stakeholder/Community Impact

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

8. Background reading/external references

8.1 Local government finance circular 10/2022

8.2 Revenue Framework 2022-27 Progress Update June 2022

9. Appendices

Appendix 1 In-scope service concessions

Appendix 2 Summary of current and proposed repayment profiles

Appendix 1

In-Scope Service Concessions

Service Area	Provider	Assets provided under arrangement	Year (Contract entered into)	Original Write Down Period	Total amount to be repaid, excl. interest
Waste Disposal	FCC	Provision of residual waste treatment at Millerhill. Joint arrangement with Midlothian Council, on an 80 / 20 basis	2016	26 years Ends 2044/45	£25.090m
Education	Edinburgh Schools Partnership	Provision of school buildings, maintenance and other facilities Ten primary, five secondary and two special schools, one close support unit and one community wing	2001	32 years Ends 2033/34	£80.332m
Education	Axiom Education Ltd	Provision of school buildings, maintenance and other facilities Two primary and six secondary schools	2007	31 years Ends 2038/39	£160.011m
Education	Hub South East Scotland	Provision of a new building for James Gillespie's High School	2013	28 years Ends 2041/42	£33.854m
Education	QHS DBFMCO Ltd	Provision of a new building for Queensferry High School	2018	25 years Ends 2044/45	£37.567m

Note: The above amounts exclude any capital contributions made by the Council towards the overall project costs.

Appendix 2

PPP1

The summary position for the PPP1 scheme (Edinburgh Schools Partnership) shows the repayment of the £80.332m debt liability for the current 32-year contract period compared to the calculation based on a 50-year annuity and highlights the following:

Current position		Principal repayments based on a 50-year annuity @ 8.968%		
PPP principal repayments	**Current repayment £000**	**Revised repayments £000**	**(Reduction) / cost £000**	**NPV 3.5% £000**
Pre 2022-23	38,308	5,636	(32,672)	(32,672)
2022-23	2,596	605	(1,991)	(1,924)
Yrs 2 to 5	15,074	3,014	(12,060)	(10,650)
Yrs 6 to 10	21,018	5,561	(15,457)	(11,889)
Yrs 11 to 25	3,336	41,836	38,500	19,284
Yrs 26 to 40		23,680	23,680	9,167
Total	**80,332**	**80,332**	**-**	**(28,684)**

- The statutory adjustment for the cumulative repayment of debt liability up to 31 March 2023 is a £32.672m reduction.
- Further annual reductions totalling £31.415m from 2023/24 to 2033/34 when the contract expires
- In the period between 2034/35 to 2051/52 the revised profile will result in a total of £64.087m of higher costs than the current repayment profile (ranging from £1.557m in 2034/35 to £6.703m in 2051/52)
- These higher costs can be partly mitigated by setting aside the £31.415m of annual reductions arising between 2023/24 and 2033/34 in a ring-fenced fund.
- The rescheduling of all the charges gives an NPV saving of £28.684m

PPP2

The summary position for the PPP1 scheme (Axiom Education Ltd.) shows the repayment of the £160.011m debt liability for the current 31-year contract period compared to the calculation based on a 50-year annuity and highlights the following:

Current position		Principal repayments based on a 50-year annuity @ 5.895%		
PPP principal repayments	**Current repayment £000**	**Revised repayments £000**	**(Reduction) / cost £000**	**NPV 3.5% £000**
Pre 2022-23	67,383	13,178	(54,205)	(54,205)
2022-23	4,286	1,348	(2.938)	(2,839)
Yrs 2 to 5	17,146	6,232	(10,914)	(9,683)
Yrs 6 to 10	29,203	10,094	(19,109)	(14,383)
Yrs 11 to 25	41,993	55,169	13,176	2,230
Yrs 26 to 40		73,990	73,990	25,619
Total	**160,011**	**160,011**	**-**	**(53,261)**

- The statutory adjustment for the cumulative repayment of debt liability up to 31 March 2023 is a £54.205m reduction.
- Further annual reductions totalling £58.332m from 2023/24 to 2038/39 when the contract expires
- In the period between 2039/40 to 2057/58 the revised profile will result in a total of £112.537m of higher costs than the current repayment profile (ranging from £3.369m in 2039/40 to £9.446m in 2057/58)
- These higher costs can be partly mitigated by setting aside the £58.332m of annual reductions arising between 2023/24 and 2038/39 in a ring-fenced fund.
- The rescheduling of all the charges gives an NPV saving of £53.261m

James Gillespie's High School

The summary position for James Gillespie's High School shows the repayment of the £33.854m debt liability for the current 28-year contract period compared to the calculation based on a 50-year annuity and highlights the following:

Current position		Principal repayments based on a 50-year annuity @ 8.205%		
PPP principal repayments	**Current repayment £000**	**Revised repayments £000**	**(Reduction) / cost £000**	**NPV 3.5% £000**
Pre 2022-23	5,499	692	(4,807)	(4,807)
2022-23	852	112	(740)	(716)
Yrs 2 to 5	3,796	547	(3,249)	(2,879)
Yrs 6 to 10	5,513	976	(4,537)	(3,435)
Yrs 11 to 25	18,194	6,781	(11,413)	(7,293)
Yrs 26 to 40		22,129	22,129	6,839
Yrs 41 to 60		2,617	2,617	639
Total	**33,854**	**33,854**	**-**	**(11,652)**

- The statutory adjustment for the cumulative repayment of debt liability up to 31 March 2023 is a £4.807m reduction.
- Further annual reductions totalling £23.625m from 2023/24 to 2041/42 when the contract expires.
- In the period between 2042/43 to 2063/64 the revised profile will result in a total of £28.433m of higher costs than the current repayment profile (ranging from £0.500m in 2042/43 to £2.618m in 2063/64)
- These higher costs can be partly mitigated by setting aside the £23.625m of annual reductions arising between 2023/24 and 2041/42 in a ring-fenced fund.
- The rescheduling of all the charges gives an NPV saving of £11.652m

Queensferry High School

The summary position for Queensferry High School shows the repayment of the £37.567m debt liability for the current 25-year contract period compared to the calculation based on a 50-year annuity and highlights the following:

Current position		Principal repayments based on a 50-year annuity @ 6.301%		
PPP principal repayments	**Current repayment £000**	**Revised repayments £000**	**(Reduction) / cost £000**	**NPV 3.5% £000**
Pre 2022-23	2,958	374	(2,584)	(2,584)
2022-23	970	141	(829)	(801)
Yrs 2 to 5	4,419	656	(3,763)	(3,331)
Yrs 6 to 10	6,258	1,082	(5,176)	(3,933)
Yrs 11 to 25	22,962	6,168	(16,794)	(9,417)
Yrs 26 to 40		29,146	29,146	7,822
Total	**37,567**	**37,567**	**-**	**(12,244)**

- The statutory adjustment for the cumulative repayment of debt liability up to 31 March 2023 is a £2.584m reduction.
- Further annual reductions totalling £28.283m from 2023/24 to 2044/45 when the contract expires.
- In the period between 2045/46 to 2069/70 the revised profile will result in a total of £30.867m of higher costs than the current repayment profile (ranging from £0.539m in 2046/47 to £2.618m in 2069/70)
- These higher costs can be partly mitigated by setting aside the £28.283m of annual reductions arising between 2023/24 and 2044/45 in a ring-fenced fund.
- The rescheduling of all the charges gives an NPV saving of £12.244m

Millerhill

The summary position for Millerhill shows the repayment of the £25.090m debt liability for the current 26-year contract period compared to the calculation based on a 26-year annuity and highlights the following:

Current position		Principal repayments based on a 50-year annuity @ 6.301%		
PPP principal repayments	**Current repayment £000**	**Revised repayments £000**	**(Reduction) / cost £000**	**NPV 3.5% £000**
Pre 2022-23	1,417	478	(939)	(939)
2022-23	305	169	(136)	(132)
Yrs 2 to 5	1,293	979	(314)	(283)
Yrs 6 to 10	2,537	2,352	(185)	(132)
Yrs 11 to 25	19,538	21,112	1,574	583
Total	**25,090**	**25,090**	**-**	**(903)**

- The statutory adjustment for the cumulative repayment of debt liability up to 31 March 2023 is a £0.939m reduction.
- Further annual reductions totalling £2.220m from 2023/24 to 2043/44 when the contract expires.
- In financial year 2044/45 the revised profile will result in a total of £3.160m of higher costs than the current repayment profile.
- These higher costs can be partly mitigated by setting aside the £2.220m of annual reductions arising between 2023/24 and 2043/44 in a ring-fenced fund.
- The rescheduling of all the charges gives an NPV saving of £0.903mm