

**ITEM No ...7.....**

**REPORT TO:** POLICY AND RESOURCES COMMITTEE –30<sup>TH</sup> SEPTEMBER 2019  
**REPORT ON:** LOANS FUND POLICY REVIEW  
**REPORT BY:** EXECUTIVE DIRECTOR OF CORPORATE SERVICES  
**REPORT NO:** 279-2019

**1 PURPOSE OF REPORT**

This report introduces a revised policy on Loans Fund debt charge repayment profiling following a review of the current repayment profiling methodology. The objective of the revised policy is to support a prudent, sustainable and deliverable longer term revenue budget strategy, whilst ensuring that provision remains prudent and appropriate to the benefits that are provided to the community from the associated expenditure.

**2 RECOMMENDATION**

The Committee is recommended to:

- approve the amended Loans Fund repayment policy from 2019/20 onwards that incorporates the changes below.
- agree to amend the loans fund advances repayment mechanism and resultant debt charges profile for current and future loans repayments, using the following criteria:
  - (a) 45 years being considered the most appropriate length of repayment for General Fund expenditure advances, which is consistent with a prudent expectation of estimated benefit received over the life of assets financed;
  - (b) 30 years being considered the most appropriate length of repayment for HRA expenditure advances, which is consistent with a prudent expectation of estimated benefit received over the life of assets financed;
  - (c) a 4.5% annuity rate methodology is applied to principal repayments; and
  - (d) the prior year repayment methodologies should be revised and reset based on (a) and (b) above to ensure consistency and prudence going forward.

**3 FINANCIAL IMPLICATIONS**

This will generate revenue savings of £3m for General Services, and £0.75m HRA in 2019/20 (£1.977 has already been assumed as a saving in the 2019/20 General Fund Revenue Budget). Overall, the proposed saving will achieve a net present value of £13m as shown below:

Table 1: Revised Loans Charges

	Debt charges - General Fund				Debt charges – Housing Revenue Account			
	Current Estimate	Revised Estimate	Variance	NPV Variance	Current Estimate	Revised Estimate	Variance	NPV Variance
	£m	£m	£m	£m	£m	£m	£m	£m
2019/20	8.9	5.9	(3.0)	(2.9)	12.1	11.4	(0.8)	(0.7)
Yrs 2 to 5	32.7	20.7	(12.0)	(10.6)	51.6	48.6	(3.0)	(2.7)
Yrs 6 to 10	50.5	35.5	(15.0)	(11.4)	68.6	64.8	(3.8)	(2.8)
Yrs 11 to 25	148.6	142.6	(5.9)	(5.9)	118.6	107.4	(11.2)	(6.1)
Yrs 26 to 65	254.0	290.0	35.9	20.3	24.2	42.9	18.7	9.8
<b>Total</b>	<b>494.7</b>	<b>494.7</b>	<b>(0.0)</b>	<b>(10.5)</b>	<b>275.1</b>	<b>275.1</b>	<b>(0.0)</b>	<b>(2.5)</b>

## 4 INTRODUCTION

The Policy and Resources Committee agreed the proposal as part of the Revenue Budget and Council Tax 2019/20 to revise the current and future debt charge repayment profiling policy on 21<sup>st</sup> February 2019 (Article II of the Minute of Meeting of the Policy and Resources Committee of 21<sup>st</sup> February 2019, Report No 96-2019 refers).

The Committee agreed to amend the loans fund advances repayment mechanism and resultant debt charges profile for current and future loans repayments, using the following criteria:

- that the most appropriate length of repayment for general services advances be based on a long term estimation of pooled assets useful lives and a similar methodology to be applied for the Housing Revenue Account. These timeframes would be consistent with a prudent expectation of estimated benefit received over the life of the respective asset types
- that a longer term average rate based on the pooled Loans Fund be used to calculate principal repayments

An independent review of the Council's loans portfolio by Link Asset Services was undertaken.

## 5 BACKGROUND

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.

The 2016 regulations have changed the basis on which the Loans Fund is accounted. The change moves from a prescriptive basis on how repayment values are to be calculated, to a prudent one with each Local Authority now provided with the ability to determine what is prudent. These changes in regulations have brought in more flexibility for Authorities to apply a prudent provision and support changes to future payments to repay the outstanding loans fund advances over a different period, if it can be considered as prudent to do so.

## 6 REGULATORY CHANGES

### 6.1 Purpose

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.

### 6.2 Requirements

The new regulations require 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.

### 6.3 Prudent Approach

The Guidance identifies that the broad aim of 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 the benefits provided to the community from capital expenditure. This is an important point to consider in the judgement and application of what is prudent.

The 2016 changes of the legislation enacted were to simplify the Loans Fund administration and provide Authorities with flexibility to determine the repayments of the Loans Fund advances. Both primary and secondary legislation confirms subsequent variation is allowable if the Authority considers it prudent to do so.

These flexibilities within the legislation enable the Council to make the most appropriate choices for its own situation and circumstances as long as it can demonstrate that any change in policy is prudent.

Whilst there are provisions within the Statutory Guidance which provide options on application neither the guidance nor legislation defines what is prudent. It is therefore for each Council to manage this appropriately and to determine prudent repayment based on its own individual circumstances.

## 7 REVIEW

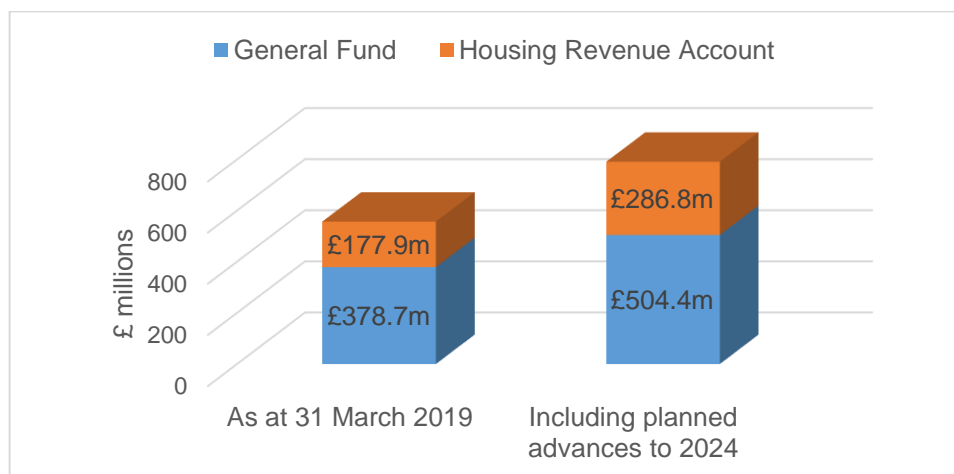
A review of the Council's Loans Fund repayment policy has been undertaken on behalf of the Council by Link Asset Services (LAS) with the objective to explore options which can re-profile the loans fund repayments in order to assist with delivery of a prudent, sustainable and deliverable longer term revenue budget strategy, whilst ensuring that the provision remains prudent and appropriate to the benefits that are provided to the community from the associated expenditure.

In considering the most appropriate options for the Council, LAS has not specifically applied any of the options set out in the guidance but has instead had regard to the Guidance in terms of taking a balanced view by considering the complete provisions on the overriding principles of prudence, financial management and financial sustainability of the Council.

### 7.1 Loans Fund Advances

Loans Fund Advances are the previous capital investment funded by borrowing and are split between the General Fund and Housing Revenue Account Loans. The Authority's working papers show that as at 31 March 2018 the total amount outstanding was £556.6m. These are shown in Chart 1 below;

**Chart 1: Loans Fund advances outstanding**



The chart above excludes Loans Fund advances relating to Scientific Services of £2m as this a ring fenced loan recharged to three Unitary Authorities at 4.55%; and also for purpose of prudence, excludes Loans Fund figures relating to Dundee House, GAM funded projects and specified capital receipts as these are specific projects based on existing asset lives.

### 7.2 Loans Fund Repayments

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;

- the annuity interest rate (the method used which links the repayment of the borrowing to the flow of benefits from an asset where the benefits are expected to increase in later years).

The 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 to the community from the capital expenditure.

The method considered most appropriate by LAS for Dundee City Council is a simplified annuity method that uses an average repayment period for all Loans Fund advances and reflects the prudence requirement as stated above i.e. that it is commensurate with the benefits provided by the capital expenditure.

The statutory duty to administer the loans fund in accordance with prudent financial management extends to the interest rate selected for the annuity calculation. The statutory guidance does not include guidance on what is an appropriate interest rate for the annuity but suggests that a Council should set out their policy on interest rate selection and apply that policy consistently.

### 7.2.1 Period of Repayment

When preparing the Annual Accounts, the asset lives in respect of the main categories where borrowing is undertaken for capital investment purposes is as follows:

- Council dwellings and other buildings – straight line allocation over the useful life of the property as estimated by the valuer
- Vehicles, plant and equipment – straight line allocation over between 3 and 10 years
- Infrastructure – straight line allocation over between 10 and 30 years

Some of the current loan repayment periods are shorter or longer than their asset lives. Loan advance repayments should be profiled over a period which reasonably reflects the period over which the community receives the economic benefit of the asset. To profile over a shorter period could be deemed imprudent as it could be viewed as requiring the tax payer to repay capital investment before receiving the full benefit from the asset. Conversely, profiling over a longer period could mean that the tax payers are not repaying the full capital investment before the assets life has ended.

Link Asset Services have based their review on a repayment period of 45 years for the General Fund and 30 years for the HRA as this period is in line with the Council's recognised asset lives and reflects the period over which the benefits from the capital expenditure are provided to the community.

HRA Loans Funds records are only available from 2008/9. For the period prior to 2008/9 the review shows that the average life outstanding for HRA balances as at 1st April 2008 was 16 years. An average life of 16 years for all HRA loans fund balances outstanding as at 1st April 2008 has therefore been applied.

Based on the analysis above, it is recommended that the following periods are appropriate and consistent over which to repay loans fund advances:

- 45 years for all post 1999 General Fund expenditure;
- 30 years for all post 2008 HRA expenditure and 16 years for balances outstanding as at 1st April 2008

A prudent approach has been taken not to include pre 1999 General Fund expenditure due to these being calculated on the differing basis of supported borrowing.

### 7.2.2 Annuity Interest Rate

The Council uses a pooled rate of interest each year, based on the total interest incurred on debt for the year divided by the equated Loans Fund debt outstanding for the year. This is applied to both the General Fund and HRA.

The overall average Loans Fund borrowing rate for the period 1999/00 to 2017/8 taking into account the level of expenditure in each year is 4.7%. Link Asset Services has used a suggested Annuity Rate of 4.5% in its review. Once calculated it is only the principal element of the calculation that represents the annual repayment of the Loans Fund advance. Based on the analysis above, it is recommended that a rate of 4.5% is considered an appropriate interest rate to use.

The 2016 Regulations stipulates that: a local authority may subsequently vary either the period or the amount of repayment (or both), if it considers it prudent to do so. Given the outcome of the review above it is appropriate to revise the prior year repayment methodologies to ensure consistency and prudence going forward.

## 8 RESULTS

Applying the above methodology to the current outstanding loans fund advances and assumed future advances (based on the current five year capital plan) will have the following effect on the debt charge payments over the period 2019-20 to 2023-24, as shown in table 3 below. Appendix 1 provides a schedule of loans fund advance repayments comparing the results using the current methodology and the revised methodology when repaying the full £495m for General Fund advances and £275m for HRA advances.

Ultimately the same amount of loan advance is repaid over the whole period however the revised profile is considered more consistent and prudent and smooths the repayment profile.

**Table 2: Revised Loans Charges over 5 year period**

	Debt charges - General Fund			Debt charges - Revenue Account		Housing
	Current Estimate	Revised Estimate	Variance	Current Estimate	Revised Estimate	Variance
	£m	£m	£m	£m	£m	£m
2019/20	8.9	5.9	(3.0)	12.1	11.4	(0.80)
2020/21	8.6	5.6	(3.0)	11.9	11.2	(0.75)
2021/22	8.8	5.8	(3.0)	12.5	11.8	(0.75)
2022/23	7.1	4.1	(3.0)	13.5	12.7	(0.75)
2023/24	8.2	5.2	(3.0)	13.7	12.9	(0.75)
<b>5 yr Total</b>	<b>41.6</b>	<b>26.6</b>	<b>(15.0)</b>	<b>63.7</b>	<b>60.0</b>	<b>(3.80)</b>

The revised estimate includes a re-profiled sum of £51m for the General Fund and £17m for the HRA that relates to the revision and resetting of prior year repayment methodologies going back to 1999/00 to align with the 45 year (GF) & 30 year (HRA) and 4.5% approach in order to ensure consistency and prudence going forwards. This excess provision up to 2019/20 can be taken to reduce the charge in future years. The change in charge is shown in the table below:

**Table 3: Loans Fund Charges to 31/3/2019**

Loans Fund Charges	General Fund £m	HRA £m	Total £m
Actual charge to 31/03/2019	211	110	321
Revised charge to 31/03/2019	161	93	254
<b>Excess to be adjusted for in future years</b>	<b>51</b>	<b>17</b>	<b>67</b>

Under this revised methodology, the allocation of this recalculation is at the discretion of the Council to determine, considering what is deemed prudent relative to individual circumstance, but without resulting in negative charge.

Appendix 1 profiles the adjustment over 45 years for the General Fund and 30years for the HRA, being the years remaining in 2019/20 applying the revised lives from the earliest expenditure.

The table over the page shows the whole life impact both in nominal terms and in net present value (NPV) terms in order to take into account the time value of money and assess the whole life impact of the option. The NPV uses a discount rate of 3.5% as suggested by the Treasury Green Book.

	General Fund		HRA	
	45 Years @ 4.5%		30 Years @ 4.5%	
	Nominal	NPV	Nominal	NPV
	£m	£m	£m	£m
2019/20	(3.0)	(2.9)	(0.8)	(0.7)
Yrs 2 to 5	(12.0)	(10.6)	(3.0)	(2.7)
Yrs 6 to 10	(15.0)	(11.4)	(3.8)	(2.9)
Yrs 11 to 25	(5.9)	(5.9)	(11.3)	(6.1)
Yrs 26 to 65	35.9	20.3	18.7	9.8
<b>Total</b>	<b>(0.0)</b>	<b>(10.5)</b>	<b>(0.0)</b>	<b>(2.5)</b>

## 9 CONSIDERATIONS

In amending the Loans Fund charges policy the Council should take into consideration:

- Risks inherent in the Council's future capital programme in terms of complexity, variability and deliverability
- CFR forecasts and the level of unsupported borrowing proposed by the Council in future years
- The requirement to make a prudent provision, including the robustness of any further legal or accounting advice sought
- Whether useful economic lives (UEL) of categories of assets used when calculating depreciation in the statutory annual accounts are appropriate and relevant
- A prudent provision in the context of this Authority
- Risks of recoverability from service areas or external bodies on existing unsupported borrowing undertaken
- Affordability, prudence and sustainability with regard to current revenue budgets of the Council, balanced against deferring costs of future Council tax payers.
- The extent to which it wishes to make a prudent provision in excess of the minimum requirements after consideration of the types and life of expenditure being incurred
- S95 officer consideration of what constitutes a prudent provision.

## 10 POLICY IMPLICATIONS

This report has been subject to an assessment of any impacts on Equality and Diversity, Fairness and Poverty, Environment and Corporate Risk. There are no major issues.

## 11 CONSULTATION

The Council Management Team have been consulted in the preparation of this report.

## 12 BACKGROUND PAPERS

None

**GREGORY COLGAN**  
EXECUTIVE DIRECTOR OF CORPORATE SERVICES

**20 SEPTEMBER 2019**

APPENDIX 1

General Fund						
Debt charges	Original Repayment £000	Recalc Adj	Revised charge £000	Revised Estimate+ Adj £000	Variance £000	NPV 3.5% £000
2019/20	8,884	(1,813)	7,697	5,884	(3,000)	(2,899)
2020/21	8,631	(2,695)	8,326	5,631	(3,000)	(2,801)
2021/22	8,781	(2,815)	8,596	5,781	(3,000)	(2,706)
2022/23	7,115	(3,899)	8,014	4,115	(3,000)	(2,614)
2023/24	8,160	(3,123)	8,283	5,160	(3,000)	(2,526)
2024/25	8,848	(2,822)	8,669	5,848	(3,000)	(2,441)
2025/26	11,018	(771)	8,789	8,018	(3,000)	(2,358)
2026/27	10,446	(1,270)	8,716	7,446	(3,000)	(2,278)
2027/28	10,549	(1,274)	8,823	7,549	(3,000)	(2,201)
2028/29	9,702	(2,202)	8,904	6,702	(3,000)	(2,127)
2029/30	9,431	(2,791)	9,223	6,431	(3,000)	(2,055)
2030/31	9,557	(2,949)	9,506	6,557	(3,000)	(1,985)
2031/32	10,681	(2,030)	9,711	7,681	(3,000)	(1,918)
2032/33	10,165	(2,926)	10,091	7,165	(3,000)	(1,853)
2033/34	9,681	(3,501)	10,182	6,681	(3,000)	(1,791)
2034/35	9,105	(4,360)	10,464	6,105	(3,000)	(1,730)
2035/36	8,048	(5,811)	10,859	5,048	(3,000)	(1,672)
2036/37	7,556	(3,497)	11,072	7,575	20	11
2037/38	8,464		11,346	11,346	2,882	1,499
2038/39	9,348		11,716	11,716	2,368	1,190
2039/40	10,341		12,131	12,131	1,791	869
2040/41	10,874		12,665	12,665	1,791	840
2041/42	11,798		13,234	13,234	1,436	651
2042/43	11,659		13,829	13,829	2,170	950
2043/44	11,857		14,459	14,459	2,602	1,101
2044/45	11,459		15,107	15,107	3,648	1,492
2045/46	11,851		15,277	15,277	3,425	1,353
2046/47	11,798		15,508	15,508	3,709	1,416
2047/48	11,814		15,394	15,394	3,580	1,320
2048/49	10,448		15,562	15,562	5,114	1,822
2049/50	10,151		15,688	15,688	5,538	1,906
2050/51	9,471		15,762	15,762	6,291	2,092
2051/52	8,861		15,430	15,430	6,568	2,111
2052/53	8,522		15,267	15,267	6,744	2,094
2053/54	8,327		15,647	15,647	7,320	2,196
2054/55	7,727		15,827	15,827	8,100	2,348
2055/56	6,314		15,405	15,405	9,091	2,546
2056/57	6,552		15,304	15,304	8,752	2,368
2057/58	6,719		14,069	14,069	7,351	1,922
2058/59	6,545		12,569	12,569	6,024	1,522
2059/60	6,652		11,646	11,646	4,994	1,219
2060/61	6,798		11,825	11,825	5,028	1,185
2061/62	6,920		11,028	11,028	4,109	936
2062/63	7,128		9,686	9,686	2,558	563
2063/64	7,258		7,836	7,836	578	123
2064/65	7,463		5,132	5,132	(2,331)	(479)
2065/66	7,472		2,515	2,515	(4,957)	(984)
2066/67	7,593		1,525	1,525	(6,068)	(1,164)
2067/68	7,771		771	771	(7,001)	(1,297)
2068/69	8,040		177	177	(7,863)	(1,408)
2069/70	8,274				(8,274)	(1,431)
2070/71	7,165				(7,165)	(1,198)
2071/72	6,030				(6,030)	(974)
2072/73	6,141				(6,141)	(958)
2073/74	4,951				(4,951)	(746)
2074/75	3,348				(3,348)	(488)
2075/76	2,468				(2,468)	(347)
2076/77	1,363				(1,363)	(185)
2077/78	1,418				(1,418)	(186)
2078/79	1,453				(1,453)	(184)
2079/80	607				(607)	(74)
2080/81	631				(631)	(75)
2081/82	514				(514)	(59)
2082/83						
2083/84						
<b>Total</b>	<b>494,714</b>	<b>(50,547)</b>	<b>545,261</b>	<b>494,714</b>	<b>(0)</b>	<b>(10,549)</b>

HRA						
Debt charges	Original Repayment £000	Recalc Adj	Revised charge £000	Revised Estimate+ Adj £000	Variance £000	NPV 3.5% £000
2019/20	12,112	(990)	12,352	11,362	(750)	(725)
2020/21	11,945	(2,112)	13,307	11,195	(750)	(700)
2021/22	12,515	(2,452)	14,217	11,765	(750)	(676)
2022/23	13,458	(2,412)	15,120	12,708	(750)	(654)
2023/24	13,670	(3,164)	16,085	12,920	(750)	(631)
2024/25	14,089	7,284	6,055	13,339	(750)	(610)
2025/26	13,837	6,759	6,328	13,087	(750)	(589)
2026/27	13,142	5,779	6,613	12,392	(750)	(570)
2027/28	13,641	5,981	6,910	12,891	(750)	(550)
2028/29	13,829	5,858	7,221	13,079	(750)	(532)
2029/30	13,423	5,127	7,546	12,673	(750)	(514)
2030/31	13,079	4,443	7,886	12,329	(750)	(496)
2031/32	12,204	3,213	8,241	11,454	(750)	(480)
2032/33	11,564	2,202	8,611	10,814	(750)	(463)
2033/34	10,818	1,069	8,999	10,068	(750)	(448)
2034/35	9,873	(280)	9,404	9,123	(750)	(433)
2035/36	8,932	(1,645)	9,827	8,182	(750)	(418)
2036/37	7,754	(3,266)	10,269	7,004	(750)	(404)
2037/38	7,121	(4,360)	10,731	6,371	(750)	(390)
2038/39	6,037	(5,928)	11,214	5,287	(750)	(377)
2039/40	5,252	(6,388)	10,890	4,502	(750)	(364)
2040/41	4,437	(6,595)	10,282	3,687	(750)	(352)
2041/42	3,636	(6,374)	9,260	2,886	(750)	(340)
2042/43	2,724	(6,546)	8,520	1,974	(750)	(328)
2043/44	1,783	(6,805)	7,837	1,033	(750)	(317)
2044/45	743	(5,141)	7,174	2,033	1,290	528
2045/46	677		6,858	6,858	6,180	2,441
2046/47	619		6,635	6,635	6,016	2,296
2047/48	577		6,399	6,399	5,822	2,147
2048/49	533		5,725	5,725	5,192	1,850
2049/50	487		5,196	5,196	4,709	1,621
2050/51	506		3,936	3,936	3,429	1,141
2051/52	527		2,948	2,948	2,421	778
2052/53	548		2,092	2,092	1,545	480
2053/54	570		1,122	1,122	553	166
2054/55	592				(592)	(172)
2055/56	616				(616)	(173)
2056/57	641				(641)	(173)
2057/58	666				(666)	(174)
2058/59	693				(693)	(175)
2059/60	721				(721)	(176)
2060/61	750				(750)	(177)
2061/62	780				(780)	(178)
2062/63	811				(811)	(178)
2063/64	843				(843)	(179)
2064/65	877				(877)	(180)
2065/66	912				(912)	(181)
2066/67	948				(948)	(182)
2067/68	986				(986)	(183)
2068/69	1,026				(1,026)	(184)
2069/70	864				(864)	(149)
2070/71	469				(469)	(78)
2071/72	488				(488)	(79)
2072/73	507				(507)	(79)
2073/74	485				(485)	(73)
2074/75	504				(504)	(73)
2075/76	521				(521)	(73)
2076/77	548				(548)	(74)
2077/78	549				(549)	(72)
2078/79	460				(460)	(58)
2079/80	434				(434)	(53)
2080/81	227				(227)	(27)
2081/82	190				(190)	(22)
2082/83	175				(175)	(19)
2083/84	128				(128)	(14)
<b>Total</b>	<b>275,070</b>	<b>(16,742)</b>	<b>291,812</b>	<b>275,070</b>	<b>(0)</b>	<b>(2,524)</b>

