Appendix 1
Report Env/60/04

FINANCIAL ASSESSMENT OF FUNDING VEHICLE AND PLANT AND MACHINERY PURCHASES UNDER PRUDENTIAL BORROWING RULES

The following is an assessment of the revenue implication for the funding vehicle and plant and machinery purchases using borrowing under the Prudential Borrowing Code. The code requires that the external interest and provision for debt repayment on borrowing undertaken to fund the purchases are "affordable" to the local Taxpayer. In Torbay this effectively means that additional annual charges to the Revenue Account arising from Prudential Borrowing must be offset by net savings in expenditure. For the Fleet Transport service this means that the cost of borrowing must be less than other methods of financing, the cost of borrowing will be charged to the Fleet Transport trading account.

A fair method of determining the financing charge which a service must bear in respect of a particular purchases where Prudential Borrowing is recommended has yet to be determined and circumstances may dictate that a different approach is adopted for individual services. Best Practice dictates that the Council's Treasury Management function is approached corporately and therefore it is not appropriate to attach a particular external loan to an individual asset, as a private operator would do with a mortgage.

The recommended approach is that the service should plan to repay the initial capital cost, less the estimated residual value, over the life of the asset (i.e equivalent to annual depreciation) together with annual interest calculated at the average Rate on the Council's overall borrowing portfolio. The table in paragraph 3 below assumes this is the case. Within this option further consideration could be given to the circumstances of a particular service to determine whether the rate of interest once determined should be fixed throughout the period and/or whether annual charges should be calculated on a reducing balance method (as illustrated) or using equal annual instalments.

1. The estimated total costs of a 7 year operating lease for a vehicle costing £10,000 are :-

	£
Lease rental payments (average of last six contracts)	10,500
Vehicle return conditions	
Transportation of vehicle to lessor	180
Engineer inspection costs	125
Excess mileage (fleet average)	60
Damage charged under fair wear and tear clause (average)	220
Total Estimated Cost of Operating Lease:	**11,085**

2. The estimated total costs of purchase a vehicle costing £10,000 with a 7 year life are :-

		£
Estimated capital cost		10,000
Estimated residual value (average)	15%	1,500
Depreciation costs over estimated 7 year asset life.		8,500
External interest @ 5%		2,225
Estimated cost of sale		150
Total Estimated Cost of Purchase:		**10,875**

Based on the estimated costs calculated above, the net operating savings on the purchase of an vehicle costing £10,000 will be **£210**

3. Statement of income and expenditure over 7 year asset life incorporating principal and interest repayments on a £10,000 loan:

Year £	Operating Lease Costs £	Principal Interest £	(Saving) £	Cumul' (Saving) £
1	1,500	1,532	32	32
2	1,500	1,532	32	64
3	1,500	1,532	32	96
4	1,500	1,532	32	129
5	1,500	1,532	32	161
6	1,500	1,532	32	193
7	2,085	1,683	(402)	(209)