Loans Fund Repayment Policy

Background

Under new regulations, as detailed below, each year Elected Members must approve a policy that charges capital costs to revenue - Loans Fund Repayments.

This document is designed to provide information to help Elected Members make an informed decision on approving the policy.

It is up to the Council to decide how to fund its capital expenditure including how much to fund through borrowing. Outstanding debt liability is the balance of borrowing used to support capital expenditure.

Each year the Council must charge an amount of the outstanding debt liability to the General Fund and Housing Revenue Account (HRA) that it **considers to be prudent**.

This is known as the Loans Fund Repayment. The Loans Fund Repayment Policy must be approved by Council or appropriate committee.

Regulations

The requirement to charge an amount (Loans Fund Repayment) is governed by The Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016 ("2016 Regulations") which 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 repeal of the Schedule 3 provisions is set out in The Local Government etc (Scotland) Act 1994 (Commencement No. 9) Order 2016. Finance Circular 29/1975 is only applicable to Loans Fund advances made before 1 April 2016.

The 2016 Regulations require the statutory Loans Fund to be administered in accordance with the Regulations, proper accounting practice and prudent financial management.

Finance Circular 4/2016 ("the Statutory Guidance") provides guidance on proper accounting practices as it relates to the statutory loans fund and prudent financial management as it relates to the repayment of loans fund advances.

Principles of a Loans Fund Repayment Provision

The term 'prudent' is not defined by the Regulations. However, the Statutory Guidance states:

"the broad aim of prudent provision is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits."

The Statutory Guidance does not prescribe the annual repayment profile to achieve this aim but suggests four methods for making Loans Fund Repayments which it considers prudent, and notes that other methods are not ruled out.

The Council regards the broad aim of Loans Fund Repayments as set out above as the primary indicator of prudent provision, whilst recognising the flexibilities which exist in determining an appropriate annual repayment profile. In determining a prudent provision, the Council should:

- **consider all the options available and their wider impact on the Capital Financing Requirement and underlying borrowing;**
- **determine what prudent means in the context of this Council; and**
- **demonstrate that the proposed Loans Fund Repayment policy complies with the requirement to charge a prudent amount.**

The Council considers that 'prudent' in this context does not mean the quickest possible repayment period, but has regard to the prudent financial planning of the Council overall, the flow of benefits from the capital expenditure, and other relevant factors.

This Loans Fund Repayment Policy therefore takes account of the financial forecast in the Council's Medium Term Financial Plan in determining what are prudent Loans Fund Repayments. In particular, this takes account of the funding needs of the Council now and in the future and the need for a managed financial transition as the Council adjusts to further funding reductions.

Consistent with the Statutory Guidance, the Council will not review the individual asset lives used for Loans Fund Repayments as a result of any changes in the expected life of the asset or its actual write off. Some assets will last longer than their initially estimated life, and others will not; the important thing is the reasonableness of the estimate.

Current Policy 2018/19

The Councils current policy is as follows:

- **For all Loans Fund Advances, the policy is to maintain the practice of previous years and apply the Statutory Method, with all loans fund advances being repaid using the annuity method;**

Proposed Policy 2018/19

The repayment profile proposed will follow a simplified prudent annuity approach as follows:

Based on Option 1:

- **For Loans Fund balances outstanding as at 1 April 2018 relating to advances made before 1 April 2016 the policy will be to maintain the practice of previous years and apply the Statutory Method, with all loans fund advances being repaid using the annuity method.**
- **For Loans Fund balances outstanding as at 1 April 2018 relating to advances made after 1 April 2016 the Authority will adopt a simplified prudent approach that uses an average Loans Fund repayment period of 40 years, applying an annuity method. The interest rate used for the annual repayment will be 5%, with this being the average consolidated rate on the Councils external borrowing for the period 2003/04 to 2017/18.**
- **The average life and average interest rate will be kept under review each year to ensure they remain prudent.**

The proposed policy is subject to the following details:

- **An average Asset life for the year's total advances will normally be used. There will not be separate schedules for the components of a building (e.g. plant, roof etc).**
- **The Average Asset Life will be determined by the Chief Officer - Finance.**
- **The interest rate used in the annuity calculation will be determined by the Chief Officer - Finance.**
- **Loans Fund Repayments will commence in the year following the year in which capital expenditure financed from borrowing is incurred, except for assets under construction where repayments will be deferred until the year after the asset becomes operational.**

- **Other methods to provide for debt repayment may occasionally be used in individual cases where this is consistent with the statutory duty to be prudent, as justified by the circumstances of the case, at the discretion of the Chief Officer - Finance.**
- **If appropriate, shorter repayment periods (i.e. less than the asset life) may be used for some or all new borrowing.**
- **The policy will aim to support the maintenance of a balanced and sustainable HRA business plan.**
- **Where revenue contributions or specific grants are received from government or other sources that can be associated with the debt financing costs of capital investment, then the repayments will be profiled in line with the income profile (e.g. TIF, City Deal). These will be kept under review to ensure the provision for repayment remains prudent.**
- **The Council may make additional voluntary debt repayment provision from revenue or capital resources. In this case, the Chief Officer - Finance may make an appropriate reduction in later years' levels of Loans Fund Repayments.**

Subsequent Review of the Policy

The Loans Fund Repayment policy will be reviewed on an annual basis in order to consider if the current policy is prudent and appropriate for the forthcoming year, takin into account the prudent financial planning of the Council overall, the financial forecast in the Councils Medium Term Financial Plan, the flow of benefits from the capital expenditure, and other relevant factors. Any subsequent changes to the policy will be reported to Council or the appropriate committee prior to implementation.