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CABINET – 2 FEBRUARY 2005 **FINANCE & SUPPORT PORTFOLIO**

EXECUTIVE SUMMARY – THE FUNDING OF THE ACQUISITION OF CAPITAL EQUIPMENT

Summary of Purpose and Recommendations:

To recommend that Members approve a policy of using borrowing rather than leasing to acquire capital assets.

Cost to Council: £0- No Cost. Estimated saving of £480k over a 4 year period

Within existing budget? Yes

Contribution to Corporate Plan (Minor/Moderate/Major/Neutral):

	+		-
	Moderate		
	Neutral		
	Major		
	Neutral		
	Minor		

	+		-
Priorities			
Clean Streets & Public Places	Neutral		
Crime & Disorder	Neutral		
Housing	Neutral		
Managing our Finances	Major		

Comments on Impacts on Corporate Objectives and Priorities:

The approval of the policy will aid the Council's efficient management of its assets as well as giving better value for money.

Organisation of excellence

Working with public and partners

Economic well being

Social well being

Environmental well being

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THE FUNDING OF THE ACQUISITION OF CAPITAL EQUIPMENT

1. INTRODUCTION

1.1 Following the introduction of the new capital finance regulations on 1/4/04, the Council must complete a financing method option appraisal when considering the purchase of capital items.

1.2 In recent years, operating leases have been arranged for the majority of the capital equipment acquired by this Council, as borrowing limits stipulated by the Government were insufficient to meet expenditure needs.

1.3 Under the new code, it is now possible to borrow funds more widely for capital projects, if the revenue implications of the loans raised are affordable, sustainable and of a prudent nature.

1.4 For 2004/05, it was agreed to stop leasing ICT equipment and to fund its purchase from a Renewals and Replacements Reserve, which has been resourced accordingly.

1.5 This report considers the future financing method for vehicles and plant, Health and Leisure Centre major equipment and other miscellaneous items of major equipment.

1.6 A full option appraisal has been completed for items acquired up to September 2004.

2. BACKGROUND

2.1 There are three options that have been considered when appraising the financing of the acquisition of equipment. The use of reserves, as with ICT, is not an option, as there are not sufficient available resources to fund the initial purchases.

2.2 Operating Leases

2.2.1 This type of lease has been used in recent years as the principal financing method for the acquisition of equipment. Rental payments are made annually and in total meet 90% of the purchase price plus an element of interest. The leasing company takes the risk that the equipment will be worth the expected residual value.

2.2.2 At the end of the lease all of the equipment is due to be returned to the lease company but the Council has been able to negotiate to buy out or extend rentals on specific items. In recent years, leasing companies have made this more difficult by sometimes insisting that all items on the lease are either purchased or returned, unfavourable purchase and extension prices have been quoted and on occasions claims have been made for allegedly damaged goods. This has also increased the administrative workload.

2.2.3 Under the new legislation, an operating lease must have a residual value of at least 10%, discounted to its present value to comply with accounting standards. This has resulted in operating leasing becoming more expensive than in previous years.

2.3 Finance Leases

2.3.1 The Council has not used this type of lease extensively for about 10 years. Under the old regulations, a finance lease counted against the Council's capital allowance and was generally not used for this reason.

2.3.2 A finance lease is one where the value of the equipment at the end of the lease can be zero. The rental payments made under the lease therefore cover up to 100% of the purchase cost of the equipment plus interest.

2.3.3 The equipment does not have to be returned to the lessor and may be purchased at the end of the lease for a minimal sum, so greater flexibility exists over asset management and useage.

2.3.4 No penalties are applied at the end of the lease because the finance company has recouped the full cost of the financing.

2.4 Borrowing

2.4.1 Under the old legislation, a calculation was required to determine how much borrowing was permitted for each Council. This was required by central government as a way of controlling the Public Sector Borrowing Requirement.

2.4.2 Under the new regulations, borrowing by Councils is restricted by the ability of the Council to meet its obligations as to the cost of the borrowing and not by formula. Councils, therefore, have more options when considering the use of borrowing to fund capital expenditure.

2.4.3 Financing from borrowing gives the Council complete flexibility over the periods that it finances the asset and also over when the asset should be disposed of.

2.4.4 Borrowing in this context may be from external sources (loans raised from an outside body such as a bank), or, internal sources, (using the council's own reserves).

3. FINANCIAL IMPLICATIONS

3.1 Equipment with a total purchase price of £512,120 has been acquired to September 2004.

3.2 A full option appraisal was completed to determine the most advantageous method of financing the equipment.

3.3 By financing these purchases by borrowing rather than operating leasing would save the Council an estimated £33,000, in net present value terms, over the term of the lease. Savings against finance leasing would be £16,000.

3.4 Looking at the savings over a longer time frame the Council would save an estimated £480,000, in net present value terms, against operating leasing and £211,000 against finance leasing over a period covering the expenditure plan period from 2004/05 to 2008/09.

4. CONCLUSIONS

4.1 The cheapest method of financing the purchase of capital equipment is to borrow the funds.

4.2 The raising of loans would mean that the Council would obtain much more flexibility in the management and useage of its assets.

4.3 Changes in capital finance regulations have opened up borrowing as an option for financing a greater level of assets.

5. RECOMMENDATION

5.1 It is recommended that Members approve the policy of using borrowing rather than leases to acquire capital assets.

Further Information
Please contact Jan Hawker, Treasury Management Accountant Ext. 5722
e-mail: jan.hawker@nfdc.gov.uk

Background Papers
The Prudential Code, CIPFA Guidance Notes and ODPM Investment Guidance.

Jsh/word/leasing/option appraisal for drawdown- cabinet report