

Internal Borrowing to Finance Capital Assets

Purpose

This policy sets out the process for internal borrowing to fund the purchase of assets such as vehicles, gym equipment and office equipment.

A reserve of £1m is set up for internal borrowing purposes. Internal borrowing should not exceed £60,000 per asset and for a period of time no greater than 10 years. The interest rate charged to services will be certainty PWLB rate at the date of the loan for the term of the internal lease.

Regard must be taken of financial procedure rule 2.7 Purchase & Disposal of Plant & Vehicles over £10,000.

Background

Capital assets can be financed either by leasing or purchasing outright. Assets to be purchased outright are either bid for via the annual capital resources programme or by a revenue contribution to capital.

Where an asset is to be leased the process has historically been handled by Chrystal Consulting or a similar organisation. They provide a complete lease tender and option appraisal service and challenge claims under the return condition scenarios. Chrystal's fees have been £1,000 and 25% of any identifiable savings arising from asset returns (damage charges and excess mileage claims).

Assets to be leased generally need to be collated together to ensure that there is significant value (around £100k) to go to the market. This can lead to time delays with assets then aging and not attracting the best lease price. There are often conflicts between a service manager's affordability and what is more cost effective for the authority. As an alternative to leasing externally, the Council can make a corporate purchase of the asset and then leases it internally to the Service.

When interest rates are higher than the long term rolling average return on the Council's internal investments (0.72% 2016/17), then it means the cost of borrowing is higher than the lost income forgone by using reserves, so it would make financial sense to use reserves for capital expenditure.

Calculation of Interest

Interest will be paid on a reducing basis, using the PWLB annuity certainty loan rate relating to the term of the internal lease normally five years although occasionally seven years. A residual value will be assumed and agreed with the service at the start of the period and the balance of the principal will be repaid at the rate each year.

Example:

| | |
|-----------------------|---------|
| Length of lease: | 5 years |
| PWLB rate: | 1.24% |
| Capital Cost of Asset | £15,200 |
| Residual value 20% | £ 3,040 |
| Amount to be repaid | £12,160 |

| Year | Balance B/F (£) | Principal Repayment (£) | Interest Repayment (£) | Balance C/F (£) |
|------|-----------------------|-------------------------------|------------------------------|-----------------------|
| 0 | 15,200 | 2,432 | | 12,768 |
| 1 | 12,768 | 2,432 | 158.32 | 10,336 |
| 2 | 10,336 | 2,432 | 128.17 | 7,904 |
| 3 | 7,904 | 2,432 | 98.01 | 5,472 |
| 4 | 5,472 | 2,432 | 67.85 | 3,040 |
| 5 | 3,040 | 3,040 | | |
| | | 15,200 | 452.35 | |

At the end of the term of the internal borrowing the asset would be sold and the balance cleared. Any surplus or deficit would be retained or met by the service. If the service manager wished to keep the asset then they would be required to fund the residual value from within their revenue budgets.

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