Cabinet

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School Loans Scheme

Report of Corporate Management Team

Joint Report of Rachael Shimmin, Corporate Director, Children and Adults Services and Don McLure, Corporate Director Resources

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Purpose of the Report

1 To set out proposals for the establishment of a new loans scheme for schools, financed and underwritten by the Council, and available to maintained schools in County Durham to access for school improvements and investment in ICT and other equipment.

Background

2 In normal circumstances, schools can only borrow from external sources with the express permission of the Secretary of State. Secretary of State loans can only be granted in exceptional circumstances, or for specific loan schemes set up to allow investment in environmental improvements. However, statutory guidance allows local authorities to set up an internal loan scheme for schools to access, though this cannot be financed through the utilisation of Dedicated Schools Grant or schools' retained balances.

3 Until 2013, the Council did operate an internal loan scheme, but this was withdrawn because of concerns about the risk being taken by the Council in respect of schools becoming sponsored academies, where under some circumstances the Council could become liable for repaying the loan rather than the school. This risk arose because it was a condition of the loan agreements that they were repaid if a school became an academy and, in the case of a sponsored academy, if repaying the loan left the school with a deficit balance or indeed they were already in a deficit position with an outstanding loan at conversion, the Council would then have to write this off at the point of conversion. This cost would be a subsequent charge to the Council's General Fund.

4 There were also concerns about the stability of school funding at the time following the funding reforms that started in 2013-14 and which have made funding for individual schools more sensitive to changes in pupil numbers and largely removed local flexibility over the formula factors that could be used. Increased volatility increases the risk for a school in committing to repaying a loan over a number of years.

5 The lack of a loan scheme has become a concern to schools, because the value of their delegated capital funding has fallen significantly in recent years and the Council has also had significant cuts to the DfE capital grant funding for capitalised maintenance and 'basic need'. This, together with the withdrawal of the Building Schools for the Future Programme, has necessitated a prioritisation of investment in essential works such that only schools with chronic conditions are being addressed. Schools have few alternative sources of funding to supplement this grant funding currently, other than through retained schools balances and many schools save up over many years to build up sufficient balances to invest in initiatives within their school.

6 Schools have the statutory powers to lease assets, but only on operating leases, which is not always suitable and can be relatively expensive. Finance leases are a form of borrowing and the DfE is consulting on changing statutory guidance to require local authorities to strengthen the restrictions on leases in their schemes of delegation.

7 In 2014 the DfE issued revised guidance which clarified that any internal loans should normally be taken on by a school converting to an academy, even where there is a deficit situation, and that this should be included in the commercial transfer agreement between the local authority and the academy trust. This changes has reduced the risk to the Council in respect of sponsored academies and has opened up the prospect of reinstating a loans scheme.

Financing the Scheme

8 The main difference between the old and proposed new scheme is that the new scheme would need to be financed by the Council from its cash reserves; the old scheme was funded by the cumulative balances held on behalf of maintained schools.

Cost of Loans and Interest Rate Chargeable to Schools

9 The scheme would require the establishment of a capital budget on a "self-financing" basis, with the interest rate set to recover the interest foregone on the surplus cash balances by lending these sums to schools instead of investing them in line with the Council's Treasury Management policy, plus an additional 0.5% premium to cover the costs of administering the scheme and the risk of changes in interest rates. Loans would be fixed interest loans; rates for new loans would be determined on a case-by-case basis, according to the prevailing interest rates available to the Council for medium-term lending.

Eligibility

10 All maintained schools would be eligible to apply for a loan, within the restrictions of the scheme which are shown below. Maintained schools include the following categories:

- Nursery
- Primary (including infant and junior)
- Secondary

- Special
- The Pupil Referral Unit (PRU)

11 Most primary and secondary schools are community schools, but some are either ‘voluntary controlled’ or ‘voluntary aided’. The assets of voluntary aided schools are owned by the diocese, which has some responsibility for capital expenditure, but in practice these schools have similar needs to incur expenditure on assets as community schools and the revenue funding that would pay for the cost of borrowing is no different from that of community schools. There are no significant differences in terms of finance or the ownership of assets between community and voluntary controlled schools.

12 Academies would not be able to borrow from the Council; this would require permission from the Secretary of State, (because they are not part of the Council, so these would not be classified as internal loans), and this is only granted in exceptional circumstances.

Purpose of Loans

13 Loans would only be approved for the purpose of funding expenditure on building works and new furniture or equipment, including ICT. Schools would not be able to borrow to cover a temporary revenue funding problem where separate arrangements exist where schools can apply for permission to run a budget deficit temporarily. A further restriction would be that schools could not borrow to fund works needed for a trading venture, such as altering a room to allow its use by a stand-alone nursery company as this could contravene state aid regulations.

14 The Council has a vested interest in the infrastructure of all schools. The Council is the landlord for community and voluntary controlled schools and it would be important that any schemes put forward in respect of building works received approval from the Asset Management Service in RED, and Technical Services in Neighbourhoods, before being agreed. This is particularly important in light of the need to manage asbestos issues and other potential building problems in schools.

15 Schools would need to fund any feasibility studies necessary prior to submitting an application for a loan and accept that these may be abortive costs if the feasibility study resulted in an unacceptably high estimate for the desired works. Where a project was linked to carbon reduction / energy efficiency measures then the Council’s Carbon and Climate Reduction team would also need to agree it was a viable and cost effective solution before it could be supported.

16 The Council is not the landlord for voluntary aided schools. However, the loans scheme would only be accessible to these schools where they could demonstrate that the appropriate feasibility studies had been carried out. Proposals would need to be checked by colleagues in Technical Services, Neighbourhoods and this would incur a small charge.

Limits on Advances

17 The old scheme limited loans to 3% of a school's current budget share (the total of all funding, including the main formula plus funding for early years, post-16 and special educational needs).

18 The table below shows the limits that would be applicable in 2015-16 using limits of 3% and 5%, based on the average budget shares. Limits for individual schools would be determined by their actual budget share:

	Average budget share	Average surplus forecast at 31 March 2016	Average maximum advance		
			At 3% of budget share	At 5% of budget share	Difference between 3% & 5%
	£	£	£	£	£
Nursery	361,619	60,412	10,849	18,081	7,232
PRU	2,283,852	-	68,516	114,193	45,677
Primary	764,845	80,403	22,945	38,242	15,297
Secondary	4,174,804	149,624	125,244	208,740	83,496
Special	2,040,580	202,532	61,217	102,029	40,812

19 Note that the average surpluses exclude schools with forecast deficits. Loans would not be made available to schools in financial difficulties, including schools with forecast deficits.

20 Based on an interest rate of 2.5% and a five year loan on an annuity basis, the annual cost of a loan at these limits would be:

	Annual repayment for average maximum advance		
	3% of budget share	5% of budget share	Difference between 3% & 5%
	£	£	£
Nursery	2,335	3,892	1,557
PRU	14,748	24,580	9,832
Primary	4,939	8,231	3,293
Secondary	26,958	44,931	17,972
Special	13,177	21,961	8,785

21 For every 0.5% increase / decrease in the interest rate applicable, the costs annual costs would increase / decrease as follows:

Annual repayment for average maximum advance (Int Rate 2.5%)			Annual repayment for average maximum advance (Int Rate +/- 0.5%)	
3% of budget share	5% of budget share		3% of budget share	5% of budget share
£	£		£	£
2,335	3,892	Nursery	34	56
14,748	24,580	PRU	213	355
4,939	8,231	Primary	71	119
26,958	44,931	Secondary	389	649
13,177	21,961	Special	190	317

22 A 5% limit would increase the potential value of advances by two-thirds, but the additional annual cost would be relatively small. There would be other checks to ensure that schools were able to meet the annual cost of a loan and for this reason it is recommended that loans be limited to a maximum of 5% of a school's budget share.

Additional Loans

23 The old scheme allowed for schools to have more than one loan. It is recommended that this be also allowed under the new scheme, subject to the total of the loans not exceeding the limits on advances for that school, i.e. 5% of the school's current budget share (the total of all funding, including the main formula plus funding for early years, post-16 and special educational needs).

Period of Loan

24 The old scheme allowed loans for up to a maximum period of seven years providing that the term of the loan did not exceed the useful life of the asset. This would be appropriate for loans in respect of building works, but equipment, particularly ICT equipment is likely to have a shorter life and it would be more appropriate to limit loans for such equipment to four years or the useful life of the asset, so that schools would not have outstanding loans for equipment that was obsolete and they were no longer using. Four years is the maximum life that is allowed for operating leases for ICT equipment.

25 An additional feature of the proposed scheme would be to allow loans of up to 10 years for the installation of photovoltaic solar panels or other energy conservation measures. This would provide a financial incentive for schools to reduce their carbon footprint where the cost benefit analysis proves a viable business case exists. All such scheme would require sign off from Technical Services, Neighbourhoods and the Council's Carbon and Climate Reduction team as being viable and cost effective before it could be supported.

Repayments

26 The old scheme provided for repayments annually in advance, and gave schools the option of starting repayments in the year of the loan or the year after. It would also be appropriate to continue with this arrangement for the new scheme. Repayments would be made early in the year, which means that schools do not need to remember to take account of the loan repayment when managing their budget during the year.

27 The previous scheme also allowed for early repayment of loans without penalty. There is no disadvantage to the Council in having loans repaid early and it is proposed that this would be a feature in the new scheme also.

Transfers of Loans

28 The loan application will make it clear that any outstanding loans will transfer to:

- Any successor school, in the event that the school is included in an amalgamation to form a new maintained school; or
- An academy trust, in the event that the school converts to academy status, whether by choice or as a sponsored academy.

Criteria for Assessing Applications

29 The suggested criteria are set out below:

Purpose of Loan

Loans in connection with building works should have approval from Technical Services (see section of ***Purpose of loan*** above). In addition, any energy efficiency / carbon reduction linked scheme would require sign off from the Council's Carbon and Climate Reduction team as being viable and cost effective before it could be supported.

(ICT or equipment would not normally need approval, because the local authority is not responsible for these in the same way as for buildings, though applicants will be encouraged to seek advice from the Council's ICT Team before committing to purchase any new ICT equipment.)

School Context

The Education Service, working with the School Finance Team, Resources would be responsible for giving approval that:

- The loan is to be used for expenditure that is appropriate in the context of the school's forward planning for educational provision;
- It is appropriate to add to this school in the context of the Council's strategy on school places;
- Consideration has been given to the school making a financial contribution to the works from their retained balances;
- It is appropriate to lend to this school in the context of anticipated outcomes from OFSTED inspections (the Council needs to consider whether to lend to schools that are expected to become academies in the near future);
- The loan can be funded without cuts to other areas of expenditure that could have a detrimental impact on the standards of education;
- It is appropriate for the school to incur the costs of a loan rather than spend this money on raising standards.

Three-Year Budget Plan

The School Finance Team, Resources should be responsible for giving approval that:

- The loan is less than 5% of the school's most recent budget share;

- The school carried forward a surplus balance at the end of the last financial year and that the current budget plan is for a surplus at the end of the current financial year of at least 2.5% of the current year's budget share plus Pupil Premium income;
- The school has submitted a robust three-year budget plan, which demonstrates that the school can afford the annual cost of the loan over that period without going into deficit or reducing its surplus balance to less than 2.5% of the total of funding plus income from the Pupil Premium.

30 The Council should reserve the right to refuse any application at its absolute discretion.

Loan Applications

31 It is important that schools can demonstrate that they have fully considered the implications of a loan and have properly investigated the proposals being put forward. In the case of building works this will require reference to condition survey data and, potentially, feasibility studies being undertaken. Schools will be encouraged to engage with colleagues in Asset Management, RED, and Technical Services, Neighbourhoods, before they submit an application for building works and to factor this into their planning. In the case of any energy efficiency / carbon reduction linked schemes, these would also require sign off from the Council's Carbon and Climate Reduction team as being viable and cost effective before it could be supported

32 To demonstrate that the scheme has been well developed and is fully supported by the governing body, applications should be approved by both the governing body and the finance committee of the governing body before submission. These approvals should take the form of resolutions which acknowledge the financial commitment being made by the school and the transfer arrangements for any outstanding loan in the event of the school amalgamating or converting to an academy.

Maximum Amount Available for Lending

33 This is for the Council to determine. The table below shows take-up and amounts lent under the old scheme, together with outstanding amounts at the end of each year:

Financial year	Loans advanced in Year	Total advanced in Year	Total outstanding at end of financial year
		£	£
2014-15	0	0	377,772
2013-14	0	0	575,918
2012-13	13	262,025	785,791
2011-12	2	45,425	939,229
2010-11	7	434,333	1,689,656
2009-10	12	536,069	1,805,799
2008-09	6	884,545	1,962,651
2007-08	6	735,216	1,729,116
2006-07	14	1,194,500	1,286,571
2005-06	9	579,160	717,066
2004-05	15	493,500	737,953
2003-04	27	543,686	669,960
2002-03	23	664,142	254,339
2001-02	2	37,000	31,588

34 The outstanding balance at 31 March 2015 for the remaining outstanding loans from the old scheme was £377,772, which will reduce to £190,000 by the end of March 2016. The final loans of the old scheme will be fully repaid in 2019-20.

35 Whilst there has been interest in re-establishing a loans scheme, actual take-up is uncertain, and other factors may reduce demand compared to the old scheme:

- There are fewer schools, because of academy conversions, amalgamations and closures;
- Funding is more volatile than it was previously, increasing the risks involved in taking on a loan.

36 Any loans subsequently made once the new loans scheme is established will be reported through the capital updates to the Member/Officer Working Group (MOWG) and into Cabinet as the capital budgets are established to facilitate these payments.

Risk

37 There are risks involved in making loans available to schools:

a) In the event that a school ran into severe financial difficulties and had to choose between setting aside money to repay a loan or reducing education provision, there would be pressure on the Council to re-schedule or write-off the loan.

b) If a school needed to be closed any outstanding loan would be a charge to the Council if the school did not have sufficient balances to cover the outstanding amount at closure.

c) If a school converted to an academy and then got into financial difficulties, repaying the loan would be unlikely to be a priority and the Council could face difficulties in enforcing the repayment.

d) A school could choose to project manage the works themselves and engage a private contractor to undertake the works, without due regard to health and safety and other compliance issues.

38 In respect of the project management risk there are powers available to the Council to mitigate this risk:

e) The Schools' Scheme of Finance spells out responsibilities of Governors / schools in respect of building alterations and repairs and maintenance works. Governing bodies are required to have due regard to duties placed on the Council in relation to health and safety, and the Council' policy on health and safety matters in the management of its budgets.

f) The Council has powers to issue directions to the governing body and head teacher of a Community, Community Special or Voluntary Controlled School on health and safety matters. These directions are enforceable on governing bodies via S.497 of the Education Act 1996 if not complied with. Section 39(3) of the School Standards and Framework Act 1998 enables LA to direct schools to take specific action (e.g. remedy a health and safety failing) or require a governing body or head teacher to comply with a specific aspect of the Local Authority's Health and Safety policy

g) Schools are reminded when they employ contractors directly that they then have a responsibility to ensure that the contractor is competent, adequately insured and that the contractor has an appropriate health and safety policy in place. Also, and importantly, that they undertake all necessary risk assessments to ensure that the contractor can comply with safeguarding requirements for working in the school environment.

39 Financial risks can be mitigated by placing limits on the circumstances in which schools will be able to borrow, and limiting the total value of loans made to schools, and also through the vetting of applications and encouraging schools to use Direct Services / Technical Services to undertake the works, but there will still be residual risks that cannot be eliminated:

- Changes in pupil numbers can have a significant impact on funding for individual schools;
- School funding and the relationship between schools and the local authority is determined by government policy and the Council has little say in changes to either; changes could affect either the ability of schools to repay loans or the Council's ability to collect repayments from schools. Changes in EFA regulations and Government funding for schools could change.

Recommendations and Reasons

40 Cabinet is recommended:

(i) To consider the establishment of a loan scheme for schools with effect from 1 October 2015, funded by the Council, as described in this report.

(ii) To give specific approval the following parts of the scheme as described in this report:

a) A limit on advances of 5% of the most recent budget share of a school;

b) That schools be allowed more than one loan, subject to not exceeding the limits on advances for that school;

c) That schools will be encouraged to make a contribution towards the scheme from their retained balances where available

d) That schools be given the option of repayment on an annuity or equal instalment of principal basis;

e) That interest rates be set at the prevailing interest rate that could be earned on an investment over the period of the loan requested, as advised by our Treasury Management advisors at the time of borrowing, plus 0.5%;

(iii) To consider the risks set out in this report and confirm that it is appropriate for the Council to accept these risks.

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Appendix 1: Implications

Finance –

The report sets out proposals to re-introduce a loans scheme, accessible to maintained schools on a self-financing basis through the charging of interest on the loans, with a 0.5% additional interest charge to cover the cost of administration and interest rate risk.

The interest charged on the loan would be based on the prevailing rates that could be earned on an investment over the period of the loan requested, as advised by our Treasury Management advisors at the time of borrowing. Schools will be encouraged to make contributions towards projects and part finance schemes from their retained balances where it is prudent to do so.

Whilst there are no provisions for this scheme to be financed and underwritten from the Dedicated Schools Grant / schools retained balances, the interest charged and the application of an additional 0.5% will ensure that the Council suffers no financial detriment on its investment income.

Availability will be publicised via the Schools Extranet. A report will also be taken to the Schools Forum and the Scheme of Financing for Schools amended accordingly in the autumn.

Staffing –

None

Risk –

There is a risk that loans may not be repaid if schools or academies get into financial difficulties. This can be partly mitigated by limiting the value of loans and scrutiny of applications, but a residual risk will remain. Safeguards are built into the application process with regards to the need to produce feasibility studies and obtain sign off of the scheme via Technical Services, Neighbourhoods and Assets, Regeneration and Economic Development.

Equality and Diversity / Public Sector Equality Duty –

None

Accommodation –

Potential for loans to be used for building works to maintain or improve school accommodation.

Crime and Disorder –

None

Human Rights –

None

Consultation –

Children and Adults Services and Resources Management Teams have been consulted on this report. If approved the introduction of the scheme will need to be reflected in the Scheme of Financing for Schools, which will need to be amended, in consultation with the Schools Forum.

Procurement –

None

Disability Issues –

None

Legal Implications –

Colleagues in Legal Services will assist in drawing up the Terms and Conditions of the scheme, and in drafting conditions which would apply to any academy commercial transfer agreements.