

Financial Control no3

Financing Major Purchases, KCC Loans and Leases

(see also Financial Control 3a & 3b)

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1 Introduction

When schools are considering purchasing assets – primarily ICT, printing, and photocopying but also other items such as electronic whiteboards and energy efficiency schemes they are often offered various forms of lease, rental or hire by equipment vendors, suppliers, or their partners. Whilst the provider will claim that these are ‘operating leases’ it is likely they could be classified, under accounting regulations, as finance leases.

There are strict financial guidelines in place regarding lease classification and without detailed knowledge of these it is impossible for schools to decide what they can sign. Trying to distinguish between different types of leases simply taking the supplier’s word or the fact that the agreement ‘looks right’ is not sufficient. Whilst technically schools have the freedom to sign Operating Leases, Finance Leases are not allowed as stated in Section 3.6 of the Scheme for Financing Schools.

It is important for the Headteacher and/or Governors to seek independent legal advice to determine what type of lease they are being offered prior to signing.

If a school finds it has entered into a finance lease, it must immediately notify the Local Authority as it forms part of KCC’s overall borrowing.

Agreements offered to schools broadly fall into two categories:

1.1 *Rental Agreements/Operating Leases*

These are arrangements to pay for the USE of equipment/services over a set period. Ownership of the equipment/service remains with the supplier who will expect to sell the asset at the end of the lease period. Payments under this type of agreement must be made from the school's annual revenue delegated budget.

1.2 *Hire Purchase Agreements/Finance Leases*

These are arrangements to make payments for equipment, which will normally last for the entire expected life of the equipment and enable the supplier to recover the full cost through the repayments. These agreements constitute a credit arrangement and are classed as borrowing. Consequently, schools are not permitted to enter into such agreements. If the school has insufficient funding to purchase an item an alternative is to apply for a KCC Schools loan.

2 KCC Loan Scheme

The Loan Scheme enables schools to borrow money; schools will pay the money back to the LA over an agreed timescale.

2.1 *Applying for a loan*

Loans that are requested for premises projects will need to be discussed initially with your Assistant Director Education.

Loan applications will be vetted to check that as far as possible no school entering into a loan agreement will be subject to merger or closure. If it becomes apparent that a school is to be closed or merged, the remaining balance of the loan becomes payable immediately.

Schools closing to become academies may continue with their loan as this will be signed and agreed under the Commercial Transfer Agreement.

The term of each loan is as follows:

- Capital projects - three, five or seven years
- ICT equipment - up to a maximum of three years

Unless specifically agreed, the loan will be repaid by equal monthly instalments over the total period of the loan. Repayments will cover capital and interest; interest only payments (holidays) are not allowed under this scheme.

The Director Education and SEN (and/or the Corporate Director Finance when applying for an Exception – see Section 4) reserves the right to refuse an application for any reason. The school will be notified by email and a reason provided.

If there is greater demand than the amount of money available, loans directly related to the Asset Management Priorities will be given priority.

The size of the loan shall not exceed 10% of the school's core annual revenue budget (I01, I02, I03, I05, I18) for each financial year, unless Section 4 applies.

All loan applications must be made initially to Schools Financial Services (SFS) and must be signed off by the Chair of Governors and the Headteacher.

2.2 To apply for a loan you need to complete the loan application form (see Financial Control 3a), ensuring you have:

1. Determined the necessity for a loan and its purpose (Governing Body minutes)
2. Determined amount required (Governing Body minutes)
3. Produced a loan quote/repayment schedule using the tool Financial 3b
4. Obtained in principle agreement from Assistant Director Education
5. Revised school's 3 or 5 yr plan (5yr plan needed for terms of 5 years or more)
6. The most recent School budget template used to produce the Three-Year Plan
7. A copy of the school's costed building maintenance schedule
8. Completed the appropriate section of the Exceptions to the scheme tab- if applicable
9. Considered the procurement process necessary to deliver the project (Governing Body minutes)

Email items 1,2,4, 5, 6, 7, 8 and 9 above, plus application to:

schoolsfinancereturns@theeducationpeople.org

It is important for schools applying for a loan to fund a capital project that they obtain the necessary permissions and approvals for the works (e.g. planning permission, building control approval, KCC approval to self-manage the project) These matters should be discussed with your Assistant Director Education when obtaining their in principle agreement.

2.3 Approval of Loan

Schools Financial Services are commissioned by KCC to ensure that loan applications are complete, and that due diligence has been completed on the school's ability to repay the loan. The relevant Assistant Director Education reviews the application and due diligence, together with the reason for the loan and confirms whether the application can proceed to the Director Education and SEN for final approval. In circumstances where the application would require an exception to the normal rules of the Scheme to be agreed (set out in section 4 below) the Corporate Director Finance is also required to approve the application.

Schools are permitted to apply for more than one loan at any given time. Each loan must be individually applied for, and will be subject to the same process, assessments and checks as outlined above.

The 10% threshold check will be applied to the consolidated value of existing and new loans.

Monies will not be released to the school until all relevant checks have been completed and a signed loan agreement between KCC and the school is in place. The Assistant Directors Education are delegated (by the Director Education and SEN) to sign the approved loan agreements on KCC's behalf.

Please note, if the loan value is in excess of £1m approval will be required by the Cabinet Member for Education and Skills via a key decision in line with KCC's Constitution. This can take several months to complete start to finish.

3 Administration of the loan scheme

Interest is charged above Bank of England base rate by a set percentage which is detailed on the loan application form.

An administration fee for setting up and maintaining the loan will be charged as follows:

Set-up fee: to be charged with the first monthly repayment. These charges are detailed on the application form.

Interest will be calculated on a daily basis from the date of the amount advanced.

A loan must be taken up within one calendar year of application. Interest will only be charged from the date monies are drawn down.

Loans will only be approved based on income assumptions at current year budget levels.

Loan advances can be drawn down as a maximum of 2 instalments. These will always be made with the normal monthly budget advance.

The loan application will be subject to an affordability assessment prior to approval.

Following receipt by SFS of all completed documents, the following timeline begins:

- SFS review and undertake affordability assessment (within 20 school working days) and make a recommendation to KCC
- KCC will review and decide the application (within 10 school working days)
- SFS will notify the school of KCC's decision and when appropriate arrange for the Final Loan Agreement document to be signed by both KCC and the School
- SFS will arrange with the school the date of the loan to be drawn down

All loan repayments are automatically deducted by KCC from the school's Statement of Account (advance) monthly. This prevents any school from defaulting on payment.

4 Exceptions to the Scheme:

If any of the following exceptions apply, schools must provide further information on the Exception tab of the application form:

- a. Loan value exceeds 10% of school's core annual income.
- b. Loan term exceeds 7 years
- c. School is requesting a 'top-up' loan for an existing project

5. Repayment of the loan

Loan repayments will be deducted monthly from the budget advances.

If schools wish to pay loans more quickly than the original agreement this is welcomed and there will be interest savings. This will enable more schools to take advantage of the scheme. If the school budget and cash-flow position shows that additional loan repayments can be made, the Local Authority can consult with the school regarding making additional payments.

6. General Information

Expenditure financed by loans should follow the Spending the Council's Money Code of Practice as laid down in the KCC Constitution.

All building projects must abide by the usual regulations of Health and Safety, Insurance, and the Construction Industry Scheme just like any other building project.

Any fees incurred in securing appropriate advice will need to be incorporated into the project's costs.

The loan should be shown in the school's financial accounts as a commitment. To request this procedure note please contact Schools Financial Services. There is an expectation that schools must budget adequately for the upkeep of the building and site. Ledger Code E12 – Building Maintenance and Improvement will be reviewed as part of the affordability assessment Schools Financial Services completes.