

REPORT TO: POLICY AND RESOURCES COMMITTEE 23 FEBRUARY 2023

REPORT ON: IMPLEMENTATION OF FUNDING FLEXIBILITY FOR SERVICE CONCESSION ARRANGEMENTS

REPORT BY: EXECUTIVE DIRECTOR OF CORPORATE SERVICES

REPORT NO: 73-2023

1 PURPOSE OF REPORT

1.1 To set out the implications of implementing the above funding flexibility and seek approval from Elected Members for the application of this with effect from 1 April 2023.

2 RECOMMENDATIONS

2.1 It is recommended that the Committee:

- (a) note the information contained in this report in relation to service concessions; and
- (b) approve the implementation of the funding flexibility for service concession arrangements on an annuity basis with effect from 1 April 2023 as set out in the Report.

3 FINANCIAL IMPLICATIONS

3.1 The current revenue budget contains provision for the payment of unitary charges payable in accordance with contractual terms as follows:

Unitary charges	Budget 2022/23 £000
PPP schools	12,788
DBFM school	2,715
Waste to energy plant	9,723
Total unitary charges	25,226

3.2 It should be noted that the application of the flexibility requires to be from inception of the service concessions up to the point of implementation and then annually thereafter. This means that the implementation of the flexibility on an annuity basis will lead to an increase to the General Fund, amounting to £39.773m, for the cumulative savings relating to past periods, and a corresponding decrease to the Capital Adjustment Account (an unusable reserve). Implementation of this funding flexibility will then realise revenue savings of approximately £3.600m in 2023/24 and details of the savings over the period of the contracts are outlined in Appendix A (based on the current budget provision noted in paragraph 3.1).

3.3 It should also be noted that this is an accounting flexibility which consequently does not release cash and therefore to make use of the cumulative savings to date the Council would have to incur borrowing costs or make use of existing cash reserves. It is therefore proposed that they be earmarked for the future costs from year 23 of the arrangement onwards unless or until any business case, demonstrating the affordability of any alternative proposal, is agreed by the Policy and Resources Committee.

3.4 This change in accounting treatment does not in any way affect the existing service concession contracts or any financial arrangements with the parties operating these assets on behalf of Dundee City Council therefore unitary charges will continue to be paid as per

contractual obligations over the agreed contract terms which includes annual inflationary increases.

4 BACKGROUND

- 4.1 The Scottish Government have introduced a series of enhanced financial flexibility arrangements to enable local authorities to vary proper accounting practice and help mitigate the financial impact of Covid-19. In September 2022, the Scottish Government issued details of arrangements for dealing with Credit Arrangements (e.g. PFI / PPP Schemes). Councils have been given flexibility to apply this change in either financial year 2022/23 or 2023/24 and it is expected the vast majority of local authorities will take advantage of this. At present Councils are required by statutory guidance to charge the debt element of service concession arrangements to their accounts over the contract period. A change to the accounting treatment will allow the debt to be repaid over the life of the asset rather than the contract period.
- 4.2 A service concession is an arrangement whereby a government or other public sector body contracts with a private operator to develop (or upgrade), operate and maintain the grantor's infrastructure assets such as roads, bridges, tunnels, airports, energy distribution networks, prisons, hospitals or schools. The grantor (in this case the Council) controls or regulates what services the operator must provide using the assets, to whom, and at what price, and also controls any significant residual interest in the assets at the end of the term of the arrangement.
- 4.3 Dundee City Council has 3 such arrangements: PPP schools (built and operated by Discovery Education PLC), a DBFM school (built and operated by Hub East Central (Baldragon) Ltd) and the Energy to Waste Plant (built and operated by MVV Environment Baldovie Ltd). Further details of these arrangements are disclosed in notes within the Council's Audited Accounts (Report No: 304-2022 to Policy & Resources Committee on 21 November 2022, refers).
- 4.4 Service concession payments, or unitary charges, are made up of the costs of the service bought, financing costs for the debt underpinning the capital costs and repaying the debt itself over the contract term. The asset is included on the Council Balance Sheet and so is the remaining debt payable to the operator. The asset is depreciated over its useful life (effectively the cost of using it up) and the debt decreases over the contract term as the debt gets repaid as the unitary charges are paid. The asset will be on the Balance Sheet for longer than the debt as the useful lives of service concession assets tend to be far longer than the duration of the service concession contracts.
- 4.5 The flexibility offered by the Scottish Government is that the cost of the debt element of unitary charges to General Fund be spread over the estimated useful lives of the assets rather than the contract period, a far longer term. This useful life is based on the expert assessment of the valuer and is reflected in the period over which depreciation is expected to be charged per the fixed asset register. This period is as follows:

	Year of first repayment	Service Concession Contract period (years)	Estimated Useful Life of asset (years)
PPP Schools	2008/09	30	60
DBFM School	2018/19	25	55
Waste to Energy plant	2021/22	25	40

- 4.6 The flexibility can be applied on either an annuity basis or an EIP (Equal Instalment of Principal) basis. The former considers the effect of time on the value of money using the interest rates implicit in the financing of the capital works, whereas EIP is a straight-line

method. The annuity method is considered to be the most appropriate and prudent basis to adopt, since:

- it better reflects the cost of consumption of the asset over its useful life - asset maintenance costs tend to increase in later years; and
- it provides a fairer charge than equal instalments as it takes account of the time value of money. (For example, paying £100 in ten years' time is less of a burden than paying £100 now.) The schedule of charges produced by the annuity method results in a consistent charge over an asset's life, considering the real value of the amounts when they fall due.

4.7 It should be noted under this guidance that the flexibility offered:

- should be applied to all service concession arrangements in place prior to 1 April 2022. In the case of the Council that means all 3 service concessions;
- does not in any way affect the existing service concession contracts or any financial arrangements with the parties operating these assets on behalf of Dundee City Council. Therefore, unitary charges will continue to be paid as per contractual obligations over the contract term;
- does not in any way affect the application of international accounting standards to our financial statements. Therefore, service concession assets will continue to be included on the Balance Sheet and the debt will continue to be written off over the contract terms;
- results in -cash movements between usable and unusable reserves, The flexibility would have the effect of increasing usable reserves (General Fund) at the expense of unusable reserves (Capital Adjustment Account) over a period of some 22 years beyond the current financial year. This would also result in an increase to the Capital Financing Reserve. After that time, for a further 28 years, the pattern will reverse and the unusable reserves (Capital Adjustment Account) benefit at the expense of the General Fund. Over the extended useful lives of the assets, however, the movements between usable and non-usable reserves would eventually cancel out;
- would not result in any cash savings. Any additional cash outlays required to finance unitary charge payments would need to be financed by the use of existing cash reserves or borrowing;
- has no impact on funding from the Scottish Government towards PPP or DBFM service concession contract costs, after these contracts have come to an end; and
- can only be implemented in the 2022/23 or 2023/24 financial years and applied from 1 April in the year in that year.

5 POLICY IMPLICATIONS

5.1 This report has been subject to the Pre-IIA Screening Tool and does not make any recommendations for change to strategy, policy, procedures, services or funding and so has not been subject to an Integrated Impact Assessment. An appropriate senior manager has reviewed and agreed with this assessment.

6 CONSULTATIONS

6.1 The Council Leadership Team were consulted in the preparation of this report.

7 BACKGROUND PAPERS

7.1 None

APPENDIX A

NET (SAVINGS) / COSTS ARISING THROUGH THE IMPLEMENTATION OF THIS CHANGE

Financial Year Ended:	PPP	DBFM	Waste	Total
	£	£	£	£
31/03/2023 (cumulative position)	(24,253,656)	(4,141,000)	(11,378,620)	(39,773,277)
31/03/2024	(1,980,951)	(836,000)	(782,783)	(3,599,734)
31/03/2025	(2,561,088)	(847,000)	(847,145)	(4,255,233)
31/03/2026	(2,594,467)	(865,000)	(916,694)	(4,376,161)
31/03/2027	(2,682,212)	(893,000)	(991,926)	(4,567,139)
31/03/2028	(2,780,214)	(927,000)	(832,670)	(4,539,885)
31/03/2029	(2,866,571)	(968,000)	(1,141,359)	(4,975,931)
31/03/2030	(2,516,863)	(998,000)	(1,234,339)	(4,749,201)
31/03/2031	(2,555,555)	(1,013,000)	(988,645)	(4,557,201)
31/03/2032	(2,688,603)	(1,024,000)	(365,584)	(4,078,187)
31/03/2033	(3,284,692)	(1,049,000)	(1,734,379)	(6,068,070)
31/03/2034	(3,375,521)	(1,077,000)	(1,587,485)	(6,040,006)
31/03/2035	(3,549,246)	(1,106,000)	(1,475,863)	(6,131,108)
31/03/2036	(3,793,201)	(1,136,000)	(1,835,138)	(6,764,339)
31/03/2037	(4,585,632)	(1,170,000)	(1,983,511)	(7,739,143)
31/03/2038	(4,694,650)	(1,206,000)	(2,143,386)	(8,044,036)
31/03/2039	932,358	(1,245,000)	(2,315,921)	(2,628,563)
31/03/2040	1,216,076	(1,383,000)	(1,095,626)	(1,262,550)
31/03/2041	1,270,799	(1,645,000)	(2,591,381)	(2,965,582)
31/03/2042	1,327,985	(1,086,000)	(2,559,518)	(2,317,533)
31/03/2043	1,387,745	312,000	(3,005,059)	(1,305,314)
31/03/2044	1,450,193	330,000	(3,245,683)	(1,465,490)
31/03/2045	1,515,452	348,000	(3,505,985)	(1,642,533)
31/03/2046	1,583,647	368,000	(1,838,559)	113,088
31/03/2047	1,654,911	388,000	1,856,108	3,899,019
31/03/2048	1,729,382	410,000	2,004,597	4,143,979
31/03/2049	1,807,204	433,000	2,164,965	4,405,169
31/03/2050	1,888,529	457,000	2,338,162	4,683,691
31/03/2051	1,973,512	483,000	2,525,215	4,981,727
31/03/2052	2,062,320	510,000	2,727,232	5,299,552
31/03/2053	2,155,125	538,000	2,945,410	5,638,535
31/03/2054	2,252,106	569,000	3,181,043	6,002,149
31/03/2055	2,353,450	600,000	3,435,527	6,388,977
31/03/2056	2,459,356	634,000	3,710,369	6,803,725
31/03/2057	2,570,027	670,000	4,007,198	7,247,225
31/03/2058	2,685,678	707,000	4,327,774	7,720,452
31/03/2059	2,806,533	747,000	4,673,996	8,227,529

31/03/2060	2,932,827	788,000	5,047,916	8,768,743
31/03/2061	3,064,804	833,000	5,451,749	9,349,553
31/03/2062	3,202,721	879,000	0	4,081,721
31/03/2063	3,346,843	928,000	0	4,274,843
31/03/2064	3,497,451	980,000	0	4,477,451
31/03/2065	3,654,836	1,035,000	0	4,689,836
31/03/2066	3,819,304	1,093,000	0	4,912,304
31/03/2067	3,991,173	1,155,000	0	5,146,173
31/03/2068	4,170,775	1,219,000	0	5,389,775
31/03/2069	0	1,288,000	0	1,288,000
31/03/2070	0	1,360,000	0	1,360,000
31/03/2071	0	1,436,000	0	1,436,000
31/03/2072	0	1,516,000	0	1,516,000
31/03/2073	0	1,601,000	0	1,601,000
31/03/2074	0	0	0	0

Overall net effect

0 0 0 0