

SERVICE CONCESSION FLEXIBILITY – ACCOUNTING CHANGE PROPOSAL

1. INTRODUCTION

- 1.1 This purpose of this report is to detail a proposed change to the accounting treatment of the Council's School PPP (Service Concession) contracts following the issuing of revised accounting guidance by Scottish Government contained in Local Government Finance Circular 10/2022.
- 1.2 As part of supporting the additional costs that arose during COVID, in 2020 the Scottish Government considered a financial flexibility that would allow councils to undertake internal accounting changes that extend the period over which the principal repayment of the unitary charge can be made which results in a one-off retrospective benefit to the Council and ongoing annual savings up to the end of the original contract period. In the remaining years following the end of the contract period, rescheduled debt repayments continue until the debt liability has been extinguished.
- 1.3 This financial flexibility was considered for some time by Scottish Government and officers have now developed a proposal based on Local Government Finance Circular 10/2022 issued on 6 September 2022 and the details are contained within the body of the report along with the potential financial implications. Whilst in the medium term financial gains are significant and are very welcome in the context of financial challenges facing the Council, it is important that Members consider the longer term implications and recognise that the use of the one-off retrospective benefit released by this proposal needs to be carefully considered. The guidance is clear that any proposal requires approval by full Council.

2. DETAIL

- 2.1 The Council have two school service concession contracts for the build of seven schools. The NPDO schools contract was entered into on 30/09/2006 at £88.432m repayable over a period of 30 years and the DBFM schools contract created on 30/09/2016 at £60.927m repayable over a period of 25 years.
- 2.2 The Council pays an annual sum called the unitary charge which covers the capital costs of the buildings, facility management costs, cyclical repairs, financing costs and a number of other costs such as insurance.
- 2.3 The PPP contracts are viewed as service concession arrangements which have specific accounting requirements. As part of the 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.

- 2.4 Scottish Government took some time to agree the flexibility and Members have been kept informed over the last two years, however, Finance Circular 10/2022 was issued on 6 September 2022 that allows the flexibility to be implemented in either 2022-23 or 2023-24. The flexibility must be applied to all service concession arrangements in line with the key accounting principle of consistency with the exception of such arrangements where the contract will expire within five years.
- 2.5 In terms of the requirements of Finance Circular 10/2022, the Council will need to show that the financial implications for the change are affordable, sustainable and prudent over the life of the asset and explain the basis for the accounting change. The proposal must also be agreed by full Council.
- 2.6 Advice and support has been sourced from the Council's treasury advisors, The Link Group and also via the Directors of Finance Section.
- 2.7 It is proposed that rather than reflecting the repayment of the capital investment in building the schools over the 25 and 30 years of the PPP contracts, the Council now account for this over a 60 year period. This reflects the repayment period for new build schools as laid down in the Councils Treasury Strategy and officers have confirmed this with our Estates team who are comfortable with assuming a 60 year life for the schools.
- 2.8 In line with the current approved policy in relation to Loans Fund principal repayments, it is proposed that the 60 year repayment is made on an annuity basis. Calculation of the debt liability repayments using the annuity method is considered a prudent approach as it reflects the time value of money as well as providing a charge that is better matched to how the benefits of the asset financed by borrowing are consumed over its useful life. That is, a method that reflects the fact that asset deterioration is slower in the early years of an asset and accelerates towards the latter years.
- 2.9 The principal repayments from the start of the contract period up to and including 2022-23 total £38.144m. Based on the proposed 60 year annuity repayment the principal repayments would have been £2.106m by 31 March 2023. This creates a one-off retrospective benefit to be transferred to reserves of £36.038m. Due to the extension of the repayment period, there is also a revenue saving each year to the end of the contract period. The amount saved each year varies from year to year due to the nature of the principal repayments profile. The revenue saving for 2023-24 is included within the policy savings in the revenue budget overview report. There will be a continuing revenue requirement to repay the principal beyond the life of the contracts. Whilst there will be ongoing revenue costs to run the building at the end of the contract period, there will be capacity within the unitary charge budget to cover the principal repayments. The calculation is summarised below and a more detailed calculation is provided in Appendix 1.

Total of PPP schemes				
	Current position	Principal repayments based on simple 60 year annuity		
PPP principal repayments	Current repayment £000	Revised repayment £000	(Reduction) /cost £000	NPV 3.5% £000
pre 2023/24	38,144	2,106	(36,038)	(36,038)
2023/24	5,232	401	(4,831)	(4,668)
Yrs 2 to 5	23,420	1,887	(21,533)	(19,038)
Yrs 6 to 10	39,546	3,180	(36,366)	(27,526)
Yrs 11 to 25	43,017	20,326	(22,691)	(15,546)
Yrs 26 to 40		66,347	66,347	20,461
Yrs 41 to 50		39,901	39,901	8,891
Yrs 51 to 60		15,211	15,211	2,408
Total	149,359	149,359		(71,057)

- 2.10 What can be seen from the table above is that the current repayment charged to the revenue account is £149.359m (column 1). The revised repayment demonstrates that the total cost remains at £149.359m but as this is now spread over a longer period time (the asset life) the annual cost is reduced in years 1 to 25 which results in a cost reduction (column 3). Over the full life of the service concession arrangements, the total repayment for the debt liability remains the same, however, when a Net Present Value (NPV) is applied, the re-profiled charges would result in an overall reduction in NPV terms of £71.057m.
- 2.11 It is important that the Council understand that this is purely an accounting adjustment. The Council will continue to pay the contractor over the term of the contract. The one-off benefit that is generated will represent a “non-cash” increase in the Council’s reserves and the use of the benefit will require to be managed through the Council’s Treasury Management approach and the exiting cash flow management arrangements. This may result in increased borrowing costs as interest will be incurred, however, there are many other factors which influence treasury management activities and cash flow such as levels of slippage, grant profiles and expenditure patterns. Therefore, this requirement to borrow will be managed in totality and the working assumption is that any additional costs can be met from the existing Loans Fund budget.
- 2.12 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 PPP budget. The use of the non-cash reserves can be managed within the overall Treasury Management Strategy and cash flow management.
- Sustainable** – the loans charges budget can be maintained at current levels.

Prudent – the approach better matches the cost of repaying debt to the useful life of the asset and the one-off retrospective benefit will assist in dealing with some short to medium term pressures.

- 2.13 At the Council’s budget meeting on 25 February 2021, the Council agreed the following: “Approves that the Council exercises the principal repayment holiday flexibility to make £5.4m available to be directed towards COVID revenue and capital costs but that the use of this flexibility be replaced by the credit arrangements financial flexibility if the Scottish Government give permission for the repayment arrangements to be made on an annuity basis. If this is the case a report will be brought back to the full Council for determination.”
- 2.14 The Council were due to take the principal repayment holiday flexibility within financial year 2022-23, however, now that the service concessions flexibility has been made available, the holiday will not be taken. The principal repayment holiday valued at £5.4m has already been accounted for in the Council’s budget. The decision of the Council means that £5.4m of the one-off retrospective benefit should now replace the need to exercise the principal repayment holiday. This also removes the revenue cost pressure that would be created over the next 20 years by taking this repayment holiday.
- 2.15 The Council needs to consider carefully how to use the remaining service concessions one-off retrospective benefit. The Council should consider directing some to the capital pressures that are facing the Council, in addition to investing in options/projects that will provide the opportunity to create a revenue saving in the future.

3. CONCLUSION

- 3.1 The Service Concession Flexibility has now been agreed by Scottish Government and allows councils to undertake internal accounting changes that extend the period over which the principal repayment of the unitary charge can be made which results in a one-off retrospective benefit to the Council and ongoing annual savings over a period of time. In the remaining years following the end of the contract payment, rescheduled debt repayments continue until the debt liability has been extinguished.
- 3.2 Based on a 60 year repayment period and exercising this flexibility within financial year 2023-24 the one-off retrospective benefit will be £36.038m with a saving in 2023-24 of £4.831m.
- 3.3 The Council agreed to use the service concessions flexibility in preference to the principal repayment holiday, but as the principal repayment holiday has already been accounted for as part of the current year budget, £5.4m of the one-off retrospective benefit will require to be used to replace the principal repayment holiday.
- 3.4 The Council needs to consider carefully how to use the remaining service concessions one-off retrospective benefit. The Council should consider directing some to the capital pressures that are facing the Council, in addition to

investing in options/projects that will provide the opportunity to create a revenue saving in the future.

4. IMPLICATIONS

- 4.1 Policy – The repayment of the principal over 60 years is in line with the Council’s Treasury Strategy.
- 4.2 Financial – The report outlines a one-off retrospective benefit of £35.926m together with revenue savings in the short to medium term.
- 4.3 Legal – None.
- 4.4 HR – None.
- 4.5 Fairer Scotland Duty – See below
 - 4.5.1 Equalities – Equality and Socio-Economic Impact Assessment has been carried out and there are no significant potential positive or negative quality impacts.
 - 4.5.2 Socio Economic Duty - Equality and Socio-Economic Impact Assessment has been carried out and there are no significant potential positive or negative quality impacts.
 - 4.5.3 Islands Duty - Equality and Socio-Economic Impact Assessment has been carried out and there are no significant potential positive or negative quality impacts.
- 4.6 Climate Change – None.
- 4.7 Risk – There is a risk that extending the debt repayment period that appropriate funds will not be in place to meet the extension of the debt repayments. This is mitigated by retaining the budget in place beyond the period of the contract.
- 4.8 Customer Service – None.

Kirsty Flanagan
Executive Director /Section 95 Officer
9 February 2022

Policy Lead for Finance and Commercial Services: Councillor Gary Mulvaney

Appendix 1 – Total Proposed Rescheduling Model

		DBFM (2019/20, £61m, 24 years)				NPDO (2006/07, £88m, 29 years)					
		Current position	Principal repayments based on simple 60 year annuity @ 4.493%			Current position	Principal repayments based on simple 60 year annuity @ 9.948%				
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 2023/24	9,050	903	(8,147)	(8,147)	29,094	1,203	(27,890)	(27,890)	(36,038)	(36,038)
1	2023/24	1,970	252	(1,718)	(1,660)	3,262	150	(3,113)	(3,008)	(4,831)	(4,668)
2	2024/25	1,990	263	(1,727)	(1,613)	3,298	164	(3,134)	(2,925)	(4,861)	(4,538)
3	2025/26	2,025	275	(1,750)	(1,579)	3,459	181	(3,278)	(2,957)	(5,028)	(4,535)
4	2026/27	2,093	287	(1,806)	(1,574)	3,897	199	(3,698)	(3,223)	(5,504)	(4,796)
5	2027/28	2,163	300	(1,863)	(1,568)	4,496	219	(4,277)	(3,601)	(6,140)	(5,169)
6	2028/29	2,138	313	(1,825)	(1,484)	5,025	240	(4,785)	(3,892)	(6,609)	(5,377)
7	2029/30	2,036	328	(1,708)	(1,342)	5,279	264	(5,015)	(3,942)	(6,723)	(5,284)
8	2030/31	2,005	342	(1,663)	(1,263)	5,534	290	(5,244)	(3,982)	(6,906)	(5,245)
9	2031/32	2,169	358	(1,811)	(1,329)	6,075	319	(5,756)	(4,223)	(7,567)	(5,552)
10	2032/33	2,375	374	(2,001)	(1,419)	6,910	351	(6,559)	(4,650)	(8,560)	(6,069)
11	2033/34	2,473	390	(2,082)	(1,426)	7,861	386	(7,475)	(5,120)	(9,557)	(6,546)
12	2034/35	2,498	408	(2,090)	(1,383)	4,241	424	(3,817)	(2,526)	(5,907)	(3,909)
13	2035/36	2,576	426	(2,150)	(1,374)		467	467	298	(1,683)	(1,076)
14	2036/37	2,688	446	(2,243)	(1,385)		513	513	317	(1,730)	(1,069)
15	2037/38	2,822	466	(2,357)	(1,407)		564	564	337	(1,793)	(1,070)
16	2038/39	2,988	486	(2,502)	(1,443)		620	620	358	(1,882)	(1,085)
17	2039/40	3,213	508	(2,704)	(1,507)		682	682	380	(2,023)	(1,127)
18	2040/41	3,567	531	(3,036)	(1,635)		750	750	404	(2,286)	(1,231)
19	2041/42	4,105	555	(3,550)	(1,847)		824	824	429	(2,726)	(1,418)
20	2042/43	3,983	580	(3,403)	(1,710)		906	906	455	(2,497)	(1,255)
21	2043/44		606	606	294		997	997	484	1,603	778
22	2044/45		633	633	297		1,096	1,096	514	1,729	811
23	2045/46		662	662	300		1,205	1,205	546	1,866	846
24	2046/47		691	691	303		1,324	1,324	580	2,016	883
25	2047/48		722	722	306		1,456	1,456	616	2,179	922
26	2048/49		755	755	309		1,601	1,601	655	2,356	963
27	2049/50		789	789	312		1,760	1,760	695	2,549	1,007
28	2050/51		824	824	315		1,936	1,936	739	2,760	1,053
29	2051/52		861	861	318		2,128	2,128	785	2,989	1,102
30	2052/53		900	900	321		2,340	2,340	834	3,240	1,154

		DBFM (2019/20, £61m, 24 years)				NPDO (2006/07, £88m, 29 years)					
		Current position	Principal repayments based on simple 60 year annuity @ 4.493%			Current position	Principal repayments based on simple 60 year annuity @ 9.948%				
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
31	2053/54		940	940	324		2,573	2,573	886	3,513	1,209
32	2054/55		983	983	327		2,829	2,829	941	3,811	1,268
33	2055/56		1,027	1,027	330		3,110	3,110	999	4,137	1,329
34	2056/57		1,073	1,073	333		3,419	3,419	1,062	4,492	1,395
35	2057/58		1,121	1,121	336		3,760	3,760	1,128	4,881	1,464
36	2058/59		1,172	1,172	340		4,134	4,134	1,198	5,305	1,538
37	2059/60		1,224	1,224	343		4,545	4,545	1,273	5,769	1,615
38	2060/61		1,279	1,279	346		4,997	4,997	1,352	6,276	1,698
39	2061/62		1,337	1,337	349		5,494	5,494	1,436	6,831	1,786
40	2062/63		1,397	1,397	353		6,041	6,041	1,526	7,437	1,878
41	2063/64		1,459	1,459	356		6,642	6,642	1,621	8,101	1,977
42	2064/65		1,525	1,525	360		7,302	7,302	1,722	8,827	2,081
43	2065/66		1,594	1,594	363		8,029	8,029	1,829	9,622	2,192
44	2066/67		1,665	1,665	367					1,665	367
45	2067/68		1,740	1,740	370					1,740	370
46	2068/69		1,818	1,818	374					1,818	374
47	2069/70		1,900	1,900	377					1,900	377
48	2070/71		1,985	1,985	381					1,985	381
49	2071/72		2,074	2,074	384					2,074	384
50	2072/73		2,168	2,168	388					2,168	388
51	2073/74		2,265	2,265	392					2,265	392
52	2074/75		2,367	2,367	396					2,367	396
53	2075/76		2,473	2,473	399					2,473	399
54	2076/77		2,584	2,584	403					2,584	403
55	2077/78		2,700	2,700	407					2,700	407
56	2078/79		2,822	2,822	411					2,822	411
57	2079/80										
58	2080/81										
59	2081/82										
60	2082/83										
	Total	60,927	60,927		(25,514)	88,432	88,432		(45,544)		(71,057)