

ALL ABOUT THE BORROWING APPROVAL SYSTEM A GUIDE TO PARISH AND TOWN COUNCIL BORROWING IN ENGLAND

Introduction

1. This guide replaces all previous guidance on borrowing by parish councils in England and reflects the legal framework in force from 1 April 2004. The law that allows a parish¹ council to borrow money is contained in paragraph 2 of Schedule 1 to the Local Government Act 2003 ("the 2003 Act"). Before such a council can borrow a sum of money, it must first receive an approval to borrow from the "appropriate person": in England the Secretary of State by way of the Department for Communities and Local Government (DCLG), and in Wales, the National Assembly for Wales. Evidence of the borrowing approval may be required at audit.

2. This guide sets out the criteria that the Secretary of State generally applies in deciding whether to give borrowing approval, and how parish councils should go about applying for approval. It applies only to England. Community and town councils in Wales should contact the Local Government Finance Division of the National Assembly for Wales (telephone: 029 20 823619 or 029 20 825668) for details of the approval system applicable to them.

3. There is no national limit on the total annual amount of borrowing approvals that will be granted. It is therefore hoped that councils will only apply for borrowing approval when they are fully ready to do so, for example, when planning permission has been obtained. Applications by councils for borrowing approval should be sent to the local County Association affiliated to the National Association of Local Councils (NALC). This applies whether or not the council is a member of NALC. If, in the Association's view:

- the application form is complete, and has no obvious omissions or errors;
- the application is made in good faith

it will forward the application to the DCLG. Where an Association has any concerns it will raise the matter with the council. The council may, if it wishes, take up any disputed issue with the DCLG. The review by the County Association is intended to assist councils in submitting well-founded applications to the DCLG.

¹ References to parish councils include town councils in England

What is a Borrowing Approval?

4. It is a formal approval issued by the Secretary of State to borrow money.
5. The Secretary of State's decision on the borrowing application will be sent direct to the clerk of the council after the DCLG has received the application form from the County Association. A copy of the decision letter will also be sent to the local County Association. Where approval to borrow is given, as well as containing the legal authority for the council to borrow money, the approval will state the maximum amount of money that can be borrowed, the purpose for which the money may be used, the period within which money must be borrowed, and the maximum period within which the borrowing must be repaid.

Who can apply for Borrowing Approval?

6. Any parish council in England.

When is a Borrowing Approval not required?

7. Under paragraph 2(3)(a)(i) of Schedule 1 to the 2003 Act, no approval is required for borrowing by temporary loan or overdraft from a bank or otherwise of sums which the council may temporarily require to meet expenses pending the receipt of revenues receivable by it in respect of the period of account in which the expenses are chargeable. Paragraphs 2(3)(a)(ii) and 2(3)(b) set out other circumstances in which approval is not required (see paragraph 16 of this guide).
8. In all other circumstances, borrowing approval is required.

How is an application for borrowing approval made?

9. In the first instance, contact should be made with the local County Association who will provide the form to be used in making the application. All questions in the form need to be answered. The making of the application must be approved by resolution of the full council (2003 Act, Schedule 1, paragraph 2(4)). The completed form should be sent to the County Association (see paragraph 3 above).

What information must be provided?

10. The application form requires the following information:

- Name of Council and Clerk
- Contact details
- District/Unitary Council area
- Purpose of borrowing
- Total cost of the project
- Funding from Council's own resources
- Funding from other sources

Whether funding from other sources is confirmed
Amount to be borrowed
Proposed borrowing source
Intended borrowing term
Details of current loans outstanding
Current level of precept
Number of electorate
Description of council's asset base and value
Value and purpose of all funds held
Confirmation of the agreement of full council

The form must be signed by the chair of the council and the responsible financial officer (in most councils the clerk is also the responsible financial officer, but the post is sometimes a separate appointment).

In addition the form must be accompanied by a copy of the council's budget for next year (or for the current year if next year's is not available), and a copy of the written report considered by the council in reaching its decision to apply for borrowing approval (see paragraph 11(d) below).

Note that where the council intends to provide a grant to another body the references to "project" in this guide and in the application form are to the assistance being provided by the council, not to the project towards which the assistance is given. For example, if a council wishes to borrow £50,000 to part finance a grant of £100,000 towards the construction by a local charity of a village hall costing £250,000, the application form should show £100,000 as the total cost of the project and £50,000 as the amount to be borrowed, and explain how the remaining £50,000 is to be financed by the council.

What are the criteria for borrowing approval?

11. The Secretary of State will generally apply the following criteria in deciding whether to give borrowing approval:

- a) the borrowing should be for a purpose that would be capital expenditure as defined in section 16 of the 2003 Act. The Appendix to this guide explains what is covered by the section 16 definition. Where the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom does not apply to the council, this criterion is to be interpreted as if it did;
- b) the amount to be borrowed should not be less than £5 multiplied by the number of local government electors for the area of the council on the first day (1 April) of the current financial year;
- c) any unallocated balances (including, where appropriate, capital receipts), beyond those required for the prudent financial management of the council, should be used in the project for which borrowing is required;

d) the council should have a realistic budget (this must be reasonably affordable, taking account of its effect on the council's precept) for the servicing and repayment of the debt. The Secretary of State will expect to see that the affordability of the loan charges and any other revenue costs arising from the project is demonstrated in the written report to the council recommending the borrowing application. A copy of the report should be submitted with the application form if the council agrees the application. The report should provide an estimate of the annual costs, and identify whether they will be covered by reductions in other expenditure, or by additional income from the precept or other sources. In the case of increases in the precept an estimate of the amount of the increase should be provided. The report should demonstrate that any risks and uncertainties affecting the financing of the project have been taken into account in assessing its affordability. It should also set out any significant financial developments, that might affect the ability of the council to finance the costs in future years, so far as can reasonably be foreseen.

When should a council apply?

12. All councils are encouraged to let their County Associations know of their borrowing requirements as soon as possible. However, councils should not apply for borrowing approval until all negotiations have been completed and all other consents (eg. planning) have been obtained. If an applicant council is successful, processing of the borrowing approval should generally take about 14 days from the date of its receipt by DCLG. The borrowing approval will authorise the council to take out a loan within a period of six months starting with the date of issue of the borrowing approval, or, if the borrowing approval is issued in the second half of the financial year, within the period which begins on the date of issue and ends on the last day of the financial year.

How much can a council borrow?

13. The amount that an individual council will be authorised to borrow will normally be limited to a maximum of £500,000 in any single financial year for any single purpose.

Where can councils go for funds?

14. Most of the statutory controls on the sources from which councils can borrow were removed by the 2003 Act. However, councils may not, without the consent of HM Treasury, borrow otherwise than in sterling (section 2(3) of the 2003 Act). In practice, most councils are likely to obtain funds from the Public Works Loan Board or the clearing banks. When councils apply for funds, the Public Works Loan Board will insist that they have sight of the original borrowing approval. Loans may also be taken out from individuals or private or voluntary sector organisations. Councils are strongly advised to seek appropriate advice if they are considering borrowing from a source other than the Public Works Loan Board or clearing banks.

15. Councils are reminded that the decision to borrow must be taken by the full council (2003 Act, Schedule 1 paragraph 2(4)). This is a separate decision from the decision to apply for borrowing approval. Lenders will generally offer a variety of loan structures such as fixed or variable repayment rates of interest, discount or premiums for early repayment in certain circumstances etc.

Timing of borrowing

16. A council can borrow by temporary loan or overdraft pending the raising of the loan permitted by a borrowing approval (2003 Act, Schedule 1, paragraph 2(3)(a)(ii)). A council must be in possession of the borrowing approval when the temporary loan is taken out, but no second approval is required. The temporary loan must be for the purposes intended to be met by the approved borrowing. This means that progress on a project need not be delayed until the longer-term borrowing is arranged. A council can also raise a further loan to repay the original loan without the need for another approval, so long as the new borrowing takes place within the fixed period (2003 Act, Schedule 1, paragraph 2(3)(b)). For the meaning of "fixed period" see paragraph 18 of this guide.

Security for the lender

17. All borrowing by a council, together with interest on it, is charged indifferently on all the revenues of the council (2003 Act, section 13(3)). A council cannot mortgage or charge any of its property as security for money borrowed or which it otherwise owes; any security given in breach of this provision is unenforceable (2003 Act, section 13(1) and (2)).

Period of loan

18. Councils must determine the period within which the money borrowed will be repaid, and they are required to make charges to revenue account sufficient to repay the principal within that period and meet the interest charges on the borrowing (2003 Act, Schedule 1, paragraphs 3 and 5). The period determined is known as the "fixed period", and the council's determination requires the consent of the Secretary of State. The borrowing approval letter will normally include consent to any period determined by the council, provided it is no greater than a maximum period specified in the letter. The maximum period will begin on the date on which the money is borrowed, and will generally be either:

- *50 years*, for the acquisition of, or works on or to, land, buildings, roads or structures, or the making of grants for such purposes; or
- *10 years*, in all other cases.

Councils are asked to consider carefully whether it would be appropriate to borrow for the permitted maximum or for a shorter period. Generally the borrowing period should be no greater than the period for which the expenditure is forecast to provide benefits to the council (or the body being assisted). Thus if a piece of equipment is

only thought likely to last for five years, it would be more appropriate to borrow for five years than for the ten years that the borrowing approval might permit.

When a borrowing approval is no longer required

19. If a council finds it no longer needs the borrowing approval issued to it, it must inform DCLG.

General advice

- Seek appropriate advice early
- Programme prudent use of balances as well as borrowing
- Budgets or revised budgets should be considered before applying for borrowing approval
- The borrowing term should not exceed the life of the asset
- Even if the council secures an interest free loan, it will still require borrowing approval
- Original borrowing approval letter should be kept in safe custody

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APPENDIX

DEFINITION OF CAPITAL EXPENDITURE

- 1 Section 16 of the 2003 Act defines "capital expenditure" as "expenditure of the authority which falls to be capitalised in accordance with proper practices". In turn section 21(2) of the Act defines "proper practices" as those accounting practices that local authorities are required to follow by virtue of any enactment, or of a code of practice or other document specified in regulations. Under this power the Secretary of State has specified (among other documents) the CIPFA/LASAAC *Code of Practice on Local Authority Accounting in the United Kingdom: A Statement of Recommended Practice* ("the SORP"). In relation to parish councils, the SORP applies only to the small number of larger councils that are required by the Accounts and Audit Regulations 2003 to prepare and publish a statement of accounts. However, the first of the criteria set out in paragraph 11 of this guide relies on the SORP's provisions to provide a uniform definition of capital expenditure for all parishes. This is done purely to ensure that all applications are judged against the same criteria, and does not imply that the SORP is in any way applicable to a council that is not required to prepare a statement of accounts by the Accounts and Audit Regulations.

- 2 The key relevant paragraphs of the 2005 SORP for the purposes of the capital expenditure definition are as follows:

"3.91 All expenditure on the acquisition, creation or enhancement of tangible fixed assets should be capitalised on an accruals basis. Expenditure on the acquisition of a tangible asset, or expenditure which adds to, and not merely maintains, the value of an existing asset, should be capitalised and be classified as a tangible fixed asset, provided that it yields benefits to the authority and the services it provides are for a period of more than one year.

3.92 Expenditure that should be capitalised will include expenditure on the:

 - acquisition, reclamation, enhancement or laying out of land;
 - acquisition, construction, preparation, enhancement or replacement of roads, buildings and other structures;
 - acquisition, installation or replacement of movable or immovable plant, machinery, apparatus, vehicles and vessels.

3.93 In this context, enhancement means the carrying out of works which are intended to:

 - lengthen substantially the useful life of the asset; or
 - increase substantially the market value of the asset; or
 - increase substantially the extent to which the asset can or will be used for the purposes of or in conjunction with the functions of the local authority concerned."

 - 3 In addition, section 16 of the 2003 Act allows the Secretary of State to adjust the definition of capital expenditure by regulation, and, in the case of a particular authority, by direction. Regulation 25 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (SI 2003/3146), as amended by the Local Authorities (Capital Finance and Accounting) (Amendment) (England) Regulations 2004 (SI 2004/534) provides as follows:

"Expenditure to be capital expenditure

25. - (1) *For the purposes of Chapter 1 of Part 1 the following expenditure of a local authority, incurred on or after 1st April 2004, shall be treated as being capital expenditure insofar as it is not capital expenditure by virtue of section 16(1) -*

(a) expenditure incurred on the acquisition or preparation of a computer program, including expenditure on the acquisition of a right to use the program, if the authority acquire or prepare the program for use for a period of at least one year for any purpose relevant to its functions;

(b) subject to paragraph (2), the giving of a loan, grant or other financial assistance to any person, whether for use by that person or by a third party, towards expenditure which would, if incurred by the authority, be capital expenditure;

(c) the repayment of any grant or other financial assistance given to the local authority for the purposes of expenditure which is capital expenditure;

(d) subject to paragraph (3), the acquisition of share capital or loan capital in any body corporate;

(e) expenditure incurred on works to any land or building in which the local authority does not have an interest, which would be capital expenditure if the local authority had an interest in that land or building; and

(f) the payment of any levy by a local authority under section 136 of the Leasehold Reform Housing and Urban Development Act 1993 (levy on disposals).

(2) Where the expenditure referred to in paragraph (1)(b) is a loan given by a parish council or charter trustees to any person, it shall not be treated as being capital expenditure by virtue of this regulation.

(3) Where the expenditure referred to in paragraph (1)(d) is -

(a) an investment in a money market fund; or

(b) the acquisition of loan capital in -

(i) a multilateral development bank; or

(ii) a financial institution that is guaranteed by the United Kingdom Government,

it shall not be treated as being capital expenditure by virtue of this regulation."

Parish councils should note in particular the effect of paragraph (2) of the regulation.