Service Concessions – Fiscal Flexibility

1. Purpose of Report

1.1. The purpose of the report is to:

- Provide information on the changes permitted to how councils account for the repayment of debt on "Services Concessions" and seek approval to implement the change.

2. Recommendations

2.1. The Council is asked to approve the following recommendations:

(1) Approve the implementation of the guidance on Service Concessions flexibility that is detailed in section 4;

(2) Agree as part of the implementation of the Service Concession flexibility that the costs accounted for in years beyond the contract term will be met from the 3R's schools and Lochside unitary charge budgets released at the end of their respective contracts (section 5.7);

(3) Approve the use of the retrospective funds released by the Service Concession flexibility for voluntary severance / early retirement payments from 2022/23 onwards c.£33m), based on the commitment to no compulsory redundancies, the approved Medium Term Financial Strategy and TOM1.2 setting out the need for recurring staff savings over the next five years of £40m; and note that the cost of accessing the retrospective reserve will incur financing costs of c.£2m, which will be incorporated into the Council's treasury management arrangements (section 6).

3. Background

3.1. As part of the Spending Review in May 2022, the Scottish Government announced that the implementation of Service Concessions Guidance was accessible to councils. As discussed at Finance & Resources Committee on 1 February 2023 the guidance on Service Concessions was being considered by officers with the implications being reported back to a future committee. Implementation of the guidance requires full Council approval.

3.2. Accounting for Service Concessions refers to how the Council accounts for its 3Rs School Public & Private Partnership (PPP) that has been in place since 2009/10, and the financing arrangement for Lochside Academy, which opened in August 2018.

3.3. The Council entered the 3Rs schools' PPP agreement in June 2006. This financed the building of new primary and secondary schools.

3.4. The Contractor built the schools and the Council agreed to make an annual contract payment for 31 years (a Unitary Charge Payment) until 2039/2040, being the initial 4 years of set-up and then the 31 years of the full contract. This unitary charge is £16 million for financial year 2022/2023 and is a payment for the provision of the schools.

3.5. As part of the process of establishing the PPP arrangements for the 3Rs agreement, the Council added assets of £148 million to its balance sheet and at the same time recognised that there is a long-term liability to fund these assets.

3.6. The element relating to the Repayment of Debt is used to reduce the long-term liability in the Balance Sheet. In effect, the accounting regulations followed mean that the Council was paying for the assets over the life of the contract (31 years). By the end of the 31 years, the debt outstanding will be nil and the assets will be transferred to the Council's ownership, with a remaining useful life.

3.7. At the end of 2021/2022, the long-term liability (notional debt) for the Schools' PPP is £86 million.

3.8. In 2018/2019 the Council accounted for the similar Lochside Academy arrangement by adding assets of £34.1 million to the balance sheet and creating a liability of £45 million. An annual payment of £3 million, rising to £4.4 million, is due over 26 years and at the end of 2021/2022, the debt outstanding is £41 million.

3.9. This paper will explain the principles behind the implementation of the Service Concessions Guidance (section 4) and will detail the financial implications of this guidance, including costs that need to be managed (section 5). It will also detail how these monies could be used (section 6). Section 7 summarises the position.

4. Service Concessions Guidance

4.1. The Council has a 31-year PPP contract for some of our schools. At the end of the 31 years, the ownership of the schools transfer to the Council. The schools are subject to a repairs and maintenance regime and are anticipated to be in a good condition when they transfer. This is not the end of their useful life.

4.2. The new guidance referred to in section 3.1 affords councils the ability to account for the payment for the assets over their expected useful life (60 years), rather than over the contract term (31 years). In effect, the benefit from the Service Concessions Arrangement is achieved by better matching the debt costs of PPP schools to the expected useful lives of the schools and, therefore, repaying the cost of debt across a longer period of time. In this instance it is suggested that the repayment period be extended from 31 years to 60 years[1].

4.3. A similar approach can be applied to the Lochside Academy contract, the benefit from this arrangement being better matched to the costs by extending the repayment period from 28 years to 60 years.

4.4. This does not change what we pay the contractors in cash every year. This is simply about the accounting transactions to pay for the assets. Neither does it change the term over which we pay the contractors, it is just how we account for the repayment of the debt in the Council's Revenue Budget.

[1] This being related to the useful life, in years, used as part of the property valuation process for schools.

4.5. Councils are allowed to apply this change in accounting treatment retrospectively. This means we can now reflect how we would have accounted for paying for the assets had we always been permitted to do so, over the life of the asset rather than the contract. This creates an overpayment in our accounts with too much having been charged to the Revenue Account to pay for the assets.

4.6. While this does not release cash (the contractors do not pay us money back), it means that we can increase the Council's General Fund Reserve balance by reversing part of the charge that has been made, which will sit in an unusable reserve (Capital Adjustment Account) – this being an accounting adjustment rather than a cash transaction.

5. Financial Implications

5.1. As noted in section 4.2, the guidance allows the debt repayments to be better aligned to the life of the asset, and also allows councils to decide on their preferred approach to making the debt repayments. The options are to make debt repayments using either the equal instalments of principal (EIP) method or an annuity method.

5.2. This report assumes the calculation of the debt repayment on the annuity basis as it best represents the consumption of the assets over their useful lives. The annuity method is used as standard practice in most PPP arrangements. Calculation of the debt liability repayments using the annuity method is considered a prudent approach as it reflects the time value of money (the impact of inflation) as well as providing a charge that is better matched to how the benefits of the asset are consumed over its useful life – it reflects the fact that an asset's deterioration is slower in the early years of life and accelerates towards the latter years. Therefore, the economic use of the asset is greater in the latter years. The use of the annuity basis is appropriate for our specific Service Concessions.

5.3. By implementing the new guidance there will be a retrospective gain to the Council. Following clarification in the guidance, officers have now finalised the calculations and the retrospective benefit to the end of 2022/2023 is £35million. The new profile of repayments means that we will have 'over-paid' debt to the value of £35 million to the end of 2022/2023. This can be taken as a financial benefit and transferred to Usable Reserves. The increase in the Council's Usable Reserves balance can be used to support a range of uses however this comes with a cost, as there is no cash involved in the creation of the reserve and therefore the money must be borrowed.

5.4. In addition, there will be an approximate £4 million benefit from 2023/2024 which means that a permanent budget saving can be taken, subject to some individual year variations, for the next 19 years from 2023/2024.

5.5. Annex 1 provides more information on how the benefit is arrived at.

5.6. **Repayment Over a Longer Term:** As a result of lengthening the repayment period as it is now aligned to asset life, there will be an extra cost each year for the 35 years after the end of the PPP contracts. This amounts to £1.4 million in 2042/2043, increasing to £8.8 million in 2067/68 then reducing to £2.3 million in 2076/2077.

5.7. It is suggested that this PPP Unitary Charge budget (currently c.£19m) that is no longer required to fund PPP payments as the payments to the contractor will have ceased, is then used to fund the additional payments resulting from lengthening the repayment period (section 5.6).

5.8. The additional costs of lengthening the repayment period will not, therefore, represent any additional future revenue budget pressure as they can be managed within the PPP Unitary Charge budget available. We are not paying the contractor for longer and are not paying the contractor more.

5.9. **Costs linked to using the retrospective benefit:** As noted in section 4.6, this is not a cash benefit, but an accounting benefit. If we want to use the retrospective benefit to support the Budget Strategy, and ultimately to pay for expenditure, then we have to access cash funds to do that. This would naturally be done through borrowing.

5.10 The need to borrow, and any resultant interest costs arise from how we choose to use the retrospective benefit, rather than because we are adopting the service concession guidance and implementing the change in accounting. How we choose to use the funds will influence how much borrowing is required, the timing of that, and the costs incurred.

6. Use of Service Concessions Benefit

6.1. This paper is looking for agreement to implement the guidance on Service Concessions as detailed in this report.

6.2. As noted in section 5.3, if the Service Concessions Guidance is implemented in 2022/2023, there will be a retrospective gain of £35 million. There will also be an annual saving with effect from 2023/2024, until 2041/42 (section 5.4).

6.3. Detailed in the Medium Term Financial Strategy, 24 August 2022, in a central scenario £134m must be saved over 5 years to balance the General Fund revenue budget. This must be done in a sustainable way through the delivery and achievement of recurring savings or recurring income streams.

6.4 This will require funding to change the way we work, where we work and how we work together and with our partners. The workforce/pay bill must be reduced substantially if the Council is to live within its means. The funding source, to support the cost of change, is not obvious, with no ‘spare’ budgets and limitations on how, for example, capital receipts can / should be used as well as limitations on their availability. Therefore the retrospective benefit ‘reserve’ must be the solution for the Council if it is to fund the cost of change.

6.5 What has to be achieved: (extract from TOM1.2, 24 August 2022)

6.6 The need for £40m of savings over the five years, with a no compulsory redundancies commitment in place, alongside the limitations placed on the Council through the Local Government Financial Settlement e.g. teacher numbers and funding protection to Health and Social Care Partnership, plus pay inflation, makes the challenge extremely difficult. The solution must come in the form of managing staff vacancies, turnover and also through Voluntary Severance or Early Retirement.

6.7 The VSER scheme costs money and delivers recurring revenue savings that add up over the period. Based on past VSER exercises it has been estimated that £33m will be required from this ‘reserve’ over the 5 years to deliver a large proportion of the required savings. The cost of accessing the ‘reserve’ has been estimated at £2m, with the management of the cashflow, timing and borrowing costs at a corporate level to minimise where possible.

6.8 The budget options for redesign of Council services as part of this budget include savings in 2023/24 of £6m and therefore to take these savings, will require committing to the funding strategy, use of the service concession ‘reserve’. This will lock in a return for the investment made in funding the VSER scheme and enable the Council to achieve recurring savings, shrinking the cost base of the Council and supporting the redesign and transformation of services.

7. Summary

7.1. Reprofiling the debt in relation to the PPP schools would mean a retrospective gain of £35 million (section 5.3) and an annual benefit of approximately £4 million starting in 2023/2024 (section 5.4). This £4 million has been included as an option for balancing the budget from 2023/24 onwards.

7.2. While there will be extra costs after the PPP schools contract ends, these will be managed from the budget no longer required to pay for the PPP contract itself (section 5.7).

7.3. As the retrospective benefit is on an accounting basis, in order to use this benefit to spend on real expenditure items, the Council will have to fund this. Funding this from borrowing will result in interest costs (section 5.10).

7.4. The need to borrow, and any resultant interest costs arise from how we choose to use the retrospective benefit, rather than because we are adopting the service concession guidance and implementing the change in accounting. How we choose to use the funds will influence how much borrowing is required, the timing of that, and the costs incurred.

7.5. Based on the proposals detailed in section 6 the potential costs of borrowing will be managed, however expect to cost £2m over the five years. (section 6.7)

7.6. The approach proposed in relation to service concessions demonstrates that implementing the Service Concessions Guidance is:

- **Affordable** – Ongoing costs of repaying debt after the end of the PPP contract are affordable from the remaining net PPP budget. Interest costs will be managed through treasury management activities.
- **Sustainable** – the annual saving provides benefit that lowers the cost on Council Tax payers and ongoing costs will be met after the contract ends through use of existing PPP budgets. Use of the retrospective ‘reserve’ will deliver recurring savings, and a return on the investment made by paying for VSER costs, funding the cost of change.
- **Prudent** – the approach better matches the costs of repaying debt to the useful life of the asset.

Background Papers

- Quarter 3 2022/23 Financial Performance Report, Finance & Resources Committee, 1st February 2023

Jonathan Belford, Chief Officer - Finance
jbelford@aberdeencity.gov.uk

Schedule of Current and Revised Repayments for Service Concession Arrangements ANNEX 1

		3Rs (2009/10, £120m, 31 years)				Lochside Academy (2018/19, £46m, 26 years)					
		Current position	Principal repayments based on simple 60 year annuity @ 6.374%			Current position	Principal repayments based on simple 60 year annuity @ 4.976%				
Year	PPP principal repayments	Current repayment £000	Revised repayment £000	(Reduction) /cost £000	NPV 3.5% £000	Current repayment £000	Revised repayment £000	(Reduction) /cost £000	NPV 3.5% £000	Total (reduction) /cost £000	Total NPV £000
0	**pre 2022/23**	34,059	4,167	(29,893)	(29,893)	6,006	720	(5,286)	(5,286)	**(35,179)**	**(35,179)**
1	**2022/23**	3,972	459	(3,513)	(3,395)	1,360	166	(1,194)	(1,153)	**(4,707)**	**(4,548)**
2	**2023/24**	2,865	488	(2,377)	(2,219)	1,443	174	(1,268)	(1,184)	**(3,646)**	**(3,403)**
3	**2024/25**	1,336	519	(817)	(737)	1,431	183	(1,248)	(1,125)	**(2,065)**	**(1,862)**
4	**2025/26**	4,109	552	(3,557)	(3,099)	1,457	192	(1,265)	(1,102)	**(4,821)**	**(4,201)**
5	**2026/27**	4,511	587	(3,924)	(3,304)	1,530	202	(1,328)	(1,119)	**(5,252)**	**(4,422)**
6	**2027/28**	4,755	625	(4,130)	(3,360)	1,505	212	(1,293)	(1,052)	**(5,423)**	**(4,412)**
7	**2028/29**	4,909	665	(4,244)	(3,336)	1,398	222	(1,175)	(924)	**(5,419)**	**(4,260)**
8	**2029/30**	2,999	707	(2,292)	(1,741)	1,593	233	(1,359)	(1,032)	**(3,651)**	**(2,773)**
9	**2030/31**	5,323	752	(4,571)	(3,354)	1,715	245	(1,470)	(1,079)	**(6,041)**	**(4,433)**
10	**2031/32**	6,398	800	(5,598)	(3,968)	1,762	257	(1,504)	(1,066)	**(7,102)**	**(5,035)**
11	**2032/33**	6,662	851	(5,811)	(3,980)	1,876	270	(1,606)	(1,100)	**(7,417)**	**(5,081)**
12	**2033/34**	6,148	905	(5,242)	(3,469)	2,040	284	(1,756)	(1,162)	**(6,999)**	**(4,632)**
13	**2034/35**	6,218	963	(5,255)	(3,360)	2,102	298	(1,804)	(1,154)	**(7,059)**	**(4,514)**
14	**2035/36**	7,977	1,024	(6,953)	(4,295)	2,234	312	(1,922)	(1,187)	**(8,874)**	**(5,482)**
15	**2036/37**	8,442	1,090	(7,353)	(4,389)	2,308	328	(1,980)	(1,182)	**(9,332)**	**(5,570)**
16	**2037/38**	8,739	1,159	(7,580)	(4,372)	2,406	344	(2,062)	(1,189)	**(9,642)**	**(5,561)**
17	**2038/39**	1,032	1,233	201	112	2,696	361	(2,335)	(1,301)	**(2,134)**	**(1,189)**
18	**2039/40**		1,312	1,312	706	2,757	379	(2,378)	(1,280)	**(1,066)**	**(574)**
19	**2040/41**		1,395	1,395	726	2,595	398	(2,197)	(1,143)	**(802)**	**(417)**
20	**2041/42**		1,484	1,484	746	2,813	418	(2,395)	(1,203)	**(911)**	**(458)**
21	**2042/43**		1,579	1,579	767	624	439	(185)	(90)	**1,394**	**677**
22	**2043/44**		1,679	1,679	788		461	461	216	**2,140**	**1,004**
23	**2044/45**		1,786	1,786	810		484	484	219	**2,270**	**1,029**
24	**2045/46**		1,900	1,900	832		508	508	222	**2,408**	**1,055**
25	**2046/47**		2,021	2,021	855		533	533	226	**2,554**	**1,081**
26	**2047/48**		2,150	2,150	879		560	560	229	**2,710**	**1,108**
27	**2048/49**		2,287	2,287	903		587	587	232	**2,875**	**1,136**
28	**2049/50**		2,433	2,433	929		617	617	235	**3,050**	**1,164**
29	**2050/51**		2,588	2,588	954		647	647	239	**3,235**	**1,193**
30	**2051/52**		2,753	2,753	981		680	680	242	**3,433**	**1,223**
31	**2052/53**		2,929	2,929	1,008		713	713	246	**3,642**	**1,254**
32	**2053/54**		3,115	3,115	1,036		749	749	249	**3,864**	**1,285**
33	**2054/55**		3,314	3,314	1,065		786	786	253	**4,100**	**1,317**
34	**2055/56**		3,525	3,525	1,094		825	825	256	**4,350**	**1,351**
35	**2056/57**		3,750	3,750	1,125		866	866	260	**4,616**	**1,385**
36	**2057/58**		3,989	3,989	1,156		909	909	264	**4,898**	**1,420**
37	**2058/59**		4,243	4,243	1,188		955	955	267	**5,198**	**1,456**
38	**2059/60**		4,513	4,513	1,221		1,002	1,002	271	**5,516**	**1,492**
39	**2060/61**		4,801	4,801	1,255		1,052	1,052	275	**5,853**	**1,530**
40	**2061/62**		5,107	5,107	1,290		1,104	1,104	279	**6,212**	**1,569**
41	**2062/63**		5,433	5,433	1,326		1,159	1,159	283	**6,592**	**1,609**
42	**2063/64**		5,779	5,779	1,363		1,217	1,217	287	**6,996**	**1,650**
43	**2064/65**		6,147	6,147	1,400		1,278	1,278	291	**7,425**	**1,691**
44	**2065/66**		6,539	6,539	1,439		1,341	1,341	295	**7,880**	**1,735**
45	**2066/67**		6,956	6,956	1,479		1,408	1,408	299	**8,364**	**1,779**
46	**2067/68**		7,400	7,400	1,520		1,478	1,478	304	**8,878**	**1,824**
47	**2068/69**						1,551	1,551	308	**1,551**	**308**
48	**2069/70**						1,629	1,629	312	**1,629**	**312**
49	**2070/71**						1,710	1,710	317	**1,710**	**317**
50	**2071/72**						1,795	1,795	321	**1,795**	**321**
51	**2072/73**						1,884	1,884	326	**1,884**	**326**
52	**2073/74**						1,978	1,978	331	**1,978**	**331**
53	**2074/75**						2,076	2,076	335	**2,076**	**335**
54	**2075/76**						2,180	2,180	340	**2,180**	**340**
55	**2076/77**						2,288	2,288	345	**2,288**	**345**
56	**2077/78**										
57	**2078/79**										
58	**2079/80**										
59	**2080/81**										
60	**2081/82**										
	Total	**120,453**	**120,453**		**(51,316)**	**45,650**	**45,650**		**(18,739)**		**(70,055)**

This table shows the difference between how the Council currently accounts for its Service Concession arrangements and how it would do so if the revised guidance on Service

Concessions as detailed in Section 4 of the report was implemented.

Summary table

	3Rs (2009/10, £120m, 31 years)				Lochside Academy (2018/19, £46m, 26 years)			
	Current position	Principal repayments based on simple 60 year annuity @ 6.374%			Current position	Principal repayments based on simple 60 year annuity @ 4.976%		
PPP principal repayments	Current repayment £000	Revised repayment £000	(Reduction) /cost £000	NPV 3.5% £000	Current repayment £000	Revised repayment £000	(Reduction) /cost £000	NPV 3.5% £000
pre 2022/23	34,059	4,167	(29,893)	(29,893)	6,006	720	(5,286)	(5,286)
2022/23	3,972	459	(3,513)	(3,395)	1,360	166	(1,194)	(1,153)
Yrs 2 to 5	12,821	2,146	(10,674)	(9,359)	5,861	752	(5,109)	(4,530)
Yrs 6 to 10	24,383	3,548	(20,835)	(15,758)	7,972	1,170	(6,802)	(5,153)
Yrs 11 to 25	45,218	20,381	(24,837)	(17,524)	24,451	5,818	(18,634)	(11,108)
Yrs 26 to 40		89,752	89,752	24,613		37,025	37,025	8,491
Total	**120,453**	**120,453**		**(51,316)**	**45,650**	**45,650**		**(18,739)**

Pre 2022/2023 we had accounted for debt repayments of £34.059 million for the 3Rs arrangements and £6.006 million for Lochside Academy, a total of £40.065 million. Under the revised guidance we should only have accounted for £4.167 million and £0.720 m, £4.887m in total, and a difference of £35.178 m.

For 2022/2023, we are due to account for £3.972 m of the debt relating to the 3Rs and £1.360m for Lochside Academy. By applying the revised guidance, these can be reduced to £0.459 m and £0.166 m respectively. The total difference is £4.707m. This is combined with the pre 2022/2023 difference to give a total retrospective benefit of £39.885m as shown in rows 1 and 2 of the Schedule of Current and Revised Repayments for Service Concession Arrangements and explained in Section 5.3 of the report.

The 'total (reduction)/cost' column shows the annual difference between the two arrangements, and it can be seen that applying the revised guidance results in lower debt repayments from 2023/2024 to 2039/2040. This allows the Council to take an annual budget saving until 2041/42 as referred to in Section 5.4 of the report.

The 'total (reduction)/cost' column also shows that from 2042/43, by lengthening the repayment period to align with the life of the assets, there are additional costs each year after the end of the PPP contract as explained in Section 5.6 of the report. These can be managed within the available PPP Unitary Charge budget, Section 5.7 of the report.

The total repayments under both approaches remain the same. It is simply the timing of the repayment that has changed.