

T: 0131-244 7950 F: 0131-244 7020
E: simon.stone@scotland.gsi.gov.uk

Local Government Finance Circular No. 13/2010

By email:

To: Local Authority Chief Executives
Local Authority Directors of Finance

Copy to: COSLA
Audit Scotland
SPPA

Our ref: B4240890
30 September 2010

Dear Chief Executive/Director of Finance,

CONSENT TO BORROW UNDER PARA 1 (2) OF SCHEDULE 3 OF THE LOCAL GOVERNMENT (SCOTLAND) ACT 1975 – GENERAL SCHEME

To provide an element of financial flexibility to local authorities in the current financial climate, COSLA requested, and Scottish Ministers agreed, to make available a general borrowing consent scheme in 2010-11. The scheme was developed through the Capital Finance Working Group, whose membership includes COSLA, local authority Directors of Finance, Audit Scotland and CIPFA.

This circular provides details of the scheme, and the information that should be provided by a local authority wishing to make an application under the scheme.

Local authorities are now invited to submit applications, which should be sent electronically to simon.stone@scotland.gsi.gov.uk no later than 5 November 2010. Any queries on the scheme, or any comments you wish to be taken into consideration should Scottish Ministers offer a future scheme, should also be sent to Simon Stone.

A separate scheme for costs relating to equal pay was issued under Finance Circular 11/2010.



Simon P Stone
Deputy Team Leader (Capital)
Local Government Division



REVENUE EXPENDITURE FUNDED FROM CAPITAL RESOURCES UNDER STATUTE

Consent to Borrow – General Scheme

Policy and Procedures 2010-11

A guidance note issued by the Scottish Government

TABLE OF CONTENTS

INTRODUCTION AND GENERAL POLICY	1
CONSENT TO BORROW – GENERAL SCHEME	1
Scope and limitations of the General Scheme	2
General Criteria of the General Scheme	2
APPLICATIONS FOR CONSENT TO BORROW	3
ASSESSMENT OF APPLICATIONS	4
Affordability Test	4
Exceptional Difficulties Test	5
SPECIAL TYPES OF COSTS	6
CONSENT TO BORROW - CONDITIONS	6
ACCOUNTING FOR ANY CONSENTS GRANTED	9
ADDITIONAL INFORMATION	9
Annex A - INFORMATION REQUIRED IN SUPPORT OF AN APPLICATION	1

INTRODUCTION AND GENERAL POLICY

1. The Local Government (Scotland) Act 1975 (the Act) sets out the statutory powers of a local authority to borrow. Under the Act, Scottish local authorities may normally only borrow to support capital expenditure. However, the Act provides Scottish Ministers with the power to consent to a local authority borrowing to meet costs that they would not otherwise be able to meet from borrowing. In providing any consent under this power, the Scottish Ministers are required to be satisfied that the expenses are of such a nature that they should be met from borrowing. In providing consent, Ministers may apply such terms and conditions as they consider appropriate.

2. In exercising their statutory powers, Scottish Ministers are required to give consideration to the UK Government's (HM Treasury's) role in managing the economy and finances.

3. Permitting local authorities to fund revenue expenditure from capital resources, such as borrowing, raises concerns at the macroeconomic level by facilitating a practice which threatens long-standing fiscal rules. For that reason, it is appropriate that the Scottish Government should control and monitor the use of capital resources used in this way and apply strict criteria in permitting such use.

4. Borrowing to meet revenue costs also runs counter to the principles of prudent financial management. Scottish Ministers will only consider issuing a local authority with consent to borrow to fund revenue expenditure for one-off payments or lump sum payments and not indefinitely continuing payments. It would be imprudent to allow a local authority to borrow to fund ongoing costs.

5. The costs of borrowing undertaken to meet revenue costs will have to be met from revenue resources over several years. Borrowing for revenue costs is therefore likely to impact on the level of capital investment available for service delivery. In making an application to Scottish Ministers to use borrowing to meet revenue costs, local authorities should consider these issues.

CONSENT TO BORROW – GENERAL SCHEME

6. During the current settlement period (2008-2011), Scottish Ministers have the ability to permit Scottish local authorities to borrow to meet revenue expenditure within limits agreed with the UK Government (HM Treasury).

7. To provide an element of financial flexibility to local authorities in the current financial climate, COSLA requested, and Scottish Ministers agreed, to make available a general borrowing consent scheme in 2010-11.

8. Scottish Ministers have already made available in 2010-11 a consent to borrow scheme to assist with teachers' early retirement costs. This scheme has now closed, but details of consents issued can be found on the Scottish Government website at the [consent to borrow webpage](#)

Scope and limitations of the General Scheme

9. The General Scheme is to assist local authorities in addressing exceptional financial difficulties arising from revenue cost pressures.

10. Consent to borrow applications which seek a borrowing consent to fund financial assistance for third party capital projects are not covered by this general scheme:

10.1 Applications for a consent to enable a local authority to borrow to finance grants to community groups to assist with capital projects is covered by a separate 'community groups' borrowing consent scheme.

10.2 Applications for a consent to enable a local authority to borrow to finance a loan to a third party to assist with a capital project are not covered by a scheme. Local authorities should apply directly to the Scottish Government, and each application will be considered individually on its merits.

11. Applications for equal pay costs are the subject of a separate 'equal pay' scheme and the borrowing limits are agreed annually with HM Treasury.

12. Details of all consent to borrow schemes may be found on the Scottish Government website on the [consent to borrow webpage](#). Alternatively, contact Simon Stone at the Scottish Government – email simon.stone@scotland.gsi.gov.uk or telephone 0131 244 7950.

General criteria of the General Scheme

13. Generally, consent should only be sought for costs which are due to factors beyond the local authority's control. It should not be requested for routine or discretionary schemes, no matter how beneficial the long-term effects. Virtually all worthwhile projects will have significant initial revenue costs as well as ongoing ones and these must all be properly budgeted for as part of the planning process, without any expectation of reliance on borrowing. The fact that a scheme may produce future revenue savings will not normally be regarded as a relevant justification.

14. It should be noted that borrowing is generally only appropriate for one-off payments, such as redundancy costs, rather than indefinitely continuing payments such as salaries. It would be imprudent for an authority to borrow to meet the latter. This does not however prevent an authority from submitting a series of applications for consent, e.g. where a programme of redundancy is implemented in phases over more than one financial year. In such circumstances, the authority would be expected to draw attention to their intention to take this approach in the initial application.

15. Consent is only likely to be granted where a local authority is placed in an unavoidable situation. Applications for funding of planned schemes are likely to be refused because local authorities should not embark on projects without budgeting appropriately.

16. Consent to borrow is only likely to be granted where a strong case, based upon the need to borrow for the costs identified, can be established by the local authority.

17. In considering applications, the following types of costs will generally not be eligible and applications are unlikely to be successful:

- Consultancy fees
- Publicity and public consultation costs
- Costs of tenants' ballots on proposed large-scale voluntary transfers of housing
- Legal costs arising from contractual disputes
- Development and procurement costs of capital projects and PFI schemes
- Costs of re-engineering administrative processes.

APPLICATIONS FOR CONSENT TO BORROW

18. The current scheme only applies to expenditure incurred in 2010-11.

19. Local authorities should apply for a consent to borrow no later than 5 November 2010. The Scottish Government intends to issue formal consent to borrow letters by 17 December 2010.

20. Applications received after the closing date above may be considered. In deciding whether to accept any late applications, consideration will be given to the reasons for the late application, and the ability of Scottish Ministers to provide any additional borrowing consents.

21. In order to consider applications as fairly as possible, the Scottish Government will need a range of information. Applications should be in the form of a comprehensive but succinct business case and present the required information as fully as possible. Please include any additional information you wish to be considered. Failure to provide all the required information may result in consideration of the application being delayed whilst the Scottish Government seeks clarification. In the event of the local authority not providing that clarification, the application will not be considered. Details of the information that should be included in the business case are set out in Annex A.

22. A final figure or detailed estimate of the costs for which consent is being requested will be required in order to process any application.

23. Applications should indicate whether they relate to the General Fund or the Housing Revenue Account. They will be assessed separately, although the values of any applications will be combined in applying the affordability test.

24. Applications must propose a repayment period for any borrowing they wish to undertake, providing reasons for the period requested.

25. Applications for a consent to borrow should be made electronically to simon.stone@scotland.gsi.gov.uk. All applications will be acknowledged by an email

response. If no acknowledgement is received, please call Simon Stone on 0131 244 7950.

ASSESSMENT OF APPLICATIONS

26. Decisions as to whether to provide a consent to individual councils will be primarily based on financial need.

27. Scottish Government reserves the right to seek further information where this is required to assess the application.

28. In general, applications will be considered against an Affordability **and** an Exceptional Difficulties test as outlined below. Scottish Ministers reserve the right to apply further criteria as required.

29. For some types of cost, the Exceptional Difficulties test may not apply. See the section on 'Special Types of cost' below.

30. Where a consent to borrow has already been agreed for any local authority, this will be taken into account when considering any application under this scheme. A consent to borrow agreed for financing a grant or loan to a third party to support capital projects will not be taken into account.

Affordability Test

31. All applications will be assessed for affordability. Affordability will be considered against two criteria: available reserves and levels of budgeted expenditure.

32. The affordability test to be applied is that the costs to be financed from borrowing should exceed both: (a) 5% of available reserves anticipated at **31 March 2011**; and (b) 0.25% of budgeted expenditure for 2010-11. This test is the initial assessment of need. If the costs to be financed from borrowing do not exceed 5% of reserves and 0.25% of budgeted expenditure this will indicate that need has not been demonstrated.

33. Generally, available reserves include both unallocated and earmarked revenue reserves. Scottish local authorities may only hold reserves if there is a statutory power to do so. Statutory powers require / permit the following revenue reserves – General Fund (including HRA), a Renewal and Repair Fund and an Insurance Fund. Other statutory powers permit other revenue reserves to be held for specific authorities e.g. Harbour Reserve. All these reserves will be treated as available unless the specific legislation restricts their use or prohibits transfer to the General Fund. The following may be disregarded when providing details of available reserves in any application:

- insurance reserve
- sums earmarked in the General Fund for 'second homes discounts' which are restricted and may only be used for affordable housing.
- the Housing Revenue Account (HRA) where the application does not relate to the HRA.

- reserves which have restricted use – details of the statutory restriction must be provided with the application.

34. For the avoidance of doubt available reserves do not include reserves that reflect the differences in timing between accounting recognition requirements and statutory recognition requirements (e.g. pension reserve and any statutory adjustment accounts).

35. Where provisions have been made, or where a budget provision has been made for the costs subject to the application, these must be identified in the application and will be considered as part of the assessment of affordability.

36. Local authorities may make a case for excluding any earmarked reserves, and where a strong enough case can be made the value of available reserves will be reduced before applying the affordability test.

37. Budgeted expenditure equates to the Total Expenditure figure for 2010-11 reported on the POBE 2010, adjusted for any proposed transfers to/from reserves, contingency, and revenue contributions to capital. Authorities may update this information with known changes, but must provide explanations of any revisions.

38. Applications which do not meet these criteria may still be considered at the discretion of Scottish Ministers.

Exceptional Difficulties Test

39. Applications will also be subject the exceptional difficulties test. This test assesses whether borrowing is necessary to help an authority manage exceptional difficulties. To be successful an application must normally meet all of the following three conditions:

- a. the expenditure for which consent is requested is unavoidable (for example because it relates to statutory duties or contractual or other commitments);
- b. the authority could not meet the expenditure out of revenue resources without there being an unacceptably adverse impact on those who use or pay for its services; and
- c. there is no alternative way of ensuring that the expenditure could be met.

40. Evidence will be required that the financial difficulties are of an extreme nature.

41. A consent to borrow should form part of a package of measures to get the authority back onto a sound financial footing. Borrowing by itself could make the situation worse rather than better by prolonging and extending the problem. Applications should identify what other measures the local authority is taking to get itself back on to a sound financial footing. The Scottish Government may ask other organisations for their views in assessing the application.

SPECIAL TYPES OF COSTS

42. For certain types of costs special criteria or conditions will apply.

Severance costs

43. It is unlikely that Scottish Ministers will permit borrowing for anything other than the statutory costs associated with severance (redundancy or early release). This means that a consent is unlikely to be available for any enhancements made to severance packages.

44. Statutory costs include those costs arising from application of Part XI of the *Employment Rights Act 1996* and *The Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulations 2009*, as amended.

45. Enhancements to severance packages as permitted under *The Local Government (Discretionary Payments and Injury Benefits) (Scotland) Regulations 2009* (as amended) are unlikely to attract a borrowing consent.

46. Applications for a borrowing consent for severance costs must include details of the local authority's policy in relation to severance. The applications must also include details of the full cost of the severance separately identifying the elements to be paid under the relevant legislation. The local authority should therefore detail the amounts payable as redundancy pay (under the *Employment Rights Act 1996*); the additional pension costs due to redundancy or early release (under the *Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulations 2009*); the amounts payable as discretionary compensation under the *Local Government (Discretionary Payments and Injury Benefits) (Scotland) Regulations 2009*; and any other payments to be made.

47. Pension Funds have the discretion to allow a local authority to spread the additional costs arising under the *Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulations 2009* (the "strain on the fund costs") over a period of up to five years. This would have a similar benefit to a local authority as being able to borrow over this period. Where an application includes strain on the fund costs, the local authority must confirm that they have approached the Pension fund and advise on their decision. If the pension fund has agreed to the spreading of the cost reasons must be provided why a consent to borrow is being requested.

48. For severance costs the exceptional difficulties test will not apply.

CONSENT TO BORROW - CONDITIONS

49. A consent to borrow issued under this scheme does not attract Scottish Government financial support (loan charge support). The local authority is responsible for ensuring that use of this borrowing consent is in accordance with the prudential indicators set by the authority and that the borrowing is both affordable and sustainable.

50. Consents granted may only be applied to the expenditure identified in the consent letter issued.

51. Consents granted may only be applied to actual expenditure incurred. It may be applied to accrued costs and an accounting provision made for such costs. However, should the accrual or provision exceed the actual eligible cost when incurred (creating a credit adjustment to the Comprehensive Income and Expenditure Statement), an additional statutory repayment of the loan fund advance shall be made to correct the over-borrowing.

52. The consent to borrow is valid only for the financial year 2010-11, meaning that any borrowing (loans fund advance) as a result of a consent under this scheme must be made by 31 March 2011. Consents that are not used may not be carried forward to future years.

53. Local authorities will be required to report any borrowing under this scheme on the capital returns submitted to the Scottish Government. If at any time a local authority identifies that it will no longer require the full amount of any consent granted to it, it should, at the earliest opportunity advise the Scottish Government, providing an estimate of the revised level of consent that is likely to be required. This will allow unused consents to be re-allocated to other local authorities if required.

54. Within three months of each financial year end the Director of Finance, or equivalent, shall advise the Scottish Government of the actual borrowing undertaken relying on any consent to borrow under this scheme. The local authority must confirm that the borrowing has been applied only for the expenditure as detailed in the consent letter.

55. Where borrowing is undertaken using the consent to borrow, an advance from the loans fund shall be made and such advance shall be separately identifiable within the loans fund.

56. The repayment period of the advance from the loans fund will be set by Scottish Ministers taking into consideration the information provided in the business case but will not normally exceed 10 years.

57. There is no requirement to apply capital receipts to redeem the loans fund advance made under a consent issued under this scheme. However, capital receipts may be used to meet the cost of the principal element of the loans fund advance made in reliance of this consent to borrow. The receipt must be applied to the total fund advance outstanding and may not be used to meet just the annual statutory repayment of this advance. If the application of the capital receipt does not extinguish the total loans fund advance outstanding the local authority is required to revise all the remaining annual statutory repayments for that advance. This revision should reflect that the capital receipt was applied to produce a proportionate reduction to all future annual statutory repayments for the loans fund advance made in relating to a consent issued under this scheme. Should an authority choose to apply capital receipts to the repayment of the loan principal these conditions apply.

58. A consent to borrow for revenue costs allows the use of capital resources (borrowing) to finance revenue expenditure. As such a condition of any consent is that a borrowing consent may not be used in the same year that there is a revenue contribution to finance the capital programme, or where there is a revenue contribution to the Capital Fund. In such cases we would expect the local authority to borrow for the capital programme, up to the proposed revenue contribution value. This will release the revenue contribution back to the General Fund and make this sum available to meet the revenue expenditure. The borrowing consent may still be used for any sum in excess of the revenue contribution. This consent condition is financially neutral for local authorities. Rather it requires a local authority to correctly align resource use for capital control purposes. An illustration may make this clearer:

	£000
Capital Programme to be financed	2,500
Financed by:	
Capital receipts	500
Borrowing	1,500
Revenue Contribution to Capital	250
Grants	250
Total financing	2,500

Consent to borrow for revenue expenditure granted – say £400k

Revised capital programme financing based on consent conditions:

	£000
Capital Programme to be financed	2,500
Financed by:	
Capital receipts	500
Borrowing	1,750
Grants	250
Total financing	2,500

Consented Revenue costs - £250k financed from the released revenue contribution to capital, and £150k financed from borrowing relying on the consent issued. The same total borrowing will have been undertaken (£1,900k) and the same use of revenue funds (£250k). However, the borrowing will have been properly aligned to capital expenditure limiting the need to borrow for revenue purposes.

59. Where a consent relates only to the General Fund this condition does not apply to revenue contributions to the Housing Revenue Account capital programme. The reverse also applies. The condition only applies in the year in which the borrowing is undertaken, not the repayment of the advance.

60. The exception is for PPP/PFI lifecycle replacement costs which are met from the unitary payment and required by statutory guidance (see Finance Circular 4/2010) to be charged to the General Fund as “Capital expenditure charged to the General Fund balance”.

61. The local authority is required to keep appropriate records of any borrowing incurred under this consent for audit purposes, and to provide such information as may be necessary to demonstrate that the conditions of the scheme have been met.

ACCOUNTING FOR ANY CONSENTS GRANTED

62. Expenditure, for which consent is provided, shall be accounted for in accordance with the local authority Accounting Code of Practice. This requires the expenditure to be charged to the Comprehensive Income and Expenditure Statement. This consent to borrow permits the revenue expenditure to be neutralised for council tax (or rent) purposes with the Capital Adjustment Account being debited (and the General Fund credited). This will increase the capital financing requirement under the prudential framework by the amount of the expenditure effectively being capitalised.

63. A statutory amount for the repayment of debt shall be made each financial year in accordance with the conditions of this consent.

ADDITIONAL INFORMATION

Over-subscription

64. Scottish Ministers may consent to Scottish local authorities borrowing to meet revenue expenditure within limits agreed with the UK Government (HM Treasury).

65. The overall total that authorities are seeking to borrow will be considered in the light of the limits agreed with the UK Government. If Scottish Ministers are satisfied that successful applications can be met from agreed limits, consents may be issued to each applicant for the full amount of the expenditure which meets the assessment criteria. If, however, successful applications exceed the agreed level, consideration will be given at that stage to a method of distributing between applicants the amount available. The approach adopted could be influenced by the scale of the reduction needed.

66. In all cases Scottish Ministers reserve the right to decide how the value of any individual consent is determined.

67. Once an application has been assessed and a decision reached on the level of any borrowing consent the local authority will be sent a letter informing them of the result of their application. Where applications are successful this letter will include details of any additional conditions applying to the consents granted.

68. Where a local authority identifies before the end of the financial year that they will not require the full amount of their consent, a revised consent letter may be issued for the revised amount.

69. Any queries concerning the scheme, applications made, or consents granted under it, should be made to simon.stone@scotland.gsi.gov.uk

70. A summary of all applications made and consents issued under this scheme will be published on the Scottish Government website.

A handwritten signature in black ink, appearing to be 'Finn', with a long horizontal stroke extending to the right.

Scottish Government
Local Government Division
30 September 2010

INFORMATION REQUIRED IN SUPPORT OF AN APPLICATION

General information

1. Name and address of the local authority
2. Contact name and details
 - Name
 - Direct telephone number
 - Email address
3. Director of Finance or equivalent
 - Name
 - Direct telephone number
 - Email address

Background and overview

4. Provide details of what actions the local authority has taken to address the issue underlying the identified requirement to borrow for the costs identified in the application.

Demonstration of need

5. The business case should set out the financial circumstances of the local authority which supports the need to borrow. This should include, as a minimum, consideration of the following:

5.1 Address the Exceptional Difficulties test conditions where this test applies:

- the expenditure for which consent is requested is unavoidable (for example because it relates to statutory duties or contractual or other commitments);
- the authority could not meet the expenditure out of revenue resources without there being an unacceptably adverse impact on those who use or pay for its services; and
- there is no alternative way of ensuring that the expenditure could be met.

5.2 Provide details of the local authority's approach to managing the costs identified in terms of budgeting and reserves. Provide details of options considered and rejected, with reasons, and why an application to borrow to meet all or part of the costs has been made.

5.3 Details of available reserves held. Include details of all available statutory revenue reserves (funds). See scheme details on what may be

excluded from available reserves. Provide for each reserve the opening reserve balance as at 1 April 2010, details (reasons) of all proposed transfers to or from these reserves in 2010-11, any excluded amounts (with reasons) and the anticipated balance of available reserves at 31 March 2011. With the exception of the agreed exclusions as set out in the scheme a strong case must be made should you wish any reserve, or earmarked part of a reserve to be disregarded when your application is considered.

5.4 The value of any provision for the costs identified in the application as at 31 March 2010 should be provided and reflected in any consideration of funds available to meet the costs identified in the application.

5.5 Any budget provision made for the costs identified in the application for financial year 2010-11.

5.6 Budgeted net revenue expenditure for the council in 2010-11. These values must be based on the POBE. Local authorities may amend these values but must provide an explanation for that adjustment.

5.7 Details of any borrowing consents agreed. You do not need to provide any details of borrowing consents for grants or loans to community groups / third parties which we have agreed as these will not form part of any assessment of the application.

Severance costs

6. Applications for a borrowing consent for severance costs must include details of the local authority's policy in relation to severance. The applications must also include details of the full cost of the severance separately identifying the elements to be paid under the relevant legislation. The local authority should therefore detail the amounts payable as redundancy pay (under the Employment Rights Act 1996); the additional pension costs due to redundancy or early release (under the Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulations 2009); the amounts payable as discretionary compensation under the Local Government (Discretionary Payments and Injury Benefits) (Scotland) Regulations 2009; and any other payments to be made.

7. Pension Funds have the discretion to allow a local authority to spread the additional costs arising under the Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulations 2009 (the "strain on the fund costs") over a period of up to five years. This would have a similar benefit to a local authority as being able to borrow over this period. Where an application includes strain on the fund costs, the local authority must confirm that they have approached the Pension fund and advise on their decision. If the pension fund has agreed to the spreading of the cost reasons must be provided why a consent to borrow is being requested.

Statutory repayment of debt

8. The business case should identify the repayment period the authority is requesting, and set out their reasons for proposing that period.