

## Leasing for schools

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## Leasing

Luton Borough Council adopts the definition of leases in accordance with best accounting practice as described in the International Financial Reporting Standards number IAS 17.

This defines two main categories of leases – finance leases (including hire purchase agreements) and operating leases. **An operating lease is the only type of lease a school can enter into.** These leases are similar to simple rental agreements.

School staff should be aware that leasing is a complex subject for which specialist advice should be sought. Schools must not enter into any leases without the agreement of the Finance Manager, Children and Learning (or his/her representative). In addition, schools are advised to seek advice from Darrell Slevin at the Link group which is the LA's preferred adviser on leasing arrangements (details are available from your School Financial Adviser or on the Children and Learning Grid).

## Finance leases

A finance lease transfers substantially all the risks and rewards of ownership to the school. It is a form of borrowing and must not be entered into by schools.

All maintained schools are **expressly forbidden from entering into any form of finance lease** as this constitutes borrowing which is prohibited under section 3.7 of the LA Scheme for Financing Schools (this prohibits any form of borrowing by schools without the express written permission of the Secretary of State for Education).

In some instances, although strictly the leased asset remains the property of the leasing company, in substance the school may be considered to have acquired the asset and financed the acquisition by obtaining a loan from the company.

A finance lease usually involves payment by the school of the full cost of the asset together with a return on the finance provided by the company.

It should be presumed that the risks and rewards of ownership transfer to the school if, at the start of the lease, the present value of the minimum lease payments (including any initial payments) amounts to substantially all (normally 90% or more) of the fair value of the asset. The fair value is the price at which the asset could be exchanged with an independent third party less any grant receivable towards the purchase or use of the asset.

A hire purchase agreement is similar in substance to a finance lease and **must not** be entered into by schools.

## Operating leases

An operating lease is any lease that is not a finance lease. This will have the character of a rental agreement with the leasing company usually being responsible for the repairs and maintenance of the asset.

Normally, the period of the lease will be for substantially less than the useful life of the asset. An operating lease is the only type of lease available to schools.

## Procuring Assets via Leasing

When looking to procure assets, a school should initially consider "lease or buy" decisions. Often, substantial savings can be obtained through buying equipment outright and this option should be fully appraised beforehand.

It is not sound financial management for school staff to purchase assets from casual sales personnel without a full option-appraisal having taken place beforehand. Lease agreements should not be entered into without the prior approval of the governing body.

Schools should ensure that on-going lease rental payments can be met within their annual budget and that suitable quotations in line with the authority's contract procurement procedures have been obtained. Only the Headteacher / Chair of Governors / Chair of Finance Committee should be authorised to sign lease agreements on behalf of the School.

If the School chooses to lease an asset, advice should be sought from The Link group, the authority's preferred adviser on leasing matters. They will confirm (or otherwise) that the lease does not constitute borrowing (i.e. it is not a finance lease) and, if possible, will offer the school a more competitive option.

Schools must not look to "pay off" an existing third-party lease agreement by having it factored into a new lease without seeking advice from The Link Group. Generally, to have one lease subsumed into a new lease is poor commercial practice and fraught with risk and additional cost.

# Telling the difference – some typical features

## Operating lease

- Ownership remains with the leasing company providing the finance
- There is no option to buy at a price below market value
- The term is fixed and should not represent the major part of the economic, or useful life, of the asset involved
- As a general rule of thumb, the whole cost of leasing should not exceed 90% of the value of the equipment

## Finance lease

- There is an option to purchase the asset at a favourable price at the beginning of the lease
- The lease term represents the major part of the economic or useful life of the asset involved (greater than 75%)
- The lease transfers ownership of the asset to the school by the end of the lease term
- The leased assets are of such a specialised nature that only the school would be able to use them without major modifications
- If the school can cancel the lease, the leasing company's losses associated with the cancellation would be borne by the school
- The school has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent
- At the start of the lease, the present value of the minimum lease payments (including any initial payments) amounts to substantially all (normally 90% or more) of the fair value of the asset
- Gains or losses arising from the fluctuation in the fair value of the asset at the end of the lease are payable to/by the school (e.g. in the form of a rent rebate equalling most of the sales proceeds at the end of the lease)

## Rolled over contracts

Schools should be wary when renewing leases when the existing contract is 'rolled over'. This means that the previous outstanding balance is often refinanced, compounding the interest and inflating the value of the lease.

Schools may be led to believe they have renegotiated a more favourable deal which would save money, when in fact contracts are often renewed at additional cost and the term of the lease extended.

## Advice for schools

### Do:

- find out if there are existing contracts within the local authority (LA) available to the school. These may be corporate contracts and so likely to be better value.
- adhere to the financial regulations/standing orders of the LA.
- seek advice before committing to any lease agreement.
- make use of Link group service – let the experts do their job and source the best deal – it will make life easier by saving time and money.

## Don't:

- sign a lease agreement without seeking advice.
- sign an incomplete agreement. Ensure costs are broken down and the contractual obligations are clear, i.e. what are the monthly or quarterly payments, the total cost/value of the contract. Generally the total amount being charged should not exceed 90% of the value of the equipment being hired.
- sign if there is anything in the contract that isn't clear. Seek advice from a source such as Link group
- let the representative take all copies of the paperwork away. Always take a photocopy of any documents that are signed.
- Sign rollover contracts

## Annual return to the Local Authority

Local Authorities are required to prepare its annual Financial Statement of Accounts in accordance with International Financial Reporting Standards (IFRS). As part of this, the Local Authority must take into account all leasing and rental arrangements that have been entered into under the International Accounting Standard (IAS) number 17.

## Checklist for leasing

<b>Description</b>	<b>Action</b>	<b>Completed by, and Completion Date</b>
<p>All schools are required to submit an annual return (available on the Children and Learning grid) to the Authority's Corporate Accountancy team by 31 March of each year identifying all existing lease agreements in operation. It is important that this return is completed in full and contains accurate information, as this will be used to classify whether a lease is an operating or finance lease.</p>		
<p>Before considering leasing schools should go through their normal commissioning process for the equipment, involving a repurchasing review to identify the need, preparing a specification, preparing evaluation criteria and obtaining quotes</p>	<p>Have you compared the cost of leasing with the cost of buying?</p> <p>Have you completed a full option appraisal of the lease v buy decision</p> <p>Have you obtained the relevant number of quotes?</p> <p>Have you ensured you are comparing like with like e.g. include maintenance and insurance costs, if appropriate?</p> <p>Is this review documented providing clear reasons for selection and supporting documentation (e.g. quotes) retained?</p>	

<p>Minimum lease period – this is the shortest period for which the school will have to make rental payments for equipment. The period is fixed regardless of other factors, such as the equipment becoming less reliable, changes in the school’s needs or changes in technology, The shorter the minimum lease period, the less likely it is that you could have to continue making rental payments when it is no longer suitable. Leases for more than five years are likely to be considered finance leases</p>	<p>Have you considered how long the school has tended to keep similar equipment in the past or spoken to other schools with similar equipment?</p> <p>Is the term of the lease short term, ideally three years?</p>	
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<p>Maintenance and insurance – the lease agreement will sometimes include a maintenance or service arrangement, so if the equipment needs servicing there would not be an additional charge</p>	<p>Have you checked if maintenance &amp; insurance are included or excluded?</p> <p>If included checked who is providing it?</p> <p>Checked what would happen if the company providing the maintenance went out of business as you could have to continue to make rental payments throughout the minimum lease period even if the equipment doesn't work?</p> <p>Checked what level of service you will get?</p> <p>Checked maintenance charges and whether a similar level of service could be obtained from a different supplier at lower cost?</p> <p>Checked whether the maintenance is a separate agreement to the lease?</p> <p>If it is, checked whether the length of the two agreements is the same and whether notice can be given?</p>	
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<p>Supplies – the lease agreement will sometimes include the provision of suppliers e.g. paper, bulbs, toner etc</p>	<p>Check what would be provided and who would provide it?</p> <p>Checked what would happen if the company providing the supplies went out of business?</p> <p>Checked whether it would be better value to buy the supplies separately over time as they are needed?</p>	
<p>Advice – the preferred adviser of Luton Borough Council is Link Group</p>	<p>Checked whether the lease terms are appropriate?</p> <p>Has the advice of Link group been sought and documented?</p> <p>Is there written confirmation that the proposed lease does not constitute a finance lease?</p>	
<p>Approval – leasing contracts should be approved by the governing body</p> <p>The Finance Manager of Children and Learning must be consulted for advice and agreement on leasing prior to the School entering into the lease</p>	<p>Has the governing body approved the lease?</p> <p>Has the governing body seen evidence that none of the features of a finance lease are present?</p> <p>Has the Finance Manager Children and Learning (or his/her representative) approved the lease in writing?</p>	



<p>Authorised signature</p>	<p>Has the lease been signed by a suitably authorised signatory?  (Headteacher/Chair of Governors/Chair of Finance)</p>	
<p>Upgrades – during the minimum lease period an equipment supplier may approach the school and suggest that you change or upgrade your existing equipment. Keeping the equipment and waiting until the end of the minimum lease period will almost always be less expensive than upgrading. Remember the minimum lease period for the existing equipment is fixed, so an upgrade could leave you paying for two pieces of equipment when you are only using one</p>	<p>Have you sought advice before upgrading (Link Group)?</p>	
<p>Annual returns – prior to the end of each financial year an annual return, detailing all existing lease agreements, should be completed in full and submitted to the Authority’s Corporate Accountancy Team</p>	<p>Has the annual return for leases been completed in full and accurately (including the purchase price of the equipment at the time the lease was entered into)?</p> <p>Has the return been submitted to the Corporate Accountancy Team prior to the 31 March of each year?</p>	