



Office of the
Deputy Prime Minister

Creating sustainable communities

Trevor Emmott
Capital Finance Policy
LGF4B
5/E2 Eland House
Bressenden Place
London SW1E 5DU

Direct line: 020 7944 4234
Fax: 020 7944 4239
trevor.emmott@odpm.gsi.gov.uk

Web site: www.odpm.gov.uk

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Chief Executives
Directors of Finance
Directors of Housing

Local Authorities in England

Dear Colleague

LOCAL GOVERNMENT CAPITAL FINANCE SYSTEM AMENDMENTS TO REGULATIONS

I enclose for your comments a draft of the ***Local Authorities (Capital Finance and Accounting) (Amendment) (England) (No 2) Regulations 2004***.

The regulations will be brought into force as soon as possible in this financial year and will amend the *Local Authorities (Capital Finance and Accounting) (England) Regulations 2003* [SI 3146], which are a key part of the legislative framework for the "prudential" capital finance system, created under Part 1 of the *Local Government Act 2003*. Web links to the earlier regulations and the Act are as follows:

<http://www.legislation.hmso.gov.uk/si/si2003/20033146.htm>
<http://www.legislation.hmso.gov.uk/acts/acts2003/20030026.htm>

Also enclosed is an informal commentary explaining the intention of the regulations. The effects of the regulations, which should all be beneficial to authorities, are broadly to:

- relax the rules on the **pooling of housing capital receipts** arising from small scale stock transfers and sales of former new town housing (regulations 2, 3, 4 and 5)
- define as "capital expenditure" authorities' **loans and grants to their staff** for (eg) house purchase (regulation 6)
- clarify the calculation of **minimum revenue provision** (regulation 7)
- modify the conditions under which **debt-free authorities** may spend amounts set aside for debt-redemption (regulation 8).

I should be most grateful for your views on the regulations, preferably by E-mail, no later than **8 OCTOBER 2004**. Please address your response (and any queries) to my colleague Ross Buchanan here at: ross.buchanan@odpm.gsi.gov.uk

Yours sincerely

Trevor Emmott

The Local Authorities (Capital Finance and Accounting) (Amendment) (England) (No 2) Regulations 2004

An informal commentary on the draft regulations by the Office of the Deputy Prime Minister

1. The regulations will amend the *Local Authorities (Capital Finance and Accounting)(England) Regulations 2003* [SI 3146] ("the 2003 regulations"). The latter were brought into force on 1 April 2004 for the purpose of implementing the new "prudential" capital finance system under Part 1 of the *Local Government Act 2003*. Earlier amendments to the 2003 regulations were made by the *Local Authorities (Capital Finance and Accounting) (Amendment) (England) Regulations 2004* [SI 534].

Pooling of capital receipts: small scale housing stock disposals (Amendment regulations 2, 3 and 5)

2. In the 2003 regulations, regulation 12 defines the housing capital receipts which are subject to the "pooling" requirement, under which part has to be paid to the Secretary of State. It excludes from pooling the receipts from certain transfers of housing stock to housing associations or other registered social landlords [regulation 12(1)(a)]. This is based on a definition of stock transfers already in primary legislation. The definition refers only to large scale disposals, involving 500 or more properties.

3. In practice, that should cover all transfers and ODPM is unaware of any authority disadvantaged by the limitation on size. However, it remains possible that a smaller scale transfer might some day need the benefit of this concession. **Regulation 3**, in conjunction with the definition in **regulation 2**, achieves that result, so that *all* transfers of stock to registered social landlords will be exempt from pooling, regardless of the number of properties involved.

4. A pooling payment may also be due (under regulation 22 of the 2003 regulations) when sales proceeds are received in a *non-money* form (for example, land or buildings). **Regulation 5** extends the regulation 3 concession to such cases.

Pooling of capital receipts: disposal of former new town housing (Amendment regulation 4)

5. New town corporation housing was transferred to local authorities on the basis that, in the event of subsequent sales, part of the capital receipt was to be paid to the Commission for the New Towns (now part of English Partnerships).

6. The former capital finance regime took account of that "clawback" arrangement in the regulations requiring part of a housing capital receipt to be "set aside" for debt-redemption. The rules were modified to relieve authorities of the double burden of providing both for the clawback and the full amount of set-aside.

7. From 1 April 2004, set-aside has been replaced by pooling. However, there will still be occasions when authorities selling houses have to make clawback payments to English Partnerships, as well as paying 75% of the total receipt to the Secretary of State under the pooling rules.

8. **Regulation 4** mitigates this double impact, by inserting a new regulation (20A) in the 2003 regulations. Authorities will first treat the capital receipt as reduced by any payment

due to English Partnerships; then, the percentage due to the Secretary of State under pooling will be calculated on the basis of whatever balance is left.

Loans, grants and financial assistance to officers (Amendment regulation 6)

9. Under regulation 25(1)(b) in the 2003 regulations, a loan or grant made by a local authority to someone for capital expenditure normally counts as capital expenditure for the authority making it. However, regulation 26 provides that loans or grants to an authority's own officers may *not* be treated as capital expenditure.

10. Both regulations continue provisions of the old capital finance system, dating from 1990. The special treatment of loans and grants to officers was helpful to authorities when, under earlier rules, part of most capital receipts had to be set aside for debt redemption. If a loan had counted as capital expenditure, then its repayment would be a capital receipt and subject to set-aside.

11. However, regulation 26 is now having an adverse impact on initiatives to attract key workers to areas with high housing costs. These measures involve financial contributions by the authority to the costs of house purchase. Most authorities need to borrow to fund such assistance and regulation 26 is preventing that, since long-term borrowing may only properly be undertaken for *capital* expenditure. **Regulation 6** solves this problem by revoking regulation 26.

Calculation of minimum revenue provision (Amendment regulation 7)

12. In the 2003 regulations, regulation 28 sets out the rules for calculating minimum revenue provision (MRP) - the annual revenue provision that authorities have to make in respect of their debts and credit liabilities. The requirement to make MRP has existed since 1990 and continues within a new framework under the prudential system. The need for four adjustments has been identified.

13. The effect of **regulation 7(a)(ii) and 7(c)(iii)** is to redefine factor "A", which is an adjustment to ensure that the new MRP regime introduced on 1 April 2004 does not produce a more severe revenue impact than the former rules. At present, it fails to deal explicitly with *non-housing* authorities (such as county councils), which were covered by a different formula under the old rules, based on a factor called the "relevant amount". The new definition clarifies the treatment of non-housing authorities in this context.

14. **Regulation 7(a)(iii)** also serves to clarify the position for *non-housing* authorities. It concerns factor "HC" (the opening Housing Revenue Account capital financing requirement for the current year) which does not apply to non-housing authorities. The amendment makes clear that, for such authorities, factor HC always has the value of nil.

15. **Regulation 7(b)** relates to a special component of MRP. When, under the former system, authorities were, exceptionally, allowed to borrow for revenue expenditure, they could be required to provide for repaying that debt over a very short *amortisation* period (normally 7 years). Some amortisation periods are still running and regulation 28(2) in the 2003 regulations ensures that authorities continue to make this additional amount of MRP at the specified rate. However, it remains the policy that an authority may stop making MRP once the provision it has set aside for debt redemption equals or exceeds its debts. This position is achieved when the *capital financing requirement* (CFR) is nil or negative. But regulation 28 currently requires the amortisation component of MRP still to be provided

for in those circumstances. The amendment therefore inserts a new paragraph (3A) in regulation 28 to make clear that *all* MRP may cease once the CFR is nil or negative.

16. **Regulation 7(c)(i)** amends the definition of the *capital financing requirement* as given in regulation 28(4) of the 2003 regulations for the purposes of the MRP calculation. This is linked to the effects of regulation 33 in the 2003 regulations, which allows debt-free authorities to convert amounts set aside under the former system into capital receipts (see paragraph 17 below). The amendment provides that for MRP purposes, the CFR is to be calculated as if the regulation 33 conversion took place on 31 March 2004. The effect is to prevent authorities having to make an artificially inflated provision for debt-redemption in 2005-06 and subsequent years.

Use of amounts set aside under the Local Government and Housing Act 1989 (Amendment regulation 8)

17. **Regulation 8** amends regulation 33 in the 2003 regulations. This concerns amounts set aside as provision for debt redemption under the former capital finance system. The former rules allowed authorities which became debt-free to use set-aside amounts for capital expenditure. However, authorities which were debt-free on 31 March 2004 (the last day of the former system) may not have had time to spend all the set-aside amounts they were entitled to under the old rules. So regulation 33 provides for those outstanding amounts to be treated as capital receipts and thus remain available for capital expenditure. This ensures that debt-free authorities do not lose spending power as a result of the transition to the new system. Several changes are needed to regulation 33.

18. **Regulation 8(a)(ii)** clarifies that authorities may choose to convert all or, if they prefer, just part of the relevant amount of set-aside into capital receipts.

19. **Regulation 8(b)** relates to the *limit* imposed by the former system on the amount of set-aside which debt-free authorities could spend. This was the equal to the amount by which their credit ceiling was less than nil on the last day of the preceding financial year. For consistency, that limit has been carried forward in regulation 33(3). However, for a few debt-free authorities there is a problem, since the amount by which their credit ceiling was negative is less than the amount they have set-aside. That means that part of their set-aside money cannot be used at all. The solution is to make reference in regulation 33(3) to the new concept of the *capital financing requirement*, the calculation of which avoids the technical anomalies associated with the former credit ceiling. The amended regulation will say that the limit to the amount of set-aside money which can be converted into capital receipts will be equal to the greater of (a) the amount by which the credit ceiling was less than nil on 31 March 2004 and (b) the amount by which the CFR was less than nil on that date. In other words, the limit is whichever of these amounts allows authorities to convert more set-aside into capital receipts.

20. **Regulation 8(b)** also inserts three new paragraphs at the end of regulation 33, dealing with the procedure for converting set-aside into capital receipts. New paragraph (4) gives authorities until 1 October 2005 to decide on the amount of the conversion (thus allowing them up to six months to finalise their accounts for 2004-05). New paragraph (5) provides that the conversion is to be treated as taking place during 2004-05 (except for the purposes of MRP - see paragraph 16 above). New paragraph (6) makes clear that in the amended regulation 33(3) (see paragraph 19 above), the term "capital financing requirement" has the same meaning as in the *Prudential Code for Capital Finance in Local Authorities* published by CIPFA.