LOANS CHARGES AND PRIVATE FINANCE ACCOUNTING TREATMENT

Briefing Note by Executive Director Finance & Regulatory

AUDIT & SCRUTINY COMMITTEE

15 February 2021

1 PURPOSE AND SUMMARY

1.1 **The purpose of this paper is to provide the Committee with the requested background and information on loans charges and the accounting treatment of the capital element of the Private Partnership (PPP)/Private Finance Initiative (PFI) funded schools.**

1.2 The debt reflected in the Councils balance sheet is made up of two main separate elements. These are the external loans held directly by the Council and the outstanding debt element of the PPP/PFI contracts. The external loans costs held directly are charged against the loans charges budget in year. The budget to fun PPP/PFI debt costs is included in the unitary charge budget within the Education revenue budget.

1.3 The loans charges purpose is to recognise the cost of capital financed by external borrowing undertaken by the Council. The loans charges budget consists of two main elements, these are payment of actual interest and notional charges representing the principle repayment calculated on a prudent basis. Scottish Borders Council calculates notional charges on an annuity basis over the asset life.

1.4 The Council currently has 3 PPP/PFI contracts for 5 secondary schools. The funding for these are provided by third parties and recharged over the life of the contracts as part of the unitary charge held within the Education service.

1.5 The asset value of the schools are included on the Council’s balance sheet with a corresponding long term debt. The current guidance requires Local Authorities to write the payment of this debt to be written down over the life of the PPP contract. This is undertaken as a technical adjustment as part of the year end accounting process.

1.6 Discussion is currently underway with Scottish Government Officials to allow LA to write down the value of the debt over the asset life instead of the contract period. This would bring the debt element of these schools into line with approach taken to writing off the Council’s other loan charges over the lives of assets.

2 LOANS CHARGES BACKGROUND

2.1 At the meeting on 23rd November, the Audit and Scrutiny Committee requested a briefing paper detailing the charges to the Loans Charges Budget and how the capital and interest element of Public Private Partnerships (PPP) and Private Finance Initiatives (PFI) are accounted for.

2.2 The Council has the power to borrow to fund its capital expenditure. Capital expenditure is also part funded from a number of others sources including Scottish Government Grant, specific grants, developer contributions and capital receipts. The borrowing undertaken is charged to the Councils Loan Fund revenue budget in a cost effective manner.

2.3 Loans Fund has the following purpose

- To recognise, by making advances from the loans fund, the expenditure incurred, or loans made to third parties, which the authority has financed from borrowing.
- To record transactions – opening balance each financial year, new advances, repayments charged to revenue (statutory repayment of debt), and a closing balance at each financial year end, being the value of the loans fund advances still to be repaid/charged to revenue

2.4 The loans charges reported within the revenue monitoring reports are made up to two main elements. These are

- **Payment of actual interest** on the external loans per the loan agreements.
- **Notional loan charge** charged on a prudent basis.

2.5 Notional loans charge represents the repayment of the debit to ensure prudent financial management. The guidance which is required to be adhered to does not define prudent. The broad aim of prudent repayment is to ensure repayments of a loans fund advance, in relation to repayment period and each year’s repayment amount, are reasonably commensurate with the period and pattern of the benefits provided to the community from the capital expenditure. It is anticipated that local authorities’ own capital expenditure projects will determine the prudent repayment of loans fund advances, reflecting the same principles as those for depreciation accounting.

2.6 The guidance allows for 4 options to be utilised for the calculation of prudent repayment. These are

1. Statutory method
2. Depreciation method
3. Asset life method (equal instalment or annuity method)
4. Funding/Income profile method

2.7 More than one method can be utilised by a local authority. Local authorities should however be consistent in applying options. Scottish Borders Council uses option 3 on an annuity basis to calculate the notional loans charges.

3 PRIVATE PARTNERSHIP (PPP)/PRIVATE FINANCE INITIATIVES (PFI) ACCOUNTING

3.1 Scottish Borders Council now has three PPP/PFI type contracts in place. These are the 3 Berwickshire High Schools, Kelso High School and Jedburgh School Campus. These contracts see the Special Purpose Vehicle (SPV) who constructs the schools put in place the funding for the constructions. The costs of the funding and the repayment of the funding are then paid to the contractor as part of the unitary charge over the life of the contract. The unitary charge also includes life cycle maintenance and can also include cleaning, janitorial and other running costs. The unitary charge budget is held within the revenue budget of the Education service.

3.2 The asset value of the schools are included in the value of the assets on the Councils balance sheet with a corresponding liability for the debt. The debt is included for accounting purposes as part of the Council Gross External Debt and the assets form part of the Capital Financing Requirement within the prudential indicators.

3.3 As part of the Year End technical accounting process the element of the unitary charge which relates to the interest element and the repayment of debt is removed from the unitary charged. The interest element for year end accounts is shown against "interest payable and similar charges" on the Comprehensive Income and Expenditure Statement. The repayment of debt reduces the "other long term liabilities" on the balance sheet. These charges do not form part of the Loans Charges budget reported during the year.

3.4 Current guidance specifies the debt must be written down over the life of the contract. This however is not in line with the Councils other debt, which is written down over the assets useful life. There is currently work ongoing with COSLA and Scottish Government to allow this guidance to be amended to bring PPP/PFI in line with the methodology used for the Councils loans charges. If the change to guidance is agreed the repayment element of the unitary will be charged over the life of the asset rather than the contract which result in the period of charges moving from 25 years to 50 years. This would have significant benefits for LA at time when budgets are under extreme pressure for costs of COVID19 without directly service provision. DOF are of the opinion that this change is within the powers of Scottish Ministers as it relates to guidance issued by them in 2010. However to date a satisfactory solution to this issue has not been achieved.

3.5 Each contract between the Council and SPV will include a section on "refinancing gain". This allows the SPV to investigate possible refinancing opportunities as they arise. If refinancing takes place there is a gain share agreed. Each contract have different terms attached to the gain share part of the agreement. These are regularly reviewed but the final decision on refinancing is the responsibility of SPV.

Approved by

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Background Papers:
Previous Minute Reference: Audit and Scrutiny Committee,

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