Inverclyde council

AGENDA ITEM NO: 7

Report To:	**Policy & Resources Committee**	**Date:**	**31 January 2023**
Report By:	**Interim Director, Finance & Corporate Governance**	**Report No:**	**FIN/01/23/AP/LA**
Contact Officer:	**Alan Puckrin**	**Contact No:**	**01475 712223**
Subject:	**Service Concession Flexibility - Accounting Change Proposal**		

1.0 PURPOSE AND SUMMARY

1.1 ☒For Decision ☐For Information/Noting

1.2 The purpose of this report is to highlight the significant financial benefits to the Council over the medium to longer term of a proposed change to the accounting treatment of the Council's Schools PPP (Service Concession) contract following the issuing of revised accounting guidance by the Scottish Government.

1.3 As part of the Financial Flexibilities raised with the Scottish Government in 2020 arising from the significant financial pressures faced by Councils during Covid, it was agreed that Councils could decide in either 2022/23 or 2023/24 that the accounting for PPP contracts could be reviewed to better align the costs being incurred by Councils with the life of the asset being paid for in these contracts. Inverclyde has one such contract, the e4i schools PPP contract.

1.4 Officers have developed a proposal based on Local Government Finance Circular 10/2022 issued on 6 September 2022 and the details are contained in the body of the report along with the potential financial implications. Whilst in the immediate and medium term financial gains are significant and will be very welcome in the context of the financial challenges facing the Council, it is important that Members consider the longer term implications and recognise this proposal represents a one off benefit, the use of which needs to be carefully considered.

1.5 In line with the Finance Circular, any proposal will require approval by the Full Council.

2.0 RECOMMENDATIONS

2.1 It is recommended that the Committee note the flexibility offered by Finance Circular 10/2022, the officer proposal contained in section 4 of the report and the potential financial implications.

2.2 It is recommended that the Committee notes the longer term implications, including the affordability assessment outlined in Section 5.2 and Appendix 3.

2.3 It is recommended that the Committee approve the proposal contained in section 4 of the report and note that any decision to implement the proposal will require to be approved at the next meeting of the Council.

Alan Puckrin
Interim Director Finance & Corporate Governance

3.0 BACKGROUND AND CONTEXT

3.1 The Council entered into a 30 year PPP contract with e4i in 2008 to build 4 schools. The Council pays an annual sum called the Unitary Charge to e4i which covers the capital cost of the buildings, facilities management costs, cyclical repairs, financing costs and a number of other costs such as insurance.

3.2 As part of the financial arrangement, the Scottish Government committed to pay £6.066million for 30 years towards the Unitary Charge which, in the first full year was £8.842million. The contract contains an indexation clause which sets the annual indexation as 2/3rds of the December RPI. In 2022/23 the Unitary Charge now sits at £10.835million.

3.3 The PPP contract is viewed as a Service Concession arrangement which has specific accounting requirements. However, as part of discussions between the Scottish Government and Cosla in 2020 during the early days of the Covid Pandemic it was agreed to investigate whether the accounting for Service Concessions could be reviewed in order to better reflect the expected life of the asset created which could generate a potential one off and/or recurring sum to be used to mitigate the impact of Covid on Council budgets.

3.4 This proposal got bogged down in a separate but related issue to do with a review of Capital Accounting and the current Statutory Mitigations which result in Council Budgets reflecting loans charges rather than depreciation and there have been several updates to Cosla Leaders over the last two years regarding developments. In the summer of 2022, the guidance regarding Accounting for Service Concessions was signed off and Finance Circular 10/2022 was issued on 6 September.

3.5 The Committee should note that this flexibility is temporary and needs to be approved and implemented in either 2022/23 or 2023/24.

3.6 Having reviewed the circular within the Accountancy team, it is the view of the Interim Director Finance & Corporate Governance that this flexibility potentially affords a major one off and recurring financial benefit which in the context of the significant Revenue, Capital and Reserves budgetary pressures should be seriously considered by Elected Members.

3.7 It is important that Members note that the foregoing proposal, if supported by the Policy & Resources Committee will require formal approval by the Full Council.

3.8 Advice and support regarding this issue has been received from the Directors of Finance Section, Scottish Government officials and the Council's Treasury Consultants, Link.

4.0 PROPOSALS

4.1 It is proposed that rather than the Council Budget reflecting the repayment of the capital investment in building the schools over 30 years as per the PPP contract, the Council account for this over a 45 year period. This compares to the current practice of writing off a Council funded new build school over 40 years. The reason for the extended life of a PPP school are the level of maintenance obligations reflected in the PPP contract.

4.2 In line with the current approved policy in relation to loans charges principal repayments, it is proposed that the 45 year repayment is made on an annuity basis rather than a fixed principal basis. Officers believe the overall annual cost of the annuity method better reflects the benefits received by the Council from the capital investment in the schools. Additionally, a Net Present Value (NPV) analysis shows a consistent net annual cost.

4.3 Officers have calculated that the principal repayments from 2009/10 to 2022/23 total £22.219 million. Based on the proposed 45 year annuity repayment then the principal repayments would be £7.471 million by 31 March 2023. This represents a one -off cost non-cash backed increase in reserves of £14.748 million which could be applied to the 2023/24 accounts.

4.4 It is important that the Committee understand that payments to e4i and grant payments from the Scottish Government will not be affected and will continue until 2039/40. This proposal represents a "non-cash" increase in the Council's Reserves which will require the Council to use cash balances when spending the sums generated and will need to be managed within the overall Treasury Management Strategy of the Council.

4.5 Due to the 15 year extension to the principal repayment period then there is an on going revenue saving over the period 2023/24 to 2039/40 in addition to the one off sum referred to in paragraph 4.3 above. The amount saved each year varies from year to year due to the nature of the PPP principal payments profile. Over the next 5 years it is proposed to generate a fixed saving of £1.65million / year. To achieve this £600,000 smoothing reserve will be required.

4.6 Appendix 1 shows the estimated savings/costs over the period to the final potential repayment in 2053/54. From this it can be seen that based on a 3.5% NPV the net financial benefit of the proposal is £18.31million.Appendix 2 shows how the 5 year saving and smoothing reserve is calculated.

4.7 The affordability of the proposals in this report needs to be considered especially in the longer term when the Scottish Government grant stops, these are outlined in paragraph 5.2 below.

5.0 IMPLICATIONS

5.1 The table below shows whether risks and implications apply if the recommendation(s) is(are) agreed:

SUBJECT	YES	NO	N/A
Financial	x		
Legal/Risk	x		
Human Resources		x	
Strategic (LOIP/Corporate Plan)	x		
Equalities & Fairer Scotland Duty			x
Children & Young People's Rights & Wellbeing			x
Environmental & Sustainability			x
Data Protection			x

5.2 **Finance**

Understandably the proposal will appear very attractive to Members given the significant financial pressures faced by the Council and the time limited period which Councils can take advantage of this flexibility. It is important however that as part of the overall consideration, Members are aware of the longer term financial implications.

Taking a prudent view, it is estimated that by 2039/40 the Unitary Charge payment will be around £15.5million. At this time the Scottish Government support will stop leaving a net Council contribution of around £9.4million of which £7.3million will be included in the Council Budget. From this sum the Council will require to fund the running costs previously paid by e4i for the 4 schools plus the deferred principal repayments which, as can be seen from Appendix 1 get as high as £4.8million in 2053/54.

When added to the estimated running costs of the four schools (suitably indexed) and the loss of investment income arising from the expending of £14.7 million "non-cash" reserves then, as can be seen from Appendix 3, the proposal is affordable and leaves some scope for reinvestment in the school estate.

One off Costs

Cost Centre	Budget Heading	Budget Years	Proposed Spend this Report	Virement From	Other Comments
Reserves	General Fund	2023/24	(£14.748) million		One off back dated adjustment based on the proposal in this report.
	SCA Smoothing Reserve	From 2023/24	£0.602million		Time limited reserve per Appendix 2 to generate a £1.65million recurring saving

Annually Recurring Costs/ (Savings)

Cost Centre	Budget Heading	With Effect from	Annual Net Impact	Virement From (If Applicable)	Other Comments
Education	Unitary Charge Payments	2023/24	(£1.65)million		Average saving over 2023/24- 2027/28.
	Capital Repayments	From 2039 to 2054	£3.4million	Unitary Charge Allowance	Average on -going annual principal repayments over 2039-2054
Miscellaneous	Internal Resources Interest	Phased from 2023/24	£0.4million (estimate)		Estimated loss of investment income arising from spending £14.7 million "non-cash" reserves and already factored into the latest 2023/25 Budget figures.

5.3 **Legal/Risk**

The proposals in this paper have no impact on the existing PPP contract between the Council and e4i or the Scottish Government commitment to pay the Council £6.066 million each year until 2039/40.

In line with the Finance Circular 10/2022, the proposals in this report will require Council approval.

5.4 **Human Resources**

There are no HR implications arising.

5.5 **Strategic**

This decision will free up resources for use towards meeting the Council's Financial Strategy objectives. It will however also tie the Council into a commitment to repay the initial capital investment in the 4 PPP schools for a further 15 years which will impact on available funding for other initiatives post 2039/40.

6.0 CONSULTATION

6.1 The Members Budget Working Group support the contents of this report and the Interim Director, Finance & Corporate Governance has consulted with Link Treasury Services, the Council's Treasury Consultants who agree the figures and technical issues arising from this proposal.

7.0 BACKGROUND PAPERS

7.1 Finance Circular 10/2022 - Local government finance circular 10/2022 - finance leases and service concession arrangements: statutory guidance:

https://www.gov.scot/publications/local-government-finance-circular-10-2022-finance-leases-and-service-concession-arrangements-statutory-guidance/

Appendix 1

Total proposed rescheduling model

Year	PPP principal repayments	Current position Current repayment £000	Principal repayments based on simple 45 year annuity @ 6.118% Revised repayment £000	(Saving)/cost £000	NPV 3.5% £000
0	**pre 2023/24**	22,219	7,471	(14,748)	(14,748)
1	**2023/24**	2,206	810	(1,396)	(1,349)
2	**2024/25**	2,309	859	(1,449)	(1,353)
3	**2025/26**	2,745	912	(1,833)	(1,653)
4	**2026/27**	2,590	968	(1,623)	(1,414)
5	**2027/28**	2,374	1,027	(1,347)	(1,134)
6	**2028/29**	3,067	1,090	(1,978)	(1,609)
7	**2029/30**	2,799	1,156	(1,642)	(1,291)
8	**2030/31**	2,771	1,227	(1,544)	(1,172)
9	**2031/32**	3,100	1,302	(1,798)	(1,319)
10	**2032/33**	3,503	1,382	(2,121)	(1,504)
11	**2033/34**	3,016	1,466	(1,550)	(1,062)
12	**2034/35**	3,547	1,556	(1,991)	(1,317)
13	**2035/36**	3,559	1,651	(1,907)	(1,220)
14	**2036/37**	4,112	1,752	(2,359)	(1,458)
15	**2037/38**	4,405	1,859	(2,546)	(1,520)
16	**2038/39**	5,104	1,973	(3,131)	(1,805)
17	**2039/40**	4,212	2,094	(2,119)	(1,180)
18	**2040/41**		2,222	2,222	1,196
19	**2041/42**		2,358	2,358	1,226
20	**2042/43**		2,502	2,502	1,257
21	**2043/44**		2,655	2,655	1,289
22	**2044/45**		2,818	2,818	1,322
23	**2045/46**		2,990	2,990	1,355
24	**2046/47**		3,173	3,173	1,390
25	**2047/48**		3,367	3,367	1,425
26	**2048/49**		3,573	3,573	1,461
27	**2049/50**		3,792	3,792	1,498
28	**2050/51**		4,024	4,024	1,536
29	**2051/52**		4,270	4,270	1,575
30	**2052/53**		4,531	4,531	1,614
31	**2053/54**		4,808	4,808	1,655
	Total	**77,637**	**77,637**		**(18,310)**

Appendix 2

Saving Smoothing Reserve Calculation

Year	Actual Saving £000	Proposed Saving £000	Difference £000
2023/24	1396	1650	254
2024/25	1449	1650	201
2025/26	1833	1650	-183
2026/27	1623	1650	27
2027/28	1347	1650	303
		Smoothing Reserve Required	602

AP
8/12/22

Inverclyde council

Appendix 3

Affordability of Service Concession Proposal
As at 2040

	£million
Estimated Unitary Charge 2039/40	15.5
less Scottish Government Grant (ends 30/9/39)	-6.1
	9.4
Less Principal Saving in 2039/40	-2.1
Budget available in 2039/40	7.3
less: 2040 post-PPP School Running costs (est)	-1.6
less: Investment Income foregone on £14.7 million	-0.4
Amount of Unitary Charge Budget remaining	5.3

Note - The remaining sum will require to fund the revised repayments set out in Appendix 1 which peak at £4.808million in 2053/54 . This demonstates the affordability within estimated resources

Finance Services
9/1/23