Capital Gains

Improving the Local Government Capital Expenditure System

Technical Supplement
The Audit Commission

... promotes proper stewardship of public finances and helps those responsible for public services to achieve economy, efficiency and effectiveness.
This Technical Supplement contains a series of background and research papers that supports the analysis and arguments of the Audit Commission’s national report, *Capital Gains: Improving the Local Government Capital Expenditure System*. The supplement divides into three main sections:

- **Chapters 1–5** provide a more detailed explanation of how the capital control system in England and Wales operates;
- **Chapter 6** provides more extensive information on the demand for capital expenditure – in particular, that related to the maintenance backlogs in various services – with details of the surveys and estimates considered by the Commission as part of its research; and
- **Chapter 7** provides an explanation of the capital expenditure system in France, highlighting areas of significant difference from the arrangements described in earlier chapters.
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1 When Is It Capital?

1. For local authorities, capital spending is defined in Part IV of the Local Government and Housing Act 1989. Capital expenditure includes:

- the acquisition, construction, preparation, enhancement or replacement of roads, buildings and other structures; where enhancement means the carrying out of works which are intended:
  - to lengthen substantially the useful life of the asset; or
  - to increase substantially the open market value of the asset; or
  - to increase substantially the extent to which the asset can be used for the purposes of or in connection with the functions of the local authority concerned.

2. Statute is silent as to what ‘substantially’ means. If the accounting treatment were challenged – for example, by an auditor or objector – the courts would ultimately have to take a view, case by case.

3. In practice it is left to local authority accountants to exercise their judgement about what falls within the definition. Redecorating a flat and replacing cracked window-panes would be unlikely to count as capital expenditure. Such work would not substantially increase the value of the flat. If the same work was carried out in 1,000 properties, the authority’s overall bill might be over £1 million – but would still not be capital, for the same reason. On the other hand, a large number of minor repairs to the same property over a short period might, arguably, improve it substantially.

4. Most authorities treat transactions below a certain minimum size, say £5,000, as revenue rather than capital. However, such minimum levels often vary between authorities, and between different service areas within the same authority.

5. Not all expenditure that meets the definition in the Act will actually be treated as capital in an authority’s accounts (‘capitalised’). If spending is to be financed from revenue reserves, there is no material reason to distinguish spending on capital and revenue items. Some authorities charge all town hall maintenance to a reserve fund kept for that purpose and topped up each year from revenue; this might pay for quite large conversions and heating-system improvements that other authorities would capitalise.

6. The Act and subsequent regulations add to the abbreviated definition of capital expenditure given above. A more complete definition includes:

- the acquisition, laying out, reclamation and enhancement of land;
- the acquisition, installation or replacement of plant, machinery and apparatus, and vehicles and vessels (including, for example, IT and communications equipment);
- making grants to third parties so that they can undertake capital expenditure;
- acquiring company shares or making loans to companies;
increasing substantially the thermal insulation of a building or the extent to which it can be used by disabled or elderly people;

- reducing substantially the fire risk in a building; and

- acquiring or writing computer software for use for a period of at least one year.
2 How the Control System Works

7. Part IV of the Local Government and Housing Act 1989 (‘the Act’) lays down the system of capital finance for almost all local authorities in England and Wales. (Parish and community councils’ borrowing is relatively small and is controlled separately under the Local Government Act 1972.)

8. In essence, all expenditure is revenue expenditure under the Act except where specific provision is made. Other legislation prevents authorities from running a revenue account deficit. So any expenditure of a type not specified in the Act must be met by revenue income in the year – with the cost falling immediately on financial reserves or the council-tax payer.

9. The most important types of expenditure that do not have to be charged to revenue are those for ‘capital purposes’ and:
   ◆ authorised by a credit approval;
   ◆ met from usable capital receipts; or
   ◆ met by a grant from a third party (other than the European Union).

10. ‘Expenditure for capital purposes’ is defined in the Act and consequent regulations (see Chapter 1). The statutory definition is similar to the definition adopted by professional accountancy bodies. Local authorities are obliged by statute to follow agreed accountancy rules except where these conflict with the Act.

11. Local authorities may borrow money for any purpose relevant to their functions. However, the amount of capital expenditure an authority can finance by borrowing is effectively limited by the Act to the value of credit approvals issued by central government.

12. Local authorities can enter ‘buy-now-pay-later’ contracts that involve capital works or the use of capital assets and payments over several years. Such contracts – which are often regarded as similar in their economic impact to expenditure financed by borrowing – are known as ‘credit arrangements’ under the Act. Authorities have to find a prescribed amount of ‘credit cover’ to meet the capital cost of the credit arrangement when the contract is signed. Credit cover has to be found from credit approvals, usable receipts or revenue. The amount of credit cover needed is prescribed in regulations. In general, it is broadly the total of payments under the contract, valued on a discounted basis, but there are many exceptions: for example, no credit cover is required for property leases of less than 10 years duration; and equipment operating leases are excluded.
13. A capital receipt is, in general, money a local authority receives from:
◆ the sale (or disposal) of a capital asset; or
◆ the repayment by a third party of a grant or loan (made to the third
  party to allow it to undertake expenditure for capital purposes).

14. Capital receipts are always cash amounts. Grants received from the
Government or other bodies are not capital receipts. The system ignores
capital receipts under £6,000.

15. All capital receipts are divided into ‘usable’ and ‘reserved’ parts when
they are received. Only the usable parts (‘usable receipts’) can fund new
capital expenditure. The standard usable proportions of capital receipts are:
◆ 25 per cent for council houses; and
◆ 50 per cent for most other assets.

16. The proportion for different types of asset may be changed by
regulation. The Government has used this approach on several occasions
either to boost local authority spending or to encourage sales of particular
types of property (Box A).

17. An authority may spend its usable receipts at any time and on any
service. There is, however, a disincentive to retain usable receipts, since the
Government takes them into account when it issues credit approvals.
(Described later, Box B.)

18. Special rules – collectively known as the ‘in-and-out’ rules – apply to
certain transactions that involve a local authority in expenditure which is
closely linked to a capital receipt. For example, an authority selling an old
school building for £1 million and building a new school to replace it for
£2.5 million, is able to use the whole £1 million receipt to finance the
project, rather than just 50 per cent.

19. If an authority disposes of a capital asset in a barter arrangement –
receiving goods or services in exchange – it may be deemed to have received
a ‘notional receipt’ equal to the value of the work it has received. In such
cases the authority then has to work out what the reserved part would have
been if the transaction had been in cash, and charge that amount to its
usable receipts or revenue.

20. Grants are always related to specific projects or types of expenditure.
Local authorities can receive capital grants and contributions from:
◆ government departments – mainly for transport, housing and
  regeneration work;
◆ non-departmental public bodies – such as the National Lottery
  distributors, the Rural Development Commission or English
  Partnerships; or
Between November 1992 and December 1993 the restrictions were almost completely relaxed in order to provide a boost to the construction industry. The change released about £1.8 billion of extra usable receipts on Department of the Environment (DoE) estimates. This ‘receipts holiday’ accounted for most of the increase in total receipts from £2.1 billion in 1992/93 to £3.5 billion in 1993/94.

Further targeted relaxations have since been introduced – partly to release resources in order to promote partnerships and Private Finance Initiative (PFI) projects. The categories and revised usable proportions are or were:

<table>
<thead>
<tr>
<th>Category</th>
<th>Proportion</th>
<th>Duration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Car parks</td>
<td>90%</td>
<td>from 1/9/95 for one year</td>
</tr>
<tr>
<td>Retail property</td>
<td>90%</td>
<td>from 1/9/95 for one year</td>
</tr>
<tr>
<td>Crematoria</td>
<td>90%</td>
<td>from 1/1/96 for 18 months</td>
</tr>
<tr>
<td>Agricultural smallholdings (including county farms)</td>
<td>90%</td>
<td>from 1/4/96 for two years</td>
</tr>
<tr>
<td>Education assets</td>
<td>75%</td>
<td>from 1/4/96 for two years</td>
</tr>
</tbody>
</table>

In addition, the DoE announced technical changes to the receipts rules, which were implemented in April 1997, and which should allow a greater proportion of the proceeds of selling:

- unoccupied council houses,
- industrial estates,
- docks and harbours,
- leisure and sports facilities,
- shops and offices, and
- vacant development land

to be used for regeneration projects in ‘deprived areas’. These areas are defined as the most deprived 10 per cent of wards, as identified by the

- the private sector – which may typically contribute towards an access road or traffic-management scheme near a new industrial or commercial development.

21. Local authorities are free to use revenue resources for capital spending. However – because of the ringfence around the housing revenue account (HRA) – they may not charge general services spending to council tenants, nor spending on council houses to local taxpayers.
HRA funding

22. The extent to which housing capital expenditure is financed from rents varies greatly between authorities, from nil to over £10 million a year in councils interviewed by the study team. Raising council rents in order to increase renovation work – a popular course in recent years – is now a less practical option, because of changes to housing benefit (HB) rules. These changes mean that, where rents are increased beyond government guidelines, additional housing benefit must be funded entirely by other tenants’ rents.

Other revenue funding

23. The use of revenue to fund general service capital projects varies greatly between authorities, and some have built up earmarked revenue reserves for specific projects over several years. For most authorities, revenue funding of capital is effectively constrained by the Government’s cap on revenue budgets.

24. As a prudential requirement, authorities must make provision to repay a prescribed proportion of their ‘credit ceiling’ (a measure of local authority debt) each year. This charge to revenue is known as minimum revenue provision (MRP). The regulations setting out the precise calculation of the credit ceiling and the associated MRP are highly complex. In broad terms, MRP is 2 per cent of debt relating to council housing and 4 per cent of all other debt. The measure of debt used in this calculation is net of any amounts previously ‘set aside as provision for credit liabilities’ (PCL); such amounts will include the reserved parts of capital receipts, MRP from previous years, and revenue set aside in respect of credit arrangements.  

25. This requirement is merely for some of the authority’s revenue income to be earmarked for debt repayment and not used to finance other revenue spending; the Act does not prescribe when an authority should repay debt.
3 How Are Resources Allocated?

26. Government departments can allocate three separate types of capital support to individual local authorities:
   ◆ capital grants;
   ◆ Annual Capital Guidelines (ACGs) – which contribute towards an authority’s block Basic Credit Approval (BCA); and
   ◆ Supplementary Credit Approvals (SCAs).

Credit approvals represent over 60 per cent of central government support (Exhibit 1).

27. ACGs are intended to represent the relative need for capital spending on a particular service. They are issued for housing, transport, education, personal social services (PSS) and ‘other services’. So a non-metropolitan district will receive only two ACGs (housing and ‘other services’), while a unitary authority will receive all five. All ACGs allocated to an authority are added together and then offset by a proportion of the authority’s usable capital receipts, the ‘receipts taken into account’ (RTIA) (Box B, overleaf). The resulting amount is issued to the authority as its BCA.

28. The BCA may be used for any type of expenditure. It permits spending in a specific financial year and must be issued before the start of that year. In practice, BCAs are normally issued to authorities just before Christmas.

Exhibit 1
Central government support by type of allocation, 1997/98

Credit approvals represent over 60 per cent of central government support.

Source: DoE
29. SCAs are usually issued for specific services, projects or types of expenditure and may only be used for that purpose. They can apply to any period (but, in practice, have normally been issued for a single financial year) and can be issued at any time up to six months after the year to which they apply. For example, an SCA permitting expenditure in 1996/97 can be issued up to the end of September 1997.

30. An SCA for 1996/97 issued in September 1997 may seem to come too late to support an authority’s capital expenditure. In fact, it can help by:

- allowing revenue or usable receipts that had been allocated to financing expenditure (of the type specified in the SCA) to be released and carried forward to the following year; and by
- increasing future revenue support through consequent revenue support grant or housing subsidy.

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**Box B**

**Receipts taken into account (RTIA)**

The device of RTIA is intended to redistribute capital resources from receipt-rich to receipt-poor authorities. It works as follows:

The Government decides how much it will allocate to local government in credit approvals and capital grants as part of the public expenditure survey (PES) round. At the same time, it seeks to redistribute resources between those authorities that have high levels of usable capital receipts and those with low levels. This is done by increasing the amount allocated by departments to local authorities and then reducing the total amount each authority actually gets by a proportion of its usable receipts, calculated so that the increase and reduction cancel out nationally. For 1997/98 the ACGs issued were £325 million (or nearly one-third) higher than the national provision for BCA, and the consequent proportion of usable RTIA was 31 per cent. Usable receipts were defined as those held at 1 April 1996 plus those received during 1996/97. This can be summarised as follows:

<table>
<thead>
<tr>
<th>At the national level:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provision for BCAs</td>
</tr>
<tr>
<td>Sum of service ACGs</td>
</tr>
</tbody>
</table>

For each authority:

| Sum of service ACGs | RTIA | BCA |

If an authority’s usable RTIA is more than the total of its ACGs, then the authority receives a BCA of zero. In 1997/98, 101 non-metropolitan districts (of 267), five London authorities (of 32), one metropolitan district (of 36) and one new unitary authority (of 27) fell into this category.

The RTIA system can be criticised. It provides a disincentive to retain receipts (because usable receipts in hand on 1 April are taxed) and so may encourage rushed planning. It is also, arguably, inefficient because it does not redistribute the excess receipts of authorities with zero BCAs: an authority with no ACGs will not be affected, however great its receipts. Nor does it affect the reserved receipts that debt-free authorities can use for new spending.
The methods used to allocate ACGs, SCAs and grants to local authorities are complex and vary significantly between government departments. Brief descriptions of the methods used are given in Box C.

**Box C**

Methods used to allocate capital resources in England

<table>
<thead>
<tr>
<th>Housing</th>
<th>Transport Policies and Programmes (TPPs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Housing Investment Programme (HIP) ACGs (and some housing SCAs) are allocated by a regional competition based on each authority's strategy for meeting local housing needs. Authorities are placed in five performance bands by the government office for the region. Middle-band authorities receive broadly the amount of ACG indicated by a needs formula: the Generalised Needs Index (GNI). Typically, a Band 1 authority might receive 120 per cent of its GNI-based allocation and a Band 5 authority 75 per cent. The assessment criteria are set by DoE ministers. In addition to strategies, authorities must provide broad spending and finance plans based on their previous year's allocation, together with variations of plus or minus 15 per cent. Funds are allocated between regions using the GNI. Home-owners on low incomes and the disabled can apply for grants to improve or adapt their homes. Resources for these schemes are also allocated by the HIP process. Within a fixed limit, DoE will issue a grant to reimburse the authority for 60 per cent of the cost of this help, with the remaining 40 per cent met locally. Authorities that spend above the limit have to meet the whole cost themselves. The limits are allocated between regions using the GNI. SCAs are also issued competitively for government initiatives outside the HIP process, such as:</td>
<td></td>
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<tr>
<td>Each authority provides a comprehensive annual statement of the highways, public transport and traffic management programmes to best meet the needs of their area, plus an outline programme for the next five years. Initial assessment of bids is carried out at government offices, usually by technically qualified staff, before final decisions are taken by the Department of Transport. Resources are allocated competitively under the headings:</td>
<td></td>
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<tr>
<td>♦ the Estates Renewal Challenge Fund;</td>
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<tr>
<td>♦ empty properties usage;</td>
<td></td>
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<tr>
<td>♦ energy efficiency; and</td>
<td></td>
</tr>
<tr>
<td>♦ cash incentives to enable tenants to buy properties (and so release public sector stock).</td>
<td></td>
</tr>
<tr>
<td>♦ Major schemes (over £2 million)</td>
<td></td>
</tr>
<tr>
<td>♦ Structural maintenance of roads</td>
<td></td>
</tr>
<tr>
<td>♦ Bridge strengthening and assessment</td>
<td></td>
</tr>
<tr>
<td>♦ Minor works/road safety measures</td>
<td></td>
</tr>
<tr>
<td>♦ Section 56 grant (under the Transport Act 1968) for public transport projects over £5 million</td>
<td></td>
</tr>
<tr>
<td>♦ Grants under the Industrial Development Act 1982.</td>
<td></td>
</tr>
<tr>
<td>Schemes deemed 'eligible for Transport Supplementary Grant (TSG)' are funded 50 per cent through grant and 50 per cent through credit approvals. Additional funding for smaller-scale local work is given entirely through credit approvals. Authorities can also bid competitively for a 'package' of measures to address a range of transport problems, usually in a limited geographical area.</td>
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</tr>
</tbody>
</table>

**Personal Social Services (TSS)**

ACG resources are issued in proportion to an age-weighted population indicator, adjusted for regional variations in building costs. SCAs resources for particular initiatives (for example, for AIDS/HIV, mental illness, IT) are allocated in a variety of needs-related ways.

**Education and Employment**

ACGs for local education authorities (LEAs) in England are mainly distributed according to 'basic need' (BN). If an authority can show that projected population growth in an area will outstrip existing capacity, the Department for Education and Employment (DfEE) allocates support on a formula basis – the number of extra school places required is multiplied by a standard factor (representing the cost per pupil of new building stock adjusted for regional variations). Each BN allocation is spread over three years in the ratio 35:50:15. Smaller amounts are also issued for: |
| ♦ exceptional basic need; |
| ♦ surplus place removal schemes; |
| ♦ special educational needs; |
| ♦ LEAs' liability for building works at voluntary-aided schools; and |
| funding for smaller-scale local work is given entirely through credit approvals. Authorities can also bid competitively for a 'package' of measures to address a range of transport problems, usually in a limited geographical area. |

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Box C (cont.)

- an amount, allocated by formula, for improvement and replacement work and all capital work not specifically covered in the priority areas.

There was no formula allocation in 1997/98. Remaining resources are distributed as SCAs through the Schools Renewal Challenge competition.

**Other Services**

The bulk of ACG resources are allocated between classes of authority in the same proportions year to year. Within each class, resources are allocated using a formula based on population (counties and districts), unemployment (mets) and previous year's allocation (London). Resources for county fire services are distributed on a population basis as part of the Other Services ACG.

For 1997/98 SCAs are to be issued for government initiatives that include:

- air quality,
- contaminated land, and
- recycling.

Up to £150 million will be issued to cover local government reorganisation costs. (These SCAs do not receive revenue support). Around £123 million in SCAs is likely to be issued as cover for EU grants given for ‘other services’ projects and sport and recreation projects.

**Single Regeneration Budget (SRB)**

The SRB includes the Challenge Fund and the continuing costs of City Challenge partnerships, Estate Action schemes and other regeneration initiatives. SRB resources that go to local authorities for capital projects are issued as capital grants.

### Capital Challenge Pilot Scheme

For 1997/98, SCAs for pilot Capital Challenge schemes were awarded competitively on a regional basis, with resources allocated to regions in proportion to previous mainstream ACG funding. Funding for current schemes is £600 million over the three years from 1997/98 to 1999/2000. After 1997/98 they will be funded by a mixture of BCAs and SCAs.

### Coastal Protection

SCAs and grants are provided by the Ministry of Agriculture for these services.

### Protective services

SCAs and grant funding are provided by the Home Office for police and probation, and by the Lord Chancellor's Department for magistrates courts.

### Fire services

The Home Office provides £20 million in SCAs to fire and civil defence authorities. Support for county fire services is given through the Other Services Block ACG.

### Summary

Although central government provides financial support across a wide range of services, nearly 60 per cent of this support is directed to three services – housing, transport and education (Exhibit 2).

### Exhibit 2

**Central government capital support to local authorities by service, 1997/98**

Nearly 60 per cent of support is diverted to three services – housing, transport and education.

![Pie chart showing distribution of central government capital support by service]

- **Local government reorganisation** 5%
- **Capital challenge** 5%
- **Other** 8%
- **PSS** 2%
- **Education** 13%
- **SRB** 15%
- **Protective services** 6%
- **Housing** 24%
- **Transport** 22%

Note: Transport SCA figure includes credit approvals issued to single service joint passenger transport authorities as BCA.

Source: CPWP96(21) revised; Basic Credit Approvals 1997/98 (handbook)
32. About 40 local authorities have become debt-free in recent years, mostly councils in relatively affluent areas that have transferred their housing stock to housing associations. Such transfers usually result in payments to the authority that are sufficient to eliminate all outstanding debt and leave some surplus.

33. The control system treats debt-free authorities differently from others in three main ways:

- all their future capital receipts are 100 per cent usable (as long as they remain debt-free);
- any surplus ‘set-aside’ receipts, no longer required to eliminate debt, may be used to finance new capital expenditure; and
- they may make financial investments with a five-year maturity, rather than the standard one-year maturity.

34. Debt-free authorities therefore escape one of the main controls of the system – restraint on the use of capital receipts. However, this has not caused problems for national expenditure control as yet, because such authorities are few in number and have a tendency to spend receipts slowly (Case Study 1). DoE returns suggest that around £200 million of some £620 million surplus ‘set-aside’ receipts available to debt-free authorities will be spent in 1996/97. Debt-free authorities also benefit by largely escaping the redistributive impact of RTIA.

35. Not all authorities in a position to become debt-free want to do so. Some say they can earn more by investing their surplus receipts than by repaying old debt.

Case Study 1
A debt-free authority

This shire district council became debt-free in 1992.

The council is proud of being debt-free. It feels that there is less central interference in its affairs, and that its status is a reflection of its sound financial management. The area’s relative affluence and the council’s £19 million stock of usable receipts mean that it receives no BCA and is unlikely to receive SRB or similar funding. As a result, relations with the local government office are limited. It still hopes to win National Lottery money, however.

The council’s budget is close to its revenue ‘cap’. The council uses its capital receipts to generate interest, which allows a higher level of spending on services than would otherwise be possible. Its policy – which has continued despite a change in administration – is to seek to maintain revenue spending, rather than rush to spend on capital. Capping is seen as the main problem.
4 Who Pays for Borrowing?

36. The Government supports local authority capital expenditure through capital grants and credit approvals. By itself, a credit approval simply permits a local authority a certain amount of capital expenditure that it can finance by borrowing. The Government will not necessarily give the authority any financial support to meet the resulting debt charges. Indeed there are cases, such as public transport projects, where no financial support is given because the cost of capital is expected to be paid for by passengers’ fares. However, the great majority of credit approvals qualify for ongoing revenue support, either through the housing subsidy system (for HRA spending), or through standard spending assessments (SSAs) and revenue support grant (RSG) for other spending. In both cases this is revenue support for the debt charges – interest and principal repayment – associated with the borrowing implied by the credit approval. Clearly, without revenue support the value of a credit approval is greatly reduced, as the cost then falls entirely on local tax-payers or on tenants’ rents. (With the current capping of revenue budgets, a more common scenario is for the council tax to remain the same, with savings needing to be found in service running costs.)

37. About 40 per cent of government support for local authority capital expenditure is given through capital grants and 60 per cent through credit approvals. The financial impact of capital grants on a council’s finances is clear-cut, but that of credit approvals has been a source of dispute – and is sometimes misunderstood even by those closely involved with capital issues. Most concern relates to borrowing for capital spending on services supported through the SSA system.

38. The Government’s explanation of the Capital Financing SSA makes no suggestion that it is intended to cover all the debt charges associated with borrowing on the strength of credit approvals. The SSA system works by sharing a given amount of money (the ‘control total’) between authorities. The way the total is decided and the way the money is shared out are essentially quite separate operations.

Deciding the total

39. Three separate SSA totals are important. These are for:
- gross debt charges,
- interest receipts earned on set-aside capital receipts, and
- other interest receipts.
The control totals used for SSAs are estimates of the actual debt charges and interest receipts that authorities are expected to incur or obtain. Some debt charges are excluded, however, as they relate to debts paid for by others or debts which the Government does not think it appropriate to support – such as those related to public transport projects. Such estimates are, however, necessarily approximate; debts and interest receipts are difficult to untangle in authorities’ accounts, and interest rates are unpredictable. The totals for interest receipts are, of course, negative rather than positive (they reduce the amount of SSA that an authority is entitled to get).

40. **Gross debt charges**. The total is shared by reference to a notional measure of the authority’s debt and a standardised calculation of its associated debt charges. The notional debt relates to debt acquired over many years and under several previous capital finance systems. It may bear little relationship to an authority’s actual debt.

41. **Interest earned on set-aside capital receipts**. The total is shared between classes of authority (for example, county councils, metropolitan districts) on the basis of their past share of actual interest on set-aside receipts. The class totals are then shared between authorities in proportion to their level of notional debt.

42. **Other interest receipts**. The total is again shared between classes of authority, but on the basis of their relative share of actual interest receipts. The class totals are then shared between authorities in proportion to overall SSAs.

**Example of the impact of grants and credit approvals on revenue costs**

43. A study of the impact of grants and credit approvals on three imaginary authorities is shown in the example below.

**Authority A**

44. Authority A receives a capital grant of £1 million. Such grants are normally only paid in full once expenditure has been undertaken and an audited claim submitted. The authority will have to borrow in the short term, until the grant is paid, but there are no other financial consequences. The capital is, in effect, free to the authority.

**Authority B**

45. Authority B is spending at the Government’s approved level (the SSA). It receives a credit approval of £1 million. This county council can expect an increase in SSA, and hence in RSG, in future years to support the charges associated with its increased debt. In practice, though, the increase in SSA will be less than the increase in its actual debt charges (the interest and repayment of principal on loans) for several reasons.
Firstly, support given through the SSA formula is normative, applying to all authorities equally. It therefore assumes a set rate for repayment of principal (4 per cent for each year after the first) and a set interest rate (8.9 per cent in 1997/98). Authority B might therefore hope to receive 4 per cent of £1 million plus 8.9 per cent (or whatever standard rate is applied for that year) of £1 million in increased RSG each year. (Technically, as each year goes by, the £1 million reduces by 4 per cent as principal is notionally repaid.) But this is not the case for two reasons:

- Firstly, the SSA formula for capital financing distributes a fixed amount (the government-assessed need for total local authority spending on debt charges) between authorities on the basis of a cumulative ‘notional debt’ for each. Although Authority B’s notional debt increases by £1 million, there is no guarantee that the total of cumulative ‘notional’ debts will correspond to the assessed ‘real’ need for debt. In practice, a scaling factor is usually applied each year to bring the two into line. For 1997/98, this factor was 85 per cent – so only 85 per cent of Authority B’s normative debt charges were supported, and it will have to supply the remaining 15 per cent itself.

- Secondly, the level of notional debt is also used in a completely different part of the SSA calculation. Different classes of authority tend to differ in their ability to raise capital receipts: in particular, shire districts seem to have been able to raise more (non-HRA) receipts than others. So shire districts, as a whole, can earn interest (by investing the receipts) or avoid interest payments (by repaying debt with the receipts) to a far greater extent than other authorities. The Government has attempted partially to equalise this income-earning potential by estimating a notional figure for the amount of interest earned by each class of authority on the set-aside parts of their capital receipts. This is then treated as a negative SSA component.

But the negative SSA component is estimated only for each class of authority – not for individual authorities. A method needs to be found to apportion the negative class SSA component for interest on set-aside receipts between individual authorities. The method chosen in consultation with the local authority associations was to use the notional level of cumulative debt. The justification for this was that the more debt an authority had, the more assets it was likely to have to sell.

The upshot is that Authority B’s additional SSA for debt charges will be offset by an increase in its negative allowance for interest.

Table 1 uses illustrative figures to indicate how relative effects of the two adjustments might differ according to whether Authority B is a shire district, county, metropolitan district, London borough or new unitary authority.
50. As can be seen, the increase in SSA for a £1 million credit approval, on these figures, represents only between 36 per cent and 82 per cent of the normative amount expected.

Authority C

51. Authority C is spending well above its SSA and is capped, freezing its spending at current levels. It also receives a credit approval for £1 million and gains the same increase in its SSA as Authority B. But the increase in SSA and RSG does not lead to increased spending – rather it leads to reduced council tax. Using the credit approval means actual debt charges will increase, however, and the authority must make savings elsewhere to stay within its cap. Authority C therefore faces a harder decision than Authority B in deciding whether to borrow, and so incur debt charges. On the other hand, if the authority were to receive a grant of £1 million, it would be in exactly the same situation as Authority A, facing no revenue consequences at all.

Revenue support for HRA credit approvals

52. The above analysis applies to non-HRA credit approvals which qualify for RSG support. The debt charges resulting from the use of HRA credit approvals are supported via the HRA subsidy mechanism. Subsidy is also given on a normative basis – in this case allowing 2 per cent for debt redemption but with the same standard rate of interest as for SSAs. But, in broad terms, subsidy is based on actual debt net of actual set-aside housing receipts (technically the HRA credit ceiling for subsidy purposes). Consequently, problems relating to the scaling of notional debt figures and the fair distribution of interest on set-aside receipts do not arise.
5 The Welsh Capital Control System

53. Local authorities in Wales operate under essentially the same legal control system as in England. Much of the system – basic credit approvals (BCAs), supplementary credit approvals (SCAs), credit arrangements and the set-aside of capital receipts – is the same. However, the method used by the Welsh Office to allocate grant and credit approvals differs markedly:

- BCAs are based on a formula agreed with the Welsh Local Government Association. The formula covers such factors as population, housing stock condition, pupil numbers, and unemployment. In 1996/97 BCAs, SCAs and capital grants were issued broadly in the ratio 30:30:40;
- the system of receipts taken into account (RTIA) when allocating capital resources was used up to 1995/96 but abandoned after local government reorganisation. Analysis suggested that the redistributive effect of RTIA over time was very weak in Wales;
- transport resources for major schemes – £5 million or more – are generally issued as 50 per cent Transport Grant and 50 per cent SCA. The equivalent limit for Transport Supplementary Grant (TSG) in England is £2 million;
- over two-thirds of resources for housing go to the private sector rather than to council housing, compared with about a third in England. Authorities are asked to produce housing strategies for the Welsh Office, and the award of housing SCAs for specific initiatives – such as ‘Area Renewal’ or ‘Estate Partnership’ – may depend on Welsh Office approval of the strategy; and
- there is no Single Regeneration Budget (SRB) in Wales. The broad equivalents for regeneration activity are the Strategic Development Scheme (SDS) and Welsh Capital Challenge (WCC). Until recently the allocation methods for SDS were similar to those formerly used for the Urban Programme in England, but support for new SDS schemes is now being distributed to authorities by formula. WCC was introduced for 1997/98. It is broadly equivalent to the pilot Capital Challenge Fund in England, although funding is more limited and the leading role of local authorities is guaranteed. Funding for SDS and WCC is normally 75 per cent grant and 25 per cent SCAs.

54. The use of formula-based BCAs and a higher cut-off for TSG funding means that authorities are much freer to decide their local spending priorities than in England. The contrast is most obvious for education: Welsh authorities have complete freedom over how to use their capital allocations, while English authorities are heavily constrained by government-imposed criteria for ‘basic need’. However, any comparison of the capital-control systems in Wales and England needs to take into account the following factors:
the differences between authorities in Wales tend to be less extreme than those in England. There are neither the inner city problems of Liverpool or Manchester, nor the comparative wealth of the Home Counties; and

relationships between local authorities and the Welsh Office appear much closer than those in England. Reasons for this may include:

- the smaller number of authorities,
- the single Secretary of State,
- relatively higher levels of state funding, and
- the Welsh Office policy of regarding the new unitary authorities as the strategic planning authorities for their areas.
6 The Demand for Local Authority Capital Expenditure

55. The Audit Commission’s evaluation of the capital control system has to be set in the context of the current debate about the adequacy of local authority funding. This requires a broad assessment of the difference between local authorities’ demand for capital expenditure and the resources available to them. The study team has approached this task by:

- drawing together from central government, local government and other sources the available data on the demand for investment on a service-by-service basis;
- evaluating the reliability and accuracy of the data;
- drawing on the results of previous Audit Commission studies, particularly where they provide a useful model for assessing present and future demand; and
- relating the data to the current level of available capital resources.

56. The services analysed in this paper cover all the main local authority services except for the police service. The services are education, housing, social services and transport. The paper also looks at those services falling within the ‘other services’ block (OSB). Given the very wide spread of services this includes, the block has for the most part been analysed as a whole. However, three areas where more detailed information is readily available – the fire service, libraries and sports centres – have been examined in greater depth.

57. The term ‘demand for capital expenditure’ is a general one. For the purposes of this paper it focuses on two main areas:

- backlog and maintenance/improvement costs (‘backlog’ refers to maintenance arrears that need to be addressed to bring buildings up to a safe and acceptable standard; ‘maintenance/improvement’ covers the cost of keeping facilities in a sound condition. However, since maintenance often results in improvements, is tied in with upgrading a property, and may be split between revenue and capital, it is not always practical to separate the two elements); and
- demographic, social and legislative costs.

58. Each section has a conclusion summarising the key points relating to a service.
59. Central government’s view of the relative need for capital expenditure on education is expressed by education Annual Capital Guidelines (ACGs). In cash terms, overall ACGs have been fairly stable since 1993/94 when further education colleges ceased to be the responsibility of local education authorities (LEAs) (Exhibit 3).

60. The Department for Education and Employment (DfEE) sets each local education authority’s ACG in the light of capital spending plans that the authority submits in the annual bidding round. The ACG is made up of a number of components which have a significant bearing on the distribution of education capital and on the availability of funds for maintaining school buildings:

- **basic need** (BN) is allocated where there is a requirement for additional school places in areas of population growth, and where there is no more capacity in all county, voluntary and grant-maintained (GM) schools in the surrounding area. BN is spread across three years in the ratio of 35:50:15. In 1996/97 Basic Need and Exceptional Basic Need (explained below) accounted for three-quarters of new ACG commitments;

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**Exhibit 3**


Overall, ACGs have been fairly stable since 1993/94.

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Source: DfEE
exceptional basic need (EBN) is an emergency sub-category of BN. It allows for the complete replacement – not repair – of condemned, unsafe or structurally unsound school buildings. But it is only allocated if a building will have to be taken out of use in the next 12 months, if repair is impracticable or more expensive than replacement, and if no alternative provision exists. The sums allocated to EBN are relatively small; for 1996/97 the Annual Capital Guideline for spending on the first year of new schemes was £6.1 million;

surplus place removal (SPR) is allocated for projects to remove permanent or temporary accommodation. Schemes have to pass a cost-effectiveness test to qualify for an SPR allocation – annual recurrent savings from removing the places have to be 8 per cent or more of the net capital cost of the project; and

formula allocation for improvement/replacement (I/R) has been used to distribute any DfEE capital resources remaining after distribution to the priority categories. In schools, these resources are used for improvement and replacement schemes – including rewiring, energy-conservation, fire precautions, means of escape and capital expenditure on health and safety (the formula also covers all capital work in the youth service, adult education and most site purchases). Until 1997/98 this money was allocated by a formula based on cash plans and pupil numbers, with allocations spread over two years in the ratio of 75:25. From 1997/98 all resources for this type of work will be channelled through the Schools Renewal Challenge Fund.

61. The Schools Renewal Challenge Fund was introduced in 1996/97 and will continue for a second year in 1997/98. Its purpose is ‘to support specific innovative projects to renew, repair, or improve school capital stock that secure good value for money and enhance effectiveness of provision in partnership with the local community and the private sector’. Supplementary credit approvals of £20 million were issued for new projects in 1996/97, together with £20 million of provisional forward commitment to support these projects in the following two years. In 1997/98 £20 million has been set aside for new projects. This may be supplemented if the DfEE’s reserve capital resources are not required, and may again be accompanied by provisional forward cover for projects lasting more than one year.

62. Although the overall cash level of Education ACG has remained stable, its formula element for improvement and replacement work has been cut dramatically. The reason appears to be that other pressures – that is, pupil growth and the removal of surplus places – have had first call on a cash-limited pot, leaving smaller sums for improvement/maintenance. However, Exhibit 2 does not tell the full story. The EBN scheme, for example, provides modest assistance for tackling school buildings in the worst conditions. And the research undertaken for the Commission’s 1996 study into the planning of school places revealed that LEAs were often able to use the SPR provision to rationalise sites and improve the overall condition of their schools.
In the short term, local authorities have been able to soften the impact of declining government support for their capital expenditure by increased use of capital receipts and contributions from their revenue budgets. LEAs have been financing an increasing proportion of capital spending from these resources (Exhibit 4). In the longer term, however, capital receipts are a finite resource and local authority revenue budgets are under pressure from conflicting demands. Local authorities consider levels of education capital spending to be inadequate. They argue that ‘for the education service the overriding need is to address the neglect, through lack of resources, of the existing building stock’ (Ref. 1).

From 1997/98 a proportion of the credit approvals that would have formed part of local authorities’ school capital programme in 1996/97 is being distributed through the cross-service Capital Challenge Pilot scheme. It is estimated that capital projects related to education will be supported by credit approvals of about £104 million over the three years of the pilot scheme.

The system is theoretically not as rigid as it appears. Although capital allocations are assessed and distributed under a number of distinct headings, the ACG for each authority is allocated, after deductions for receipts taken into account (RTIA), in the form of a Basic Credit Approval (BCA). This means that authorities have flexibility as to how to use the allocation. They do not have to use BCAs on the projects for which ACGs were made. In practice, however, the DfEE acknowledges that there is strong pressure on local authorities to apply their allocations in the way in which they bid for them.

Exhibit 4
Local authority self-financed capital spending as a proportion of total capital spending on education services

LEAs are financing an increasing proportion of education capital spending from their own resources.

Note: On 1 April 1993 the funding of further education and sixth form colleges was transferred from local authorities to the Further Education Funding Council.

Source: DfEE and DoE (figures for 1995/96 and 1996/97 are based on estimates)
66. In 1996/97, capital grants amounting to £62.6 million were made to voluntary-aided schools, of which £7.4 million was distributed using a formula. Capital expenditure by grant-maintained (GM) schools is excluded from the calculation of the public sector borrowing requirement (PSBR) and distributed by a separate system of categories (Table 2 and Box D).

### Table 2
**Capital allocations to GM schools**  
1994/95–1996/97

<table>
<thead>
<tr>
<th>Year</th>
<th>1994/95</th>
<th>1995/96</th>
<th>1996/97</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital allocation (£ million)</td>
<td>124.6</td>
<td>145.25</td>
<td>138</td>
</tr>
</tbody>
</table>

*Source: DfEE*

### Box D
**Capital allocations for GM schools**

GM schools obtain capital grants from the Funding Agency for Schools (FAS), which makes allocations under the headings of BN, SPR, an I/R formula, Challenge Funding, Disability Access Initiative and urgent health and safety work (Table 3). In 1996/97, the I/R formula allocation gave each GM school £12,000 plus £28 per pupil, with a minimum allocation of £18,000.

The I/R formula allocations mean that in 1996/97 GM schools are receiving on average around £28,000 each. The equivalent figure for LEA-maintained schools is around £600. The DfEE points out that most improvement/replacement work in county and voluntary-controlled schools (at present running at over £300 million a year) is funded by local authority capital receipts and revenue, rather than credit approvals. In addition while five out of six GM schools are secondary, five out of six LEA-maintained schools are in the primary sector. This is significant, because secondary schools are larger and consequently have higher maintenance costs.

In addition to formula allocations, capital grant is also made available by the Agency for new buildings or for improvement of existing stock. Funding is allocated according to priorities set each year by FAS with guidance from the Secretary of State. For 1997/98 the FAS priorities are: commitments from previous years; expanding schools where there is a need for new school places (basic need); implementing statutory proposals that have been approved by the Secretary of State; and funding for emergencies and high-risk health and safety work.

The Agency also operates a ‘Challenge’ funding scheme, under which schools are expected to contribute a proportion of their own funds in return for a capital grant from the agency.

GM schools are allowed to carry one year’s formula capital allocation into the next, and under the Nursery Education and Grant Maintained Schools Act 1996 are now able to finance capital projects through capital borrowing.
Backlog, maintenance and replacement costs

Association of County Councils’ (ACC) and Association of Metropolitan Authorities’ (AMA) survey

67. The DfEE has no national estimate of maintenance work. It considers that ‘it is for local education authorities and school governors to assess the need for maintenance work in respect of school premises which they own and maintain’ (Ref. 2). Partly as a consequence of this approach, the local authority associations carried out a survey in 1995 (Ref. 3) to establish the backlog of maintenance and improvement work in education buildings. Officers were asked to identify specific deficiencies in school accommodation and the cost of landlord work needed to keep school buildings in use, in particular where failure to carry out the work would require closure of the building in whole or in part. The national response rate was 75 per cent, and national figures were obtained by grossing up the results from those authorities which had responded.

68. The survey asked authorities to break down their estimate of the expenditure required into three categories: buildings (internal and external); engineering (mechanical and electrical); and external (boundaries, roads, playing fields, etc). The results, when compared on a per-pupil basis, show significant variations between authorities’ estimated needs (Exhibit 5, overleaf). Differences in the age and condition of buildings would account for some of the variation, but the scale of the differences suggests that the requirements of the survey may have been interpreted inconsistently. This variation also makes it difficult to make robust estimates for those authorities that did not respond to the survey. Taking the lowest and highest estimates per pupil for each type of authority produces a total need for capital expenditure of £193 million to £640 million per year over the next five years.

<table>
<thead>
<tr>
<th>Category</th>
<th>Allocation (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Committed expenditure</td>
<td>63.0</td>
</tr>
<tr>
<td>Basic need and surplus place removal</td>
<td>23.2</td>
</tr>
<tr>
<td>Improvement/replacement formula</td>
<td>30.8</td>
</tr>
<tr>
<td>Disability Access Initiative</td>
<td>1.0</td>
</tr>
<tr>
<td>Challenge funding</td>
<td>4.0</td>
</tr>
<tr>
<td>Contingency and health and safety</td>
<td>16.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>138.0</strong></td>
</tr>
</tbody>
</table>

*Source: FAS*
Exhibit 5
Need for spending per pupil over the next five years on school buildings

There are significant variations between authorities' estimated needs.

Source: AMA/ACC

69. The survey also highlighted the improvement work required in three other areas – the replacement of outside toilets and temporary classrooms and the improvement of school halls. Over 600 primary schools are having to rely on outside toilets. Over 25,500 classes are being taught in temporary classrooms every day – which, assuming 30 pupils in a class, represents 765,000 children. The local authority associations argued that all these temporary classrooms should be replaced over the next five years at a cost of £700 million. There are also nearly 2,000 primary schools with school hall facilities that are considered inadequate to deliver the PE national curriculum.

70. There is clear evidence of a backlog of work needed to bring school buildings up to an acceptable standard, but it does not follow that all the potential expenditure identified in the survey represents unfulfilled demand for capital expenditure. Even with unrestricted capital, temporary classrooms would still be a cost-effective way to meet short-term mismatches between supply and demand. And building a new school hall is only one way of ensuring that a school can meet the PE national curriculum; joint use of other community facilities – such as a parish hall – may provide an acceptable alternative.
SCALA surveys

71. A further source of information on the education building maintenance backlog is the regular survey by the Society of Chief Architects of Local Authorities (SCALA). The latest published SCALA estimates date from March 1997 and give figures up to and including 1996/97 (Ref. 4). While the society has made strenuous efforts to raise the response rate to its questionnaire, it has still been completed by only 17 per cent of authorities in England and Wales. For English education authorities the response rate varies from 12 per cent for the London boroughs to 49 per cent for the county councils. Caution is also required when making comparisons of this new data with the figures for earlier years, since different local authorities have returned questionnaires from year to year. SCALA concludes that under-funding of building maintenance continues to be a widespread problem with the finance allocated being lower than the perceived need.

1988 Audit Commission study

72. In 1988 the Audit Commission published a handbook on local authority property management. It included an examination of the school building programme from 1945 to 1985 (Ref. 5) and showed that the peak period for building schools and providing extra places was between 1960 and 1975, reaching a peak in the early 1970s. The study team then produced a computer model to produce a crude estimate of the expenditure likely to be needed as the stock of school buildings aged. This predicted maintenance need rising steeply from the mid-1990s and not peaking until around 2009.

73. The forecast is supported not only by the ACC/AMA survey but also by the Commission’s 1996 questionnaire, which asked local authorities to identify their greatest problems with the current education ACG system. Neglect of basic maintenance emerged as the biggest issue (Exhibit 6).

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Exhibit 6
LEAs’ opinions on the problems with the current education ACG system

Neglect of basic maintenance emerged as the biggest issue.

Source: Audit Commission survey of local authorities
Demographic, social and legislative costs

74. The current method of distributing capital resources means that spending to meet population growth and changes in pupil distribution is squeezing out other demands on capital. The pressures that give rise to this trend are likely to intensify over the medium term. Although the number of pupils in the primary sector is projected to remain stable, the number in the secondary sector is set to rise by 11 per cent before stabilising around 2005 (Exhibit 7). However, the overall figures disguise the complexity of the problem. Research in local education authorities, carried out by the Commission’s study team on planning for school places, showed that:

◆ the projected rates of population vary widely between LEAs;
◆ there can be significant variations between different areas within an LEA; and
◆ not all the extra pupils will require new spending, as the system contains around 900,000 surplus places. However, these places are not evenly distributed across schools and are not necessarily in areas of population growth.

75. In 1995 and 1996/97 the DfEE provided BN allocations for around two-thirds of the growth in secondary school pupil numbers. Taking this proportion, and applying the DfEE’s formula for calculating the capital cost of a secondary place for an 11–16-year-old to the increase in the secondary school population between 1997 and 2001, indicates that a sum of around £650 million will be required in total over five years.

Exhibit 7
Forecast of pupil numbers, 1996–2005, England and Wales

The number of pupils in the secondary sector is set to rise by 11 per cent.

Note: Pupil numbers expressed as full-time equivalents (FTE) and including pupils in GM schools.

Source: DfEE and the Welsh Office
76. Factors other than the purely demographic should also be considered. Curriculum-led changes, IT developments and the need for increased security in schools are likely to result in demands for increased capital spending.

Conclusions

77. Four main conclusions can be drawn from the evidence on the demand for education capital expenditure:

- central government capital support for local education authorities is broadly stable in cash terms, but it is being directed towards the consequences of pupil growth and changes in pupil distribution at the expense of spending on maintenance of school buildings;

- estimates of the additional spending needed to maintain school buildings in use range from £193 million to £640 million per year over a five-year period;

- the demand for maintenance spending on school buildings is both a short-term and a medium-term problem, and is unlikely to peak until the end of the first decade of the next century; and

- the continuing rise in the secondary school population and the associated distributional consequences are likely to cost approximately £650 million in total over the next five years.

Fire service

78. The local authority associations have used a Home Office Services Expenditure Forecasting Group to assess the spending requirements of the fire service. This has reported annually as part of the public expenditure discussions between central and local government. Table 4 summarises this group’s recent estimates of fire service capital expenditure requirements, based on a regular survey of fire authorities.

79. The group’s 1996 report forecasts a rise in the need for fire service gross capital expenditure to £130 million in 1999/2000.

<table>
<thead>
<tr>
<th>Year</th>
<th>Gross capital expenditure requirement for year (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994/95</td>
<td>85 (minimum)</td>
</tr>
<tr>
<td>1995/96</td>
<td>100 (minimum)</td>
</tr>
<tr>
<td>1996/97</td>
<td>95.3</td>
</tr>
<tr>
<td>1997/98</td>
<td>114.6</td>
</tr>
</tbody>
</table>

Source: Local Authority Associations (Home Office Services Expenditure Forecasting Group)
80. In contrast, net capital spending by the fire service since the introduction of the present capital control system climbed from £50.1 million in 1990/91 to a peak of £73.7 million in 1994/95. The fire service argues that the gap in capital funding prevents the rationalising of fire stations to improve operational efficiency and results in the expensive maintenance of ageing, or even life-expired, buildings. In addition to this ongoing demand for capital spending there is a need to finance new initiatives and service improvements. For example, about £60 million in total may be needed in a programme, likely to start in 1999, to replace ageing radio systems, unless the project is dealt with under the Private Finance Initiative.

81. Fire authorities in England were able to bid for an allocation of credit approvals under the Capital Challenge pilot scheme. There were bids from 16 fire authorities, and 9 secured support amounting to £18.7 million in total over the three years from 1997/98. In November 1996 fire services were invited to bid for financial support towards the costs of developing a number of pathfinder Private Finance Initiative projects. This support will amount to a grant of about £70,000 to each project in 1997/98 towards the professional fees and other costs incurred in developing these pilot schemes. Eight bids involving ten brigades have been chosen for pathfinder status.

Housing

Overview

82. Housing is the largest component of local authority capital expenditure. In 1995/96 capital spending on council housing totalled around £1.7 billion. Although the overall level of expenditure has declined significantly during the 1990s, the amount spent on renovation has been more stable (Exhibit 8).

83. The number of council homes has also been decreasing. Between 1990 and 1996 the number of dwellings went down by around 350,000. About half this fall was due to homes being transferred to housing associations under the Large Scale Voluntary Transfer (LSVT) arrangements, with most of the remainder coming from the sale of homes to tenants. The other key development during the 1990s has been the increase in local authority housing rents. These rose from a weekly average of £23.74 in 1990 to £40 in 1996 – an increase in real terms of 38 per cent. This increase has generated additional resources for maintaining and improving the local authority housing stock.

84. In addition to capital resources for local authority housing, local authorities also provide home improvement grants for low-income households in private accommodation. Sixty per cent of the grant is reimbursed by the government, with the balance met from a local authority’s own resources. In 1995/96 around £550 million was paid out in home-improvement grants. However, the Housing, Construction and Regeneration Act 1996 meant that the system became discretionary rather than mandatory, although a specific capital grant for this work was maintained. This is likely to result in local authorities switching spending away from private-sector home improvements, particularly as the Government has reduced the capital grant for 1997/98 by 12 per cent.
Exhibit 8
Local authority capital expenditure on renovation as a proportion of total direct investment, 1990/91–1995/96

The overall level of expenditure has declined significantly during the 1990s, but the amount spent on renovation has been more stable.

Notes: Cash figures have been converted to 1995/96 price levels. ‘Renovation’ includes Single Regeneration Budget funding earmarked for estate action projects – £316 million in 1995/96 and £257 million in 1996/97.

Source: DoE, Housing Data and Statistics, March 1996

Backlog, maintenance and replacement costs

Audit Commission model

In 1986 The Audit Commission published a report on *Improving Council House Maintenance* (Ref. 6). The research showed that:

- the method of construction was an important determinant of maintenance needs. The report calculated, for example, that the average backlog of maintenance on dwellings of non-traditional construction was about £2,500 per dwelling higher than on those of the same age built by traditional methods; and

- as dwellings age, more maintenance work and improvements are required. The Commission’s analysis found that traditionally constructed houses built from 1919 to 1944 had an average backlog of maintenance and improvements of £6,000 per dwelling, whereas for those built after 1964 the backlog was only £2,000. The problems were not the same everywhere. Maintenance needs were highest in London and the metropolitan districts.
86. The information supplied by local authorities for the 1996/97 Housing Investment Programme (HIP) bidding cycle illustrates the relevance of this analysis (Exhibit 9). It highlights the maintenance pressures facing authorities as a result of the post-war construction boom between 1945 and 1965 and the vogue for non-traditional construction from 1945 to 1974.

87. The 1986 Commission report included a financial model which gave a broad estimate of the effect of an ageing stock on the need to replace various building elements. The model suggested that expenditure on programmed repairs needed to be £1.37 billion (£282 per dwelling) in 1986 and be increased to a total of about £1.71 billion (£352 per dwelling) for the period 1986–2000, all at 1985 prices.

88. Spending on programme maintenance is not separately identified and monitored in either CIPFA or DoE published statistics. Furthermore, a report published in 1996 showed that authorities varied in how they charged housing repair work to revenue or maintenance budgets (Ref. 7). As a result, capital and maintenance expenditure have to be considered together in assessing actual spending against the Audit Commission’s earlier analysis. Exhibit 10 compares the earlier projection of the required expenditure per dwelling with actual capital renovation spending per dwelling and revenue maintenance per dwelling since 1985. The starting point in 1985 is based on local authority assessments of the work required. As all data is shown at 1986 prices, the precise comparison may be altered by the use of alternative cost indices.

Exhibit 9
Profile of present-day local authority housing stock by construction type, 1945–post 1974

Authorities face maintenance pressures as a result of the post-war construction boom.

Source: DoE
Revenue maintenance and capital renovation: index changes since 1985/86

Capital spending on renovation has declined since 1990, relative to 1985/86.

Note: 1985/86 = 100; adjusted for price changes using GDP deflator.

Source: Audit Commission analysis of DoE data and Audit Commission modelling

Two significant points emerge from the index:

- in the period leading up to 1990 capital expenditure on maintenance increased, because under the previous capital control system authorities could use 100 per cent of their receipts from council house sales and other sources for maintenance, but were restricted in the use of them for other purposes, such as building new homes. Expenditure was particularly high in 1989/90, because that was the last year of the old system. The Commission calculated in 1992 that the effect of this spending had been to reduce the housing maintenance backlog to £8.5 billion at 1991 prices (Ref. 8). Since 1990, capital spending on renovation has fallen back to its 1985/86 level; and

- spending on revenue maintenance has shown a modest (but in real terms steady) increase over the last decade. The higher rent levels noted above are feeding through into increased maintenance standards. Lower levels of capital renovation are, therefore, being offset by higher levels of revenue maintenance. However, from the evidence available it is not possible to say whether this higher revenue spending is being directed towards programme maintenance or more immediate repairs arising from a longer-term failure to address renovation problems.

English House Condition Survey

The 1991 English House Condition Survey (EHCS) (Ref. 9) obtained data on 21,133 dwellings, and had internal access to 57 per cent of them. The sample covered 5,800 local authority dwellings, including 159 vacant dwellings. Although the sample is not large enough to draw conclusions about individual authorities, the survey does provide a useful overview of the local authority housing stock. It gives three measures of repairs:
- **urgent repairs** – including only those items regarded by the surveyor as needing urgent action (i.e., those works needed to remove threats to the health, safety, security and comfort of the occupants and those needed to forestall further rapid deterioration in the building). This level of repair can be interpreted as ‘serious and immediate’ problems requiring action within the year;

- **general repairs** – taking in all those works identified by the surveyor as needing to be done within five years, including repairs to fabric, services and amenities. It does not take into account the replacement of building elements where these could be delayed by short-term repairs; and

- **comprehensive repairs** – taking in ‘general repairs’ and including the replacement of building elements which the surveyor felt had less than ten years of remaining life. This measure provides a better basis for predicting the annual investment required over an extended period and broadly corresponds with the components of a local authority or housing association ‘rolling programme’ of repairs. It is also the approach nearest to that used by the Audit Commission in developing its 1985 replacement cost model.

91. The EHCS survey does, however, exclude certain items: lifts, external water tanks, fire precautions, landings and works on other communal areas. In addition its definition of ‘repairs’ does not include improvements – for example, updating kitchen facilities or replacing outside toilets with internal ones. However, based on the EHCS definitions, the average cost of repairs to a local authority dwelling was estimated at £620 for urgent repairs, £930 for general repairs and £1,790 for comprehensive repairs. In overall expenditure terms the backlog for comprehensive repairs to the local authority housing stock in 1991 amounted to nearly £7 billion at 1991 prices (Exhibit 11). This equates to about £8 billion in today’s prices. The equivalent figure for Wales is around £250 million.

**Exhibit 11**

**Cost of repairs to local authority housing stock based on EHCS definition**

The backlog for comprehensive repairs amounted to nearly £7 billion at 1991 prices.

<table>
<thead>
<tr>
<th>Total (£ billion)</th>
<th>Urgent repairs</th>
<th>General repairs</th>
<th>Comprehensive repairs</th>
</tr>
</thead>
<tbody>
<tr>
<td>7</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>0</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Source: EHCS and DoE*
The 1991 EHCS did not suggest a significant difference between the levels of work needed in traditional and non-traditional dwellings. This contrasts with the 1985 survey used in the Audit Commission’s report on *Improving Council House Maintenance* (Ref. 6). Several reasons may be advanced for the EHCS not supporting the earlier survey’s evidence of a need for a more substantial investment per dwelling of non-traditional construction. The original survey may have been inflated because the DoE had only recently announced that substantial work would be needed on these properties. Alternatively, in the period between two surveys local authorities may have dealt with the high-cost work on non-traditional construction. Finally, as the surveys used in the EHCS were only visual, they may not have picked up defects in system-built stock.

The average condition of local authority housing stock is broadly comparable with owner-occupied stock. However, the EHCS showed that the condition of the private rented stock was significantly worse. Comprehensive repairs were estimated at £3,540 per dwelling. This means that there is a £7 billion backlog at 1991 prices for this sector. The main responsibility for addressing this lies with the owners of the properties, though the findings also have implications for levels of home-improvement grant.

The Chartered Institute of Housing

A report commissioned for the Chartered Institute of Housing (CIoH) estimates ‘the total current investment requirements for council housing renovation ... as being closer to £20 billion’ (Ref. 10). The report reaches this sum by taking the EHCS figure for comprehensive repairs and then increasing it to allow for the following factors:

- stock condition surveys undertaken for LSVT transfers have ‘typically identified investment requirements 50–100 per cent higher for “catch-up repairs” than identified in the EHCS survey’. The main reason for this, the report argues, is that the definition of catch-up repairs includes some provision for modernisation and upgrading as part of the essential repair process;
- urban authorities with large estates comprised of flats, which account for around half the stock, are likely to have higher-than-average repair costs; and
- significant sums are needed to improve estate and dwelling security.

While the CIoH is correct in identifying some significant omissions from the EHCS assessment, such as the cost of lifts and fire precautions, its report does not include a methodology for converting the needs identified into cash sums. The figures should, therefore, be treated with some caution.
Local stock-condition surveys

96. A further potential source of data are the stock-condition surveys carried out locally by housing authorities as part of the HIP process. However, the problem with drawing conclusions from this data is that the surveys vary in type and frequency (Exhibit 12). Independent research carried out for the DoE reported that ‘while authorities are increasingly using stock-condition surveys as a means of assessing repairs and maintenance need, government offices see little consistency in the methodology used, either for conducting the surveys or converting the data into repairs and maintenance programmes’ (Ref. 11). For the 1997/98 HIP bids the DoE asked authorities to make estimates of the backlog on maintenance, based on their local assessments.

Demographic, social and legislative costs

97. The Government’s latest projections (Ref. 12) show an increase of 3.5 million households in England and 176,000 in Wales between 1991 and 2011. As with pupil projections, the picture is not uniform across England. East Anglia and the south-west have the highest proportionate increases, while Merseyside and the north-east have the lowest. The local authority associations also point to the one million households on their waiting lists and the 50,000 homeless households as further evidence of the need for an increase in new local authority housing stock. In practice, whether these trends produce significant new demands for local authority capital expenditure will depend on development of the social housing sector and of local authorities’ statutory housing responsibilities.

98. Research undertaken for the DoE suggests that the social housing sector will need to provide between 66,000 and 100,000 additional social housing units per year over the next 10 years to help meet this demand. The rest of the demand is to be met from the private and private rented sectors. A report by the Joseph Rowntree Foundation concludes that the number of additional social housing units needed up to 2001 is around 90,000, with over 100,000 required in the period thereafter (Ref. 13). However, this increased social housing demand does not necessarily imply any significant increase in local authority capital spending, because single-person households are not usually entitled to new local authority tenancies. Of the projected net increase in households, 78 per cent in England and 84 per cent in Wales comprise one-person households. At present housing associations are building or converting around 40,000 new units per year, and other initiatives, such as shared ownership and tenant incentive schemes, are providing around a further 20,000 social housing units.
Conclusions

99. Six main conclusions can be drawn from the evidence on the demand for housing capital expenditure:

- local authority capital expenditure on housing renovation has been relatively stable, though it has declined in real terms in the last two years;
- the decline in capital spending has been offset by an increase in the level of revenue maintenance, though on the evidence available it is not possible to conclude whether this is being directed towards improving programmed maintenance or used on immediate repairs to make up for the absence of a more programmed approach;
- the profile and ageing of the housing stock is likely to create an increased demand for maintenance support;
- there is a substantial backlog of local authority housing maintenance which, excluding improvements, may be in the region of £8 billion. Assuming that current levels of spending (capital and revenue) mean that it is getting no worse, an extra £1.6 billion is needed each year for the next five years to clear this backlog;
- the maintenance backlog for the privately rented sector will create a continuing demand for capital support from central and local government; and
- the main new demand for housing capital expenditure will be for the provision of additional social housing units, but on current policies housing associations are likely to be the main vehicles for providing these.

Overview

100. Local authority capital spending on arts and libraries in 1994/95 was £62 million, of which around £36 million was on libraries (Ref. 14). Provisional figures show the amount for arts and libraries in 1995/96 down to £50 million, but up slightly in 1996/97 to £56 million. The only central government capital support for this funding is a notional element in the ‘Other Services Block’ ACG. However, libraries are now benefiting from the National Lottery. By the end of June 1996, 13 libraries had received awards totalling £8.4 million.
Backlog, maintenance and replacement costs

101. In 1994 the Federation of Local Authority Chief Librarians (FOLACL) carried out a capital needs audit of all public libraries in England and Wales (Ref. 15). Its objective was to produce an informed estimate of the need for capital expenditure in the library service for the next five years, so as to help the Department of National Heritage make a case for adequate funding. The survey, therefore, attempts not to measure a backlog but to identify a realistic five-year programme. Chief librarians were asked to include only those projects that could be realistically coped with in a five-year period, were funding to be available.

102. The overall response rate was just over 70 per cent, although there were significant variations across the classes of authorities. Ninety per cent of London boroughs responded but less than 40 per cent of Welsh districts and counties. Overall figures on the need for capital funding were calculated by extrapolation, using the per capita averages for each class of authority. However, FOLACL noted that authorities adopted different approaches towards capitalising expenditure – particularly that for buying book stock and library IT and other equipment. Disregarding these items, the survey identifies a need for £538 million over the next five years (Table 5).

103. Over half the expenditure is needed for new buildings (Exhibit 13). The nature of the survey makes it impossible to assess whether these are needed to replace libraries that have come to the end of their serviceable life or to improve the quality of the local service. Just under £50 million of the £170 million identified as needing to be spent on existing buildings falls under the heading of repairs; most of the rest is needed for adaptations and extensions. The sum for computer equipment reflects the increasing role that IT is playing in access to information services.

### Table 5
Capital needs of public libraries in England and Wales

<table>
<thead>
<tr>
<th>Class of authority</th>
<th>Gross capital needs (£m)</th>
<th>Adjusted capital needs (gross needs less spending on books and library equipment)</th>
</tr>
</thead>
<tbody>
<tr>
<td>London boroughs</td>
<td>111.9</td>
<td>92.4</td>
</tr>
<tr>
<td>Metropolitan districts</td>
<td>189.7</td>
<td>154.8</td>
</tr>
<tr>
<td>English counties</td>
<td>283.2</td>
<td>263.6</td>
</tr>
<tr>
<td>Welsh districts</td>
<td>3.7</td>
<td>2.7</td>
</tr>
<tr>
<td>Welsh counties</td>
<td>24.4</td>
<td>24.4</td>
</tr>
<tr>
<td>Total</td>
<td>612.9</td>
<td>537.9</td>
</tr>
</tbody>
</table>

Note: The figures for Wales reflect the distribution of the library function between counties and districts in Wales in 1994.

Source: FOLACL.
Over half the expenditure is needed for new buildings.

Demographic, social and legislative costs

104. Awards from the National Lottery are likely to play an increasing role in the development of new library services. This will create a demand on local authorities to provide matched funding. For example, the unsuccessful local authority millennium bid to connect all public libraries to the Internet involved authorities finding £45 million in matched funding, in addition to the computer-related expenditure identified by FOLACL. A major libraries project in Norwich is still under consideration for Lottery funding.

Conclusions

105. Three main conclusions can be drawn from the evidence on the demand for capital for the library service:

- the FOLACL survey shows that library authorities estimate that they need a total of £538 million over the next five years to maintain adequate services. Although this estimate does not specifically identify a backlog element, this can be presumed to be encompassed within it;

- at current levels, capital expenditure by library authorities over the next five years will be £180 million. This represents a shortfall from the requirement identified by FOLACL of £358 million; and

- awards from the Lottery are likely to be an increasingly important source of funds, although the need for matched funding may affect local authorities’ ability to take full advantage of Lottery awards.
Overview

106. In cash terms, capital spending on social services rose during the early 1990s but has now levelled off (Exhibit 14). The same period has seen a fall in the number of places in local authority residential homes: from around 125,000 in 1990 to about 75,000 in 1995 (Ref. 16). More recently, central government support fell from £166 million in 1995/96 to £81 million in 1997/98.

Backlog, maintenance and replacement costs

Local authority association surveys

107. Since 1990 the local authority associations have taken two initiatives to help assess capital expenditure requirements for social services. In 1991 they undertook a survey to calculate the cost of bringing Part III residential homes up to registration standards (Ref. 17) and in 1994 authorities were asked to estimate the cost of ensuring that the physical condition of children’s homes complied with Department of Health Guidance (Ref. 18).

108. The 1991 survey used data on 343 homes in 10 authorities in England to calculate an average cost of bringing a home up to the required standard. This unit cost (£137,000) was then applied to all homes. An adjustment was made for homes that:

- needed no improvement;
- were so far below the standard that they would have to be closed; and
- might potentially be transferred to the private sector.

Exhibit 14
Local authority capital expenditure on social services, 1990/91–1996/97

Capital spending on social services rose, in cash terms, during the early 1990s but has now levelled off.

Sources: HM Treasury and DoE (figures for 1995/96 and 1996/97 are based on provisional estimates)
The adjustments made were fairly arbitrary, as there was not enough time for the associations to test them with local authorities.

109. The associations’ surveys showed that Part III homes required between £130 million and £160 million of capital to be spent on them. In the 1994 survey on children’s homes 41 authorities responded, of which 31 provided usable information on costs. The total investment needed for the 19 authorities amounted to £19.3 million which, when grossed up, indicated a total capital investment figure of £57.6 million.

Department of Health survey

110. Both the local authority association surveys suffered from a poor response rate. Further evidence, however, is available from a 1995 survey by the Department of Health (DoH) of local authority capital spending for all personal social services (Ref. 19). The survey sought information on the use of capital resources in 1994/95 and 1995/96, and on how much essential or highly desirable expenditure was likely to be deferred in 1995/96 due to lack of resources. The quality of the information supplied was variable, but grossed-up results of the survey show that:

- 45 to 50 per cent of capital expenditure was going on residential provision and 15 to 20 per cent on day care. The remainder was on aids and adaptations and office equipment;

- 56 per cent of projected capital expenditure in 1994/95, and 78 per cent in 1995/96, was spent on repairs and maintenance to meet minimum standards (as prescribed in legislation or by regulatory authorities) on refurbishing existing premises. Only relatively small amounts were being spent on new buildings: £35 million in 1994/95 and £18 million in 1995/96 – the majority going on replacing existing facilities; and

- an estimated £307 million of expenditure was deferred in 1995/96 due to shortage of resources, of which £135 million related to improvements. Expenditure on more routine repairs and maintenance (£44 million) and refurbishment/upgrades (£63 million) also had to be deferred. However, 40 per cent of the £307 million relates to residential provision, an area where independent providers have already demonstrated their readiness to make capital investment and deliver a service (Ref. 16). The independent sector now accounts for 63 per cent of the total residential and nursing-home budget, compared with 39 per cent in 1993/94. This must undermine attempts to make accurate projections of future local authority capital expenditure for this service.
Cost of demographic, social and legislative change

111. There are two particular demands which potentially affect social services. The associations have highlighted the removal of the SCA for community care technology needs, which was worth £12.2 million in 1995/96. This is particularly inappropriate, they argue, given that both the Social Services Inspectorate and the Audit Commission itself have identified the need for improved information systems. Their survey of expenditure pressures for 1997/98 identified a need for additional capital expenditure of £47 million for improved IT systems.

112. The second area affecting social services is the changing age profile of the population. The number of people aged over 75 is set to grow significantly in the early years of the next century – both absolutely and in proportion to the total population (Table 6). Although this will lead to increased demand for social services it is far from certain that all of this will feed through into demand for additional capital expenditure given the role that the private sector is now playing in the care of elderly people.

Conclusions

113. Three main conclusions can be drawn from the evidence on the demand for capital for social services:

◆ capital spending on social services has levelled off after a period of growth, and future trends are uncertain;

◆ there is evidence of a backlog of work needed to bring social services establishments up to required standards. Estimates of the scale of this work should be treated with some caution, because they are critically dependent on the evolving role of the private sector; and

◆ the need to develop effective IT systems (to manage resources and cases) and the rise in the elderly population will both add to pressures on social services budgets. In the former case the sums involved are relatively small, and in the latter they are difficult to quantify, given the growing role of the private sector in providing social care.

![Table 6](source: Government’s Actuary’s Department, Population Projections, 1994–2064)
Sports centres and swimming pools account for only a small proportion of local authority capital expenditure. In 1994/95 capital spending on all sports and recreation in England totalled £182 million, of which just over £82 million went on indoor sports and leisure centres (Ref. 20). Provisional figures for 1995/96 and 1996/97 show overall spending rising to £197 and £220 million respectively (Ref. 21). By comparison, in the period March 1995 to June 1996, the Sports Council made awards totalling £225 million in England and £17 million in Wales out of proceeds from the National Lottery (Ref. 22).

Backlog, maintenance and replacement costs

The majority of public indoor sports centres have been built since 1945, and a high proportion are less than 25 years old. The Sports Council realised that, as the stock of these centres aged, increased capital spending would be required for major repairs, renovation and replacement to maintain the quality and quantity of facilities. It was concerned that the levels of expenditure on capital repairs/replacements, which in the three years to 1993/94 were running at an average of £51.4 million per year, were inadequate. Accordingly, in 1994 the Sports Council commissioned a study of the investment needed to upgrade and maintain the post-1945 stock of both sports centres and swimming pools (Ref. 23). Ninety per cent of the centres included in the study were less than 25 years old and the average age was 18 years.

The first stage of the study collected information on just under half these centres (695 out of 1,490) to determine the condition of the stock and the capital cost of bringing it up to a safe and acceptable level (defined by reference to the standards and specifications currently applicable to new sports centres). As might be expected, the study found that, with such a young stock, centres were reported to be in relatively good or fair condition. At present, therefore, they needed either no work or only minor repair work. However, the cost of even minor works, spread over five years, amounted to £210 million.

The second part of the study developed a model to estimate the future need for capital spending across the whole stock of post-1945 sports centres. This calculated the cost of maintaining and replacing each element of the facility over a stipulated period of time. Box E illustrates the key parameters used.

**Box E**
Illustration of lifecycle costs for a roof

<table>
<thead>
<tr>
<th>Roof element</th>
<th>Lifecycle costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Routine maintenance costs</td>
<td>£5,500 every five years</td>
</tr>
<tr>
<td>Periodic maintenance costs</td>
<td>£500 per annum</td>
</tr>
<tr>
<td>Major repair/replacement costs</td>
<td>£110,000 every 45 years</td>
</tr>
</tbody>
</table>

Source: The Sports Council
The model summarised in Table 7 showed that the capital cost (that is, the cost to replace with new buildings) of the stock of 1,490 public sports centres in England was £2.6 billion. It estimated that about 2.4 per cent of the capital cost of the stock should be spent every year to maintain the stock to a safe and acceptable standard, and an additional 1.6 per cent needed to be spent annually between 1995 and 2000 to bring the stock up to the correct standard. In total, therefore, the Sports Council estimates that just under £105 million per year is required for each of the next five years for upgrading (£42 million) and maintenance (£63 million). The Sports Council states that this is broadly in line with local authorities’ own estimates.

The relative youth and good condition of the post-1945 stock of public sports centres means that the stock has not yet reached full maturity in terms of refurbishment and/or replacement of major building requirements. The model predicts a peak in major repair and replacement around the period 2000 to 2005 and another between 2025 and 2035.

### Demographic, social and legislative costs

The other main pressure on capital resources is likely to arise from local authorities having to find matched funding to meet successful lottery bids.

### Conclusions

Four main conclusions can be drawn about the demand for local authority capital spending on sports centres:

- sports centres account for a small proportion of local authority capital expenditure;
- the Sports Council has adopted a robust methodology to calculate the level of capital required to bring centres up to an acceptable standard and maintain them in this state;

#### Table 7

**Capital cost of repairs to sports centres, based on Sports Council model**

<table>
<thead>
<tr>
<th>Type of centre</th>
<th>Number</th>
<th>Cost to build new (£m)</th>
<th>Annual upgrade cost (£m)</th>
<th>Annual maintenance cost* (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dry</td>
<td>590</td>
<td>740</td>
<td>10.71</td>
<td>17.22</td>
</tr>
<tr>
<td>Wet</td>
<td>260</td>
<td>320</td>
<td>7.02</td>
<td>7.82</td>
</tr>
<tr>
<td>Wet and dry</td>
<td>640</td>
<td>1,540</td>
<td>24.21</td>
<td>37.87</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1,490</td>
<td>2,600</td>
<td>41.94</td>
<td>62.91</td>
</tr>
<tr>
<td><strong>Five-year total</strong></td>
<td></td>
<td></td>
<td></td>
<td>209.7</td>
</tr>
</tbody>
</table>

*Excludes routine annual maintenance met from revenue

Source: The Sports Council
the size of the future shortfall in spending on the capital repair and upgrading of sports centres and swimming pools depends on whether the rise in capital expenditure achieved since 1993/94 is maintained; and

the Lottery is likely to be a major source of funds for new facilities in the future, although the need for matched funding may affect local authorities’ ability to take full advantage of Lottery awards.

Transport

Overview

122. The Department of Transport (DoT) argues that ‘there is no reliable way of measuring the true need for local authority capital expenditure. The only thing that can be said with any certainty is that we are always faced with more worthwhile bids from local authorities than we are able to fund’ (Ref. 24). Trends over the past few years show the latter part of that statement to be increasingly true.

123. Central government support for transport capital expenditure has been falling during the 1990s. During the same period, bids for resources – as measured by local authority submissions for Transport Policies and Programmes (TPP) funding – rose. However, until 1996/97 spending in cash terms remained fairly constant, as local authorities used other resources (such as capital receipts, revenue and contributions from developers) to maintain transport expenditure. As a result, the gap between central government support, which is made up of grant and credit approvals, and actual expenditure has risen (Exhibit 15).

Exhibit 15

Transport capital bids, spending and resources, 1992/93–1996/97

The gap between central government support and actual expenditure has risen.
During the consultation over the 1997/98 finance settlement the local authority associations did not produce a statement of the total need for local authority capital expenditure for transport. Instead they have shown how the 1996/97 settlement falls short of their calculation of ‘the minimum level of resources required’ (Ref. 25). The associations then estimated the additional capital support needed in each of the next three years to ‘meet statutory requirements, to provide new roads and public transport to ease traffic growth and congestion and to maintain roads, highways and bridges’ (Ref. 26) (Table 8). The £457 million of additional resources sought by the associations for 1997/98 represented almost 60 per cent of central government support to local transport in 1996/97 (£780 million).

### Backlog, maintenance and replacement costs

**National Road Maintenance Conditions Survey (NRMCS)**

125. The NRMCS (Ref. 27) provides a logical starting point for assessing the need to spend on maintaining the nation’s highway infrastructure. The 1996 NRMCS report includes details on the results of the 1995 survey and plots trends over the 19 years it has been carried out.

126. The 1995 NRMCS concludes – from the results of a defects index resulting from visual surveys – that non-trunk (that is, local authority) roads in England and Wales ‘reached their peak condition in the early 1980s and then deteriorated until the mid-1990s. Since then their condition has been fairly stable.’ But this overall pattern for all roads masks considerable variations between different types of road. For example:

- the condition of urban principal roads has stabilised and improved slightly, after deteriorating in the early 1990s;
- the condition of urban classified roads shows a long-term deteriorating trend – their condition is worse than in the early 1980s; and
- the condition of rural classified roads is stable and has been restored to the level of the mid-1980s.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Roads, parking and public transport</td>
<td>196</td>
<td>246</td>
<td>296</td>
</tr>
<tr>
<td>Reinstatement of carriageways</td>
<td>92</td>
<td>92</td>
<td>92</td>
</tr>
<tr>
<td>Bridge strengthening</td>
<td>47</td>
<td>47</td>
<td>47</td>
</tr>
<tr>
<td>Minor works</td>
<td>122</td>
<td>157</td>
<td>192</td>
</tr>
<tr>
<td><strong>Total additional support needed</strong></td>
<td>457</td>
<td>542</td>
<td>627</td>
</tr>
</tbody>
</table>

*Source: Local authority associations*
The report also contains an assessment of road condition derived from the use of a device called a deflectograph to measure the impact on the road of different vehicle weights. This complements information about the visual condition of principal roads and allows a more objective measure of their underlying structural condition. This measure is called its residual life (see Box F).

Deflectograph surveys measure the residual life of a road: the life remaining in its structure and surface before the road reaches its critical condition – at which time it can be strengthened with an overlay. If the road deteriorates beyond critical condition, it will still give serviceable life (albeit with an increased frequency of minor works, such as patching) for several years before reconstruction is necessary. In order to optimise highways maintenance expenditure, it is good practice to ensure that roads do not reach critical condition.

‘Residual life’ is a standardised measure. In practice, the rate of deterioration (and hence the useful life of a road) will depend on the volume and type of traffic using it.

127. The report also contains an assessment of road condition derived from the use of a device called a deflectograph to measure the impact on the road of different vehicle weights. This complements information about the visual condition of principal roads and allows a more objective measure of their underlying structural condition. This measure is called its residual life (see Box F).

128. Deflection surveys of trunk and principal roads have been carried out since 1975, but changes in methodology make it problematic to compare the results over the period of NRMCS surveys. From 1992 the DoT has asked all authorities to carry out such surveys on the whole of their principal road network over a three-year period. During 1994 the procedure for producing residual-life distributions from deflection data was revised. This followed extensive research into the wear caused by commercial vehicles and the introduction of new traffic models to take account of traffic changes over the last decade. The net effect has been to increase the assessed remaining life of those roads which carry the highest volumes of traffic in general, and of commercial traffic in particular. This illustrates the technical difficulties of assessing the backlog in road maintenance expenditure: the measured backlog has effectively been reduced by changing the method of analysing existing data.

129. The results of the 1995 survey indicate that a fifth of principal roads, which are the responsibility of local authorities, have a residual life of less than five years (Exhibit 16). However, the DoT considers that the condition of principal roads has improved slightly since 1992. A study commissioned by the County Surveyors’ Society (Ref. 28) has challenged this conclusion. It argues that the NRMCS has, understandably, sought to provide the best possible estimate of road condition for the year of reporting, by including all the available data in the reporting year.
Particularly for principal roads, the extent of the network included and the number of highway authorities participating in the study have both increased substantially since the 1993 report. This presents the data establishing reliable trends in condition. The study goes on to overcome this problem by reconstructing data on trends between 1992 and 1995, using a sample of authorities that have collected deflectograph measurements throughout the period. From this it concludes that the structural condition of the principal road network has deteriorated between 1993 and 1996.

During study visits a number of local authorities argued that restraints on capital spending had led to excessive use of patching and surface dressing, rather than reconstruction. If this were so, then a higher proportion of roads than indicated in the NRMCS survey would be expected to have reached a critical state and come to the end of their residual life. Statistics on local road-maintenance expenditure (Ref. 29) provide some information that helps to explain what might be going on. The overall figures for England show that spending on patching and surface dressing accounts for less than one-fifth of carriageway structural maintenance on principal roads, and around a half on non-principal roads (Exhibit 17). In other words, it is non-principal roads, which are not covered by the NRMCS deflectograph survey, that are being patched up.

Exhibit 17
Spending on structural carriageway maintenance by type

Non-principal roads are being patched more than principal roads.

Source: DoT
132. Using this data to make comparisons before 1992/93 is problematic, because of the difficulty of distinguishing between revenue maintenance and capital spending for roads. For example, it might be thought that the need for more substantial repairs (which, by convention, have been treated as capital) would reveal a revenue maintenance backlog. However, definitions have changed during the 1990s, with strengthening and other structural maintenance of bridges and highways being transferred from revenue funding, through Revenue Support Grant (RSG), to capital funding through Transport Supplementary Grant (TSG) and Transport ACGs. Provision for this work in 1996/97 is £88 million, compared with £220 million when it was transferred from revenue in 1992/93.

133. Besides data collected by the DoT and the local authority associations, there are four other sources of evidence on the demand for investment in the part of the highway network that is the responsibility of local government.

The Institution of Civil Engineers (ICE) 1995 Local Transport Survey (Ref. 30)

134. The ICE surveyed 129 authorities, including all county councils in England and Wales, the metropolitan districts, London boroughs and the Scottish regional and island councils. Seventy authorities responded – a response rate of 54 per cent. The conclusions on the quantification of the demand for expenditure (Box G, overleaf) need to be interpreted with some care, as they are ‘grossed up estimates based on the data supplied by the responding authorities’. The term ‘allocated’, in the context of the second and fourth questions, is not defined but appears to mean budgeted local authority expenditure. The total demand for capital expenditure identified in this survey (£4.882 billion) is more than double the total local authority TPP bids (£2.302 billion) for 1995/96, although the size of TPP bids may have been tempered by the scale of resources likely to be made available.

The British Road Federation (BRF)

135. The BRF in its submission to the Transport Select Committee (Ref. 31) and its paper on the 1996 Public Expenditure Review (Ref. 32) has highlighted how local authorities are responsible for the maintenance of 96 per cent of road length. The BRF argues that:

- expenditure for maintaining these roads has been reduced, in real terms, by up to 15 per cent in the last decade, despite a 35 per cent increase in traffic on local roads and a 5 per cent increase in road lengths;
- the cash settlement – by which they mean the Standard Spending Assessment (SSA) – has remained at £1,759 million in each of the last three years and ‘is below that necessary to maintain the network in good order’; and
- failing to maintain proper standards of repair and maintenance has an additional cost in the form of:
  - insurance claims for damage and personal injury;
Box G
ICE survey: expenditure needs and shortfall

<table>
<thead>
<tr>
<th>Q</th>
<th>How much money is needed each year to spend on the construction or improvement of road transport infrastructure to meet needs?</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>£2,445 million</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Q</th>
<th>What is the difference between this and the amount of expenditure which has actually been allocated this year?</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>£1,129 million</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Q</th>
<th>How much money is needed each year to maintain transport infrastructure assets to a satisfactory standard?</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>£2,437 million</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Q</th>
<th>What is the difference between this and the amount of expenditure which has been allocated this year?</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>£846 million</td>
</tr>
</tbody>
</table>

– the diversion of revenue funds away from planned maintenance to fulfilling a local authority’s obligation to repair potholes; and
– higher costs when repairs are eventually made.

136. The BRF has called for the ‘establishment of more reliable data collection on road conditions ... as a matter of urgency. The setting of agreed standards for maintenance condition should be given similar priority’ (Ref. 33). The BRF points to the UK Pavement Management System, which not only allows the standardisation of condition data but is also able to evaluate the cost-effectiveness of different maintenance regimes and strategies. The system is being used to help evaluate TPP bids, though the Highways Agency is in the process of developing its own pavement management system.

137. The BRF concludes that a 15 per cent increase in maintenance budgets is needed and should be sustained for at least five years.

House of Commons Transport Select Committee

138. The House of Commons Select Committee on Transport has recently investigated expenditure on road and bridge maintenance. In its report (Ref. 34), published in January 1997, it reports that the overwhelming message from the evidence received was that spending on national and local road and bridge maintenance has been insufficient to maintain these important national assets in good condition. It is concerned that future levels of spending will be too low.
The report recognises that the development of the UK Pavement Management System is an important step towards a national maintenance standard. This common standard should, it argues, encourage local and central government to provide an acceptable minimum of funding for road maintenance. The committee stressed that the Department of Transport should pay particular attention to improving the National Road Maintenance Condition Survey, especially in the light of three studies commissioned by the County Surveyors Society.

County Surveyors Society

This section has already highlighted the DoT’s concern about being able to define accurately the need for capital spending on transport. Definitions of capital, revenue and road condition have changed over recent years, making it difficult to compile time-series comparisons. In addition the local authority associations, professional bodies and the BRF have doubts about the statistical reliability of road-condition data and are concerned about how representative it is.

It is against this background that the County Surveyors Society has commissioned the three studies: *Highways Maintenance Funding* by Coopers & Lybrand, *Condition of the Principal Roads* by WPM Ltd and *Highway Condition Information* by TRL. There has been extensive liaison with the DoT, which has generally welcomed proposals to change the interpretation of NRMCS data to more accurately reflect year-on-year changes in highway conditions.

**Demographic, social and legislative costs**

In addition to these costed demands, the local authority associations have identified a number of uncosted demands for local authority capital expenditure on transport (Box H, overleaf). The list includes several policy-driven items and reinforces the problem of producing an objective and agreed assessment of the need for capital expenditure.

**Conclusions**

Five main conclusions can be drawn from the evidence on the demand for transport expenditure:

- central government support (in the form of capital and revenue allocations) for local authority highways and transport responsibilities has been declining;
- the condition of the roads for which local authorities have responsibility is broadly stable; but there are particular problems with urban classified roads and rural unclassified roads, and one-fifth of principal roads have a residual life of four years or less;
- there are doubts over the reliability and representative nature of the road-condition data and there is no agreed standard basis for calculating an objective need to spend;
present, low levels of revenue maintenance will result in more expensive
capital reconstruction work in the future;
- demand for spending on roads and public transport is increasing; and
- estimates of the additional capital sums required range from £457
  million to £1,129 million per year.

**Box H**

**Uncosted demands for local authority transport capital expenditure**

The local authority associations identified a need for additional transport
capital expenditure to:
- meet the additional demands of rising population, increasing car
  ownership and the additional use generated by economic growth;
- reduce CO\(^2\) emissions to their 1990 levels by the year 2000;
- reduce the level of accidents and casualties by the year 2000 to the
  average level they were before 1985;
- strengthen bridges to ensure that they meet the new European Union
  40-tonne weight limit, in the light of the assessment being carried out by
  local authorities using TPP funding in 1996/97;
- implement the recommendations of the revised Policy Planning Guidance
  Note 13 (PPG13), which advises local authorities to adopt land use and
  transport policies that reduce dependence on cars;
- act on the principal objectives for capital expenditure on local roads and
  public transport set out in the Transport Policy and Programmes circular
  and the Supplementary Guidance notes on the ‘package’ approach;
- act on the recommendation of the Royal Commission on Environmental
  Pollution; and
- implement the Citizen’s Charter, which requires prompt and efficient
  action to maintain local roads and services.

References

1. Local authority associations’ submission to the Consultative Council on Local Government Finance, July 1996.


3. Survey of capital expenditure on schools, Association of County Councils and Association of Metropolitan Authorities, 1996.


15. Federation of Local Authority Chief Librarians, Public Libraries in England and Wales: Capital Needs Audit, FOLACL, April 1996. (Since the survey was carried out FOLACL has changed its name to the Society of Chief Librarians in England and Wales.)


17. Association of Metropolitan Authorities/Association of County Councils, submission to the Personal Social Services Expenditure Group, 10 May 1991.
18. Association of Metropolitan Authorities/Association of County Councils, submission to the Personal Social Services Expenditure Group, 19 May 1994.


24. Letter from the Department of Transport to the Audit Commission, dated 12 June 1996.


31. The UK Road and Bridge Maintenance Programme: A Submission to the Transport Select Committee, British Road Federation, 1996.


33. The UK Road and Bridge Maintenance Programme: A Submission to the Transport Select Committee, British Road Federation, 1996; and A Network in Crisis: Roads and the 1996 Public Expenditure Review, British Road Federation, 1996.

7 Capital Controls and Funding for Local Authorities in France

144. This chapter sets out the findings from LRC research into the capital finance regime for local authorities in France, carried out in January 1997. The findings are set out under the following headings:

- Local authority capital spending in context: background data
- Sources of capital: central versus local funding
- Allocation of state funding and evaluation of need
- Revenue budget constraints: authorities’ own capital spending
- Revenue budget constraints: authorities’ guarantees to joint bodies
- Time horizons: information on future funding
- Provision for asset maintenance and replacement
- Local authority debt, macroeconomic policy and the ‘PSBR’ issue.

145. In France as in the UK, a number of central government departments participate in specialised aspects of capital finance for local government – notably regeneration funding and specific grants – with the Budget Ministry (Treasury) keeping a close eye on overall strategy. However, policy on capital controls and allocation of mainstream funding rests primarily with the Local Finance Division of the Local Authorities Department within the Interior Ministry.\(^2\) Besides study of documents provided by the Ministry, this project involved interviews with the director of that Division and the head of its Bureau for Local Budgets and Financial Analysis.

146. Discussion of the finances of French local government has to allow for the immense complexity of its structure. This has several aspects.\(^3\) Firstly, at its lowest tier (the *commune*), it still retains a vast number of very small authorities; those with over 10,000 inhabitants made up just 2.3 per cent of the 36,551 communes in 1990. Secondly, there are two tiers above the commune (the department and the region), plus a quasi-tier of ‘groupings’ of communes created in a bid to overcome the limitations of their very small average size. Thirdly, not only do authorities on each of these levels exercise separate taxation powers but, in a process of ‘cross-financing’, they also channel substantial amounts of the resulting revenue between (or within) tiers. Lastly, the structural reforms in train for most of the period since 1982 have brought widespread change in financial flows, so that it is often difficult to interpret time series data on local government finance.

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1 This chapter was prepared by Richard Stanton of the London Research Centre (LRC) for the Audit Commission.

2 Sous-DIRECTION des Finances Locales et de l’Action Economique of the Direction des Collectivités Locales in the Ministère de l’Intérieur. Note that all terminology relating to the French administrative and financial systems used in this note, and quotations about them, are the author’s translations from the original French which have not been endorsed by French authorities.

3 For a fuller account see Ref. 1.
Underlying its more detailed findings, the research identified three basic characteristics that mark out a radical difference between French and British systems. They relate essentially to higher-tier authorities and larger communes, not to the mass of micro-communes, whose financial behaviour and legislative regime is markedly different. Adopting for simplicity the French usage in which central government (less social security agencies) are referred to as ‘the state’, the three key issues may be summarised as follows.

Political commitment to decentralisation

The French constitution includes a pledge to ensure the ‘free administration of local authorities’. Major structural change after 1982 (especially during 1982–85) shifted power decisively away from the centre, most strikingly by reassigning a large fraction of the state’s taxation capacity to the local authority sector. Though elements of the old hierarchical Jacobin order persist, the idea that in substantial areas of its work local government should be able to act independently of the central state now appears far more deeply rooted in the French political establishment than in its UK counterpart.

Primacy of local funding

French local authorities above the micro-level typically fund most of their capital expenditure from sources available to them at their own discretion, which in their case includes all borrowing. Only a minority of the resources needed for their large investment programmes are allocated to them by outside agencies; and, of that transferred funding, a sizeable portion (for communes especially) consists of subsidies from other local government tiers. Whereas during the 1990s the local authority sector in England has usually drawn around 60 per cent of its capital funding from sources controlled by the central state (grants or borrowing regulated by credit approvals), leaving locally determined resources as the secondary element, French authorities typically find at least that percentage of funds from locally determined savings, receipts or borrowing.

State role: Statutory rules not political intervention

Local authority capital investment in France is indeed subject to a centrally imposed framework of controls. Except in rare crisis situations, though, this regime makes little use of quantitative limits set by government ministers or their representatives to constrain an individual authority’s use of resources – in contrast to the UK system, with its capping and prescriptive credit allocations. Instead, the French control regime consists almost entirely of statutory rules intended to ensure that capital budgets are prudently managed, at any given level of spending – especially by making debt-servicing costs an automatic and visible charge on revenue budgets. It implicitly assumes that such rules (which in effect extent the

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1 Author’s term. Official analysis variously identifies as those over 3,500 or over 10,000 inhabitants.
UK’s Minimum Revenue Provision to cover actual cost, rather than a notional percentage) both protect authorities’ financial viability and make clear the long-term impact of investment choices on taxpayers. The political questions – how much should be spent, and whether the long-term cost is acceptable – are then left for council members and their electorate to resolve between themselves.

151. The large weight of capital investment in French authorities’ spending is indicated by Table 9, which shows the breakdown of total annual budgets between current activity and investment over the decade to 1994.1 After a rise of 47 per cent in real terms between 1985 and 1989 – partly reflecting new functions acquired through decentralisation – by the end of this period investment spending represented nearly two-fifths of aggregate local authority expenditure.

### Table 9


<table>
<thead>
<tr>
<th>Year</th>
<th>Current account (FFbn)</th>
<th>Proportion of total expenditure (%)</th>
<th>Investment account (FFbn)</th>
<th>Proportion of total expenditure (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>342</td>
<td>68.0</td>
<td>161</td>
<td>32.0</td>
</tr>
<tr>
<td>1986</td>
<td>349</td>
<td>67.0</td>
<td>172</td>
<td>33.0</td>
</tr>
<tr>
<td>1987</td>
<td>353</td>
<td>63.6</td>
<td>202</td>
<td>36.4</td>
</tr>
<tr>
<td>1988</td>
<td>363</td>
<td>61.4</td>
<td>228</td>
<td>38.6</td>
</tr>
<tr>
<td>1989</td>
<td>375</td>
<td>61.3</td>
<td>237</td>
<td>38.7</td>
</tr>
<tr>
<td>1990</td>
<td>388</td>
<td>61.6</td>
<td>242</td>
<td>38.4</td>
</tr>
<tr>
<td>1991</td>
<td>400</td>
<td>61.0</td>
<td>256</td>
<td>39.0</td>
</tr>
<tr>
<td>1992</td>
<td>418</td>
<td>61.6</td>
<td>261</td>
<td>38.4</td>
</tr>
<tr>
<td>1993</td>
<td>433</td>
<td>62.5</td>
<td>260</td>
<td>37.5</td>
</tr>
<tr>
<td>1994</td>
<td>446</td>
<td>61.7</td>
<td>277</td>
<td>38.3</td>
</tr>
</tbody>
</table>

1 Here and throughout, these terms are used to translate the standard French terms fonctionnement and investissement for the two types of account, which (see text) diverge slightly from the UK categories of revenue/capital.
152. In French accounts the ‘investment’ budget covers repayment of debt and capital transfers to other agencies, as well as the gross new expenditure by authorities directly on their own assets – which most closely corresponds to local government capital investment in its usual UK sense. In 1994 debt repayment accounted for 26 per cent of the overall investment figure, and authorities’ own gross direct investment for 49 per cent.¹ These proportions for the whole sector apparently reflect extensive rescheduling of debt in that year, with widespread early repayment, and the high proportion of regions’ capital budgets devoted to subsidising other authorities. For communes the corresponding percentages in the five years to 1993 hovered around 20 per cent and 70 per cent respectively, the latter slipping to 65 per cent in 1993 and 64 per cent by 1995 (communes of all sizes). But whether new direct investment is typically about half the investment budget figures in Table 9 – and hence 15 to 19 per cent of total expenditure – or a rather higher share, it clearly plays a more prominent role in local government activity in France than in the UK.

153. Local authorities’ contribution to investment in real assets by the public sector and across the wider economy is also evident from national accounts data on gross fixed capital formation (GFCF). For national accounts purposes, they appear in the category of ‘administrations publiques locales’ (APUL) or local public bodies, which also includes various ancillary public-sponsored organisations,² but it is assumed that capital spending in this category comes overwhelmingly from local authorities. In 1994 aggregate national GFCF of FF1,338 billion, itself representing 18 per cent of GDP, comprised three main public sector components (Table 10). APUL, essentially local authorities, thus contributed over 70 per cent of all gross fixed capital formation by the public sector.

<table>
<thead>
<tr>
<th></th>
<th>% of national GFCF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total public sector of which</td>
<td>18.7</td>
</tr>
<tr>
<td>APUL – local public bodies</td>
<td>13.3</td>
</tr>
<tr>
<td>Central state</td>
<td>2.3</td>
</tr>
<tr>
<td>Other (incl. social security agencies)</td>
<td>3.1</td>
</tr>
</tbody>
</table>

Source: Conseil Economique et Social, l’Endettement Public, No. 11, 1996

¹ For the purposes of this study the budgetary term ‘équipement brut’ is interpreted by the latter concept: authorities’ gross direct real investment. The percentages quoted here are derived from Ref. 2 where the base amount – total spending – is FF4 billion higher than the figure shown in Table 9, which is apparently a revised figure.

² These include, for example, ‘chambers of agriculture, commerce and professions’. The major sub-sector of local authority-sponsored joint companies is excluded, since they are treated as private organisations.
Table 11 indicates the way local authorities’ spending in France, and taxation to support it, have related to GDP in recent years. The first two columns confirm that investment – as defined in French accounts – made up over one-third of their total expenditure. The last two columns show that taxpayers contributed almost twice as much to authorities’ revenue budgets via the local fiscal system as they did via central taxation, with taxes raised by APUL in 1994 equivalent to 4.5 per cent of GDP. While overall taxation moved up only slightly over the five years to reach 25 per cent of GDP in 1994, both central and local fiscal contributions to APUL budgets showed a significant rise as proportions of GDP.

Direct support to local authority investment by the French state consists of a range of capital grants. Funds raised by authorities themselves comprise, of course, their own fiscal revenue, the proceeds of asset sales and borrowing to meet any remaining deficit. A further distinctive feature of the French system is the substantial flow of cross-financing among authorities, especially from higher tiers down to communes. This is very difficult to quantify, however, and in any case inter-authority flows should represent no net addition to capital resources when accounts are consolidated for the whole sector. The present analysis is therefore confined to sketching, on the one hand, funding distributed by the state and, on the other, capital sources which authorities can use at their own discretion.

<table>
<thead>
<tr>
<th>Year</th>
<th>Local authority total spending</th>
<th>Local authority investment spending</th>
<th>Total tax raised: national and local</th>
<th>State tax revenue transferred to APUL</th>
<th>Local tax revenue raised by APUL</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989</td>
<td>8.7%</td>
<td>3.4%</td>
<td>24.5%</td>
<td>2.05%</td>
<td>3.90%</td>
</tr>
<tr>
<td>1990</td>
<td>8.7%</td>
<td>3.4%</td>
<td>24.4%</td>
<td>2.05%</td>
<td>4.05%</td>
</tr>
<tr>
<td>1991</td>
<td>9.1%</td>
<td>3.6%</td>
<td>24.7%</td>
<td>2.21%</td>
<td>4.10%</td>
</tr>
<tr>
<td>1992</td>
<td>9.3%</td>
<td>3.6%</td>
<td>24.2%</td>
<td>2.27%</td>
<td>4.13%</td>
</tr>
<tr>
<td>1993</td>
<td>9.6%</td>
<td>3.6%</td>
<td>24.3%</td>
<td>2.37%</td>
<td>4.38%</td>
</tr>
<tr>
<td>1994</td>
<td>9.8%</td>
<td>3.8%</td>
<td>25.0%</td>
<td>2.38%</td>
<td>4.49%</td>
</tr>
</tbody>
</table>

Notes:
1. APUL (‘administrations publiques locales’) national accounting category. Mainly local authorities (see text).
2. Refers to state revenue support to APUL.

Central government capital grants

156. Ostensibly the French state offers substantial support in this form, which in recent years has made up around 15 per cent of its total financial settlement for the local government sector and has covered about one-third of authorities’ aggregate direct investment. Of this ‘support for investment’, however, about two-thirds is the FCTVA¹ or VAT Compensation Fund, which reimburses to authorities the approximate equivalent of their VAT outlay after a two-year lag. Among French authorities there is a widespread and persuasive view that the FCTVA represents no net subsidy to their spending – capital or revenue – but is rather a form of forced saving, to be counted as part of their own revenue funding.

157. Apart from the disputed FCTVA, resources distributed by the state to fund local authority investment fall essentially under two main headings:²

- **Investment block grant** (DGE – *dotation globale d’équipement*). This is provided for both départements and communes. As from 1996, larger communes – hitherto eligible for DGE as a (very small) automatic percentage subsidy to capital expenditure – ceased to receive it. At this tier DGE is reserved for communes of under 20,000 inhabitants whose tax base is near or below the national average.³

- **Hypothecated subsidies**. A relic of the traditional method of ministerial support for approved projects, such grants are allocated direct by 18 central ministries to local authorities. In the mid-1990s they have been worth in aggregate more than half the value of the DGE.

Locally controlled resources

Self-financing

158. The internal resources applied by French authorities to their capital programmes are primarily savings on their current accounts. Capital receipts appear to be a minor funding source; official aggregate statistics on local government capital finance nowhere identify them separately. The self-financing of capital investment thus depends essentially on an authority’s ability to generate a disposable surplus from its current spending, after providing for debt charges. This in turn will depend on revenue from two sources:

- **Local taxation**: French authorities’ fiscal capacity is not only large – substantially enhanced by the transfer of taxation powers to local government as part of the 1980s decentralisation process – but also diverse. These authorities have access to four main direct taxes: three on property and the business tax (*taxe professionelle*), assessed on payroll

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¹ Fonds de Compensation de la TVA.
² An additional grant redistributing to communes the proceeds of traffic fines, hypothecated to transport investment, was worth about one-fifth the value of the DGE in 1993–95.
³ Ref. 3, p33.
and assets, which yields about as much as the other three combined. Business taxpayers enjoy statutory relief above a fixed ceiling, the state compensating authorities for revenue foregone. The four direct taxes are backed up by a range of smaller indirect local taxes.

**Revenue grants from the state**: in total, these were equivalent to about 37 per cent of budgeted gross revenue spending for the local authority sector in 1994 and 1995.¹ The basic revenue support, between half and two-thirds of the total value of such provision, is the current-account block grant (DGF – *dotation globale de fonctionnement*). This is accompanied by grants to cover statutory relief from local taxes, grants to compensate local authorities for costs arising from the transfer of functions following decentralisation; and various smaller specific grants, mostly for education.

**Borrowing**

159. The French regime imposes no quantitative limit on local authorities’ borrowing, though there are constraints. For example, the law requires an authority to follow rigorous procedures for contracting debt – including submitting such contracts to its departmental préfet to check their legality – and to seek special authorisation for foreign loans. Other statutory rules relate the cost of debt to revenue budgets; provided such prudential rules are observed, the state exercises no control over the amount of borrowing a local authority undertakes. A key part of the logic behind its position is indicated by the Interior Ministry: ‘Since decentralisation, the state is no longer the guarantor of last resort for local authorities’ undertakings towards banks’.²

160. From available statistics, the proportion in which local authorities use the various sources described above can be calculated only tentatively. Aggregate data on budget estimates for all authorities seem to indicate that resources for their own direct investment found from borrowing may have reached 70 per cent or more in 1994 and 1995. While it was at a very high level by 1994 (reflecting depressed tax yields and the renegotiation of loans across the sector) analysis elsewhere casts doubt on this figure, suggesting that borrowing then contributed more like 50 per cent of authorities’ direct investment funding. This is approximately consistent with the following proportions in earlier years (Table 12, overleaf).³

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¹ Ref. 2, pp42, 44, 88. Note that the total spending figure is based on non-consolidated accounts for the three local government tiers, and hence will be inflated by the double counting of inter-authority transfer payments. Against a consolidated estimate of the sector’s spending, the value of state grants would probably be over 40 per cent of the total.

² Ref. 2, p100.

³ Ref. 2, pp36-7. The higher proportion mentioned is derived from pp42, 44. The alternative estimate of 50 per cent for 1994 is from LRC, 1996, p139.
Table 12
Percentage of authorities' direct investment funded by borrowing 1989–93

<table>
<thead>
<tr>
<th>Year</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989</td>
<td>49.6</td>
</tr>
<tr>
<td>1990</td>
<td>43.3</td>
</tr>
<tr>
<td>1991</td>
<td>42.9</td>
</tr>
<tr>
<td>1992</td>
<td>51.7</td>
</tr>
<tr>
<td>1993</td>
<td>59.4</td>
</tr>
</tbody>
</table>

161. Typically, borrowing may thus represent about half of total investment resources. State grant and self-financing could then normally be expected each to provide roughly one-quarter of the necessary resources – if, adopting the official view, the VAT reimbursement fund FCTVA is deemed to be part of state support to investment. To the extent that FCTVA is treated rather as a form of local authority saving, the state contribution dwindles and self-financing increases in importance. Even without that adjustment, however, state-controlled resources are clearly secondary to those for which access is determined at local level.

162. There is, on the evidence of this study, very little evaluation of need in the allocation of the capital grants outlined above. This appears in part to reflect the historical legacy of bid-based discretionary subsidies; but it may also reflect a sense that elaborate needs assessments are unnecessary for allocations that play a relatively minor part in total funding.

163. In none of these cases are the criteria for distribution related systematically to investment need. The largest, the VAT reimbursement fund or FCTVA, simply follows original expenditure. One fraction of the DGE for départements is distributed partly on road lengths, but otherwise the allocation is simply a percentage of spending, adjusted according to taxation capacity. For the micro-communes, as indicated above, DGE is allocated within départements through a process of negotiation between the authorities concerned, in which the préfet – representing the state – is broker and arbiter. In the case of specific subsidies, distribution apparently depends on varying sets of criteria and political judgements, adopted ad hoc by the ministry concerned.

164. Crucial to the French capital finance regime is the statutory obligation on local authorities to make explicit provision in each year’s current account for the full cost of servicing outstanding debt. This is expressed as a requirement to budget for gross current-account savings (épargne brut) at least equal to the ‘annuity’ – sum of interest and principal repayments – due on borrowing contracted up to the start of that year. Any planned revenue surplus, net of that annuity, is seen as disposable savings (épargne disponible) available for new investment. The gross figure is what French authorities would also refer to as their self-financing of investment.
165. As from 1997, in a move confirming the importance attached to its transparency, the procedure for funding the debt annuity has been refined as part of a major reform of the accounting system for communes, based on recommendations from a joint central/local government working party. Prompted by a concern that setting funds aside as revenue and spending them as a contribution to investment within the same financial year could ‘distort the readability’ of an authority’s accounts, the new system known as M14 divides the procedure between years.1

166. In year N the commune is required to include the necessary surplus as an item in its current-account estimates, while expenditure on the annuity creates a shortfall on the investment (capital) account. At the year-end the surplus for self-financing must be assigned to reserves. From here, in year N+1, it will be credited to the year N investment account to eliminate its deficit, as part of the process of ‘integrating’ (balancing) the authority’s accounts for the past year, which in France involves a retrospective supplementary budget. Payment of the self-financing sum into reserves at year-end must have priority in closing the year N current account. If it proves to be in deficit after this sum has been debited, the local authority is expected to make the necessary adjustments to net spending – current or capital – elsewhere in its final supplementary budget for this may involve changes in its year N+1 budget estimates. Any deficit left outstanding on either account (above a specified margin) will be investigated by the regional Court of Accounts, which may ultimately call for mandatory intervention by the préfet, representing the state, if balancing adjustments are not agreed by the authority.

167. Given the scale of their capital investment, debt-servicing inevitably has a major impact on local authorities’ current expenditure. Table 13 shows the relationship between debt annuity and total current account receipts for the three main local government tiers between 1990 and 1995. For communes this statutory charge absorbed around 20 per cent of current income through the first half of the decade.

### Table 13
Debt annuity as a percentage of total current account receipts, 1990–95

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<td>13.2</td>
<td>16.1</td>
<td>17.2</td>
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<td>19.9</td>
<td>16.0</td>
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Source: MI-DGCL 1995, p86

1 Ref. 4, p22. The following outline of the M14 procedure is based on this source, pp22–5.
168. The significant fall in 1995 reflects the preceding cut in rates of investment – itself a response to declining tax yields – as well as the debt rescheduling already mentioned. For regions and départements the ratio was lower in 1990 but grew rapidly, in line with the much steeper growth of their capital programmes, after decentralisation.

169. On evidence available to the present study there are no instances where the obligatory funding of charges on authorities’ own debt, described here, has put their financial stability at risk. Rather, its effect has been to put sustained upward pressure on local taxes. An investigation into public-sector debt by the national, officially convened Economic and Social Council in 1996 (Ref. 5) notes that the increase in local taxation from 1990 to 1994 averaged about 7 per cent per annum, and adds: ‘The rise in rates of local taxation – whose base is old and questionable – is reaching a limit; it is difficult to envisage that [these] taxes could continue to increase 6–7 per cent as in recent years.’

170. If the debt annuity rule has effectively transmitted the cost of investment decisions to local taxpayers, it may have thereby reinforced the electoral constraint on capital expenditure. This effect is likely to be especially marked in communes whose small size usually brings elected maires, literally, close to voters. There is a strong correlation between France’s six-year electoral cycle and communes’ capital investment: elections in 1995 may well partly explain the 5.5 per cent fall in their direct investment spending in that year, with a 17 per cent drop in borrowing.¹ Whatever its precise link with local political processes, the power of the debt annuity rule is reflected in reports that at national level it has been criticised by banks, which argue it has become an unduly powerful deterrent to authorities’ use of borrowing.

171. Local authorities in France are involved on a far larger scale than their UK counterparts with devolved bodies that link them as investors with other authorities, voluntary and private sectors. Though the authorities themselves may set up these joint ventures and contribute capital to them, they are treated as private agencies for national accounts purposes. Besides undertaking most social housing investment in France, they have been widely used for regeneration and other local non-commercial initiatives. Amongst many other forms the SEM (société d’économie mixte), in which local authorities hold a controlling stake, has been particularly prominent in regeneration work, with correspondingly large capital budgets.

172. Apart from any direct investment, local authorities regularly support such devolved agencies by guaranteeing their debts. By the 1990s the total sums thus guaranteed were very large, as Table 14 confirms for 1992, the latest year for which data are available. Across the sector as a whole, guarantees were equivalent to 61 per cent of the value of authorities’ own stock of debt. For communes they amounted to over two-fifths of that stock.

¹ Ref. 2, p46, p67.
and for départements they exceeded it by more than one-third. The implication is that, beyond the cost of servicing their own debt discussed above, authorities may face a substantial extra burden on their current accounts, should guarantees be called in. For communes in 1995, while in aggregate annuities on their own debt were 17.9 per cent of current-account receipts, annuities on borrowing they had guaranteed were equivalent to 10.1 per cent of that total income.1

173. In an attempt to ensure that individual authorities cannot expose themselves to undue risk through guarantees, statutory constraints have been imposed on their use. The crucial rule defines a maximum permissible ratio between potential costs arising from guarantees and an authority’s annual revenue income. An authority may undertake a new guarantee on loan X by an outside body only if the sum of the annuity on its own debt, the first year’s annuity on loan X and the total value of annuities on all debt already guaranteed does not exceed 50 per cent of its budgeted current-account receipts for the year in question.

174. This basic constraint is supplemented by rules designed to spread risk, and to share it with lenders. Thus, firstly, the value of guarantees that an authority extends to any one outside body (again in terms of potential debt charges) cannot exceed 10 per cent of its maximum ‘guaranteeing capacity’ formulated above – that is, one-twentieth of its annual current income. Secondly, no more than 50 per cent of the value of any one loan may be guaranteed by a local authority or consortium of authorities. According to the official account, this requirement is aimed at ensuring that ‘lending institutions have properly evaluated the risks’ of the project in question.2

Table 14
Stock of local authorities’ debt and guarantees of borrowing, 1992

<table>
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<tr>
<th></th>
<th>Authorities’ debt (FFbn)</th>
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<tr>
<td>Regions</td>
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<td>3.3</td>
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<tr>
<td>All authorities</td>
<td>445</td>
<td>272</td>
<td>61.1</td>
</tr>
</tbody>
</table>


1 Ref. 2, pp40, 85.
2 Ref. 2, p89.
175. Notwithstanding the statutory safeguards just outlined, however, serious problems have arisen for a number of communes from the practice of extending guarantees to outside joint bodies. In the late 1980s some municipalities faced budgetary crises, a few of them prompting intervention by préfets, when lenders called in guarantees whose build-up had not been adequately monitored locally. These cases typically involved social housing associations. The 1990s have seen a further series of crises, particularly those stemming from communes’ role in SEM joint companies set up to promote local economic development.

176. The national Court of Accounts included in its 1995 annual report to the Head of State, for example, a detailed scrutiny of risks posed to participating communes in the Île-de-France region by such development ventures. Having invested heavily in property for redevelopment, many were caught by the early 1990s slump in the commercial property market. The Court describes how these difficulties were compounded by weak SEM management, private-sector partners’ reluctance to share losses and, more basically, the failure of local authority members to recognise the implications of their guarantor role. The 1996 annual report concludes: ‘Whilst there has so far been no major disaster, the difficulties faced by many developers and SEMs in the Île-de-France as a result of the property market crisis highlights the persistent weakness of the existing institutional arrangements.’

177. With effect from 1997 the Government – as part of its M14 accounting reform – has responded to these problems by requiring local authorities to make an explicit minimum provision in their current account budgets for costs potentially arising from guarantees they have undertaken. This takes the form of a contingency item equal to 2.5 per cent of the total value of debt annuities on all borrowing guaranteed at the end of the previous year.

178. The accumulation of off-balance sheet commitments remains, on the evidence of this research, the most acute current weakness in the French local government capital finance regime. It may be worth emphasising that its origins lie in a set of financial relationships between authorities and devolved agencies which, under existing legislation, could not possibly be replicated by councils in the UK. The problems just indicated are manifestly not to do with French authorities’ freedom to borrow on their own account.

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1 In this annual report the Court reviews public sector financial management over the preceding year (apparently with an emphasis on prudence and probity rather than efficiency/effectiveness/economy). The analysis referred to here is in Cour des Comptes, 1995, pp331–44.

2 Ref. 4, p14.
179. Annuality is as fundamental to the public finance system in France as in the UK, in the sense that it insists absolutely on agreeing budgets and monitoring outcomes year by year. In two important respects, though, the French local government finance system gives authorities guidance about state allocations in future years which is more reliable than that given by the UK Government. This longer time horizon, which applies equally to revenue and capital resources, has particular potential for improving the efficiency of capital investment. It is established firstly by widespread indexation of the value of resources distributed by central government, and secondly by the device known as ‘programme authorisation’.

Indexation

180. The French state’s direct support to local authority capital spending is limited to grant aid of modest proportions, but it has already suggested that this should be seen in conjunction with state revenue grants which enhance authorities’ scope for self-financing investment. For both types of grant, change in aggregate provision or ‘control totals’ is generally index-linked. In 1995, for example, the Government concluded a three-year ‘financial stability pact’ with local authorities, defining an ‘envelope’ of grants whose combined value was to rise from 1996 to 1998 in line with the retail price index. Most major grants were included, including the DGE capital block grant. The arrangement obviously allows for the envelope’s components to differ somewhat and in rates of change; in particular, the major revenue block grant, the DGF, was to rise within it in line with the sum of change in RPI plus 0.5 x change in GDP. Nevertheless it should have enabled authorities to form reasonably clear expectations about future control totals and hence – given that distribution procedures are relatively simple and apparently stable – to make worthwhile projections of their individual allocations beyond the current year.

181. Some areas of state capital funding do remain essentially discretionary or subject to political negotiation. Whatever commitments are made about control totals, outcomes for individual authorities in these areas may be less predictable. Examples are the DGE grants – which are divided among very small communes in a forum of their representatives, with the préfet as broker – and the hypothecated capital subsidies, distributed by central ministries. The same applies to individually negotiated regeneration schemes, like the contrats de ville, up to the point where the government commits itself to them; beyond that point, like corresponding regeneration schemes in the UK, they usually offer in principle a commitment to funding over several years.
Programme authorisation

182. When the French state agrees its annual budget, whether revenue or capital, most areas of spending within it will be set out in two forms. The sums which it intends actually to disburse in that year are identified as ‘payment items’ (crédits de paiement). But ministers may choose also to present their expenditure proposals within the framework of a ‘programme authorisation’ (autorisation de programme). This is in effect a three-year financial plan, indicating intended spending for each year and the way it is to be financed. An approximate parallel in the UK capital-finance regime might be the three-year funding commitments involved in certain components of education and transport ACGs. The French programme authorisation, however, is generalised; major block grants outlined above regularly take this form.

183. Though the programme authorisation was originally an instrument reserved for central government, in recent years its use has been extended to higher tiers of local government. Since 1992 communes with over 3,500 inhabitants have also been allowed to adopt it for capital expenditure. At whichever level it operates, its status is inevitably ambiguous in a system where budgets are made annually. Parliament, regional assemblies or local councils may decide at the start of a year to change the amount they had previously agreed within a programme authorisation as provision for that year. Within central government, the budget (Treasury) minister in one recent instance refused to release payment items necessary to fulfil a programme authorisation. Nevertheless, it is generally agreed that this mechanism has a real impact on the way operations are managed. Because it stands as the decision of the relevant assembly unless explicitly revised, it gives executive officers the power to commit funds to tasks up to two years before their implementation date.

184. Its considerable potential as a management instrument is reflected in current demands from communes for the right to apply it more widely, and in the state’s reluctance to agree. Central government has, for example, been loath to accede to requests from micro-communes of under 3,500 inhabitants for permission to apply programme authorisations in their budgets, essentially because (as one source observed) they create ‘a great power for the mayor’. It is feared this could destabilise micro-communes, with their minimal financial room for manoeuvre. Again, larger communes taking part in contrats de ville have urged the state to allow them to adopt programme authorisations for current-account budgets, so that multi-year revenue funding can be offered to partner agencies.
185. Up to 1996 the French capital-finance regime left it to the individual local authority to decide whether to budget for maintenance and replacement of assets. As from January 1997 the revised M14 accounting system has introduced a more rigorous approach. Financial provision, to be made via a contingency item in the current account, is still optional as regards the upkeep of fixed assets that are ‘non-amortisable’: that is, structures whose value can be preserved over time by such maintenance works. Key examples are highways and buildings in public use. For other assets, however, the new accounting rules make it compulsory for communes of over 3,500 inhabitants to identify a specific sum in their budgets to cover amortisation.¹

186. This amortisation requirement applies, then, to all assets whose depreciation cannot be reversed by maintenance. It is set out by the M14 regulations in some detail. They give a wide-ranging classification of the relevant assets:

- movable goods;²
- fixed income-generating assets, including property which is let for a rent or fee and not available for public use or service; and
- ‘intellectual property corresponding to costs of studies not implemented, research and development costs and software.’

The calculation of amortisation is to be based on historic cost. The regulations do not prescribe its method or period, but they make recommendations on both. Thus, for example, they offer a schedule of proposed amortisation periods ranging from two years for software, to 20 to 30 years for lifts.

187. The procedure laid down for securing the amortisation provision within communes’ budgets closely parallels the method by which revenue savings are applied to cover the cost of servicing their debt. The annual authorisation provision is to be voted as a spending item within the authority’s current account, found from the surplus on that account, and the same sum is then credited to its investment account: ‘Amortisation appears as a mandatory allocation of part of the current account surplus to the investment account, and thus constitutes a form of minimal self-financing dedicated to asset renewal.’³

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¹ The amortisation requirement remains optional for communes below that population threshold. The following account of the rule for larger communes is based on Ref. 4, pp15–17.

² Other than collections or works of art.

³ Ref. 4, p17.
188. The Interior Ministry points out that under the revised system of accounts the amortisation provision, together with the contingency item (if any) for maintenance of non-amortisable assets, will become a ‘more important’ element of the automatic self-financing of authorities’ investment expenditure, alongside the well-established provision for debt annuity. More broadly, then, the new rules on asset maintenance and amortisation may be seen as part of the strategy – pursued by the state apparently with local government backing – to ensure that authorities’ investment is always underpinned by adequate self-financing from current income.

189. Concern about public-sector debt is high on the French policy agenda. In March 1996 a major report on the issue (Ref. 5) was published by the Economic and Social Council (CES – Conseil Economique et Social), a consultative body established by statute and convened by central government with members drawn from different sectors. It declares: ‘Public debt can no longer continue to grow at its present pace without serious risks. The question is no longer to work out whether measures to curb public deficits can be avoided, but to choose the most effective methods.’ Curbing public debt, the Council notes, is not just a question of meeting the Maastricht convergence criteria (in fact, the report notes, France’s public debt/GDP ratio for 1995 was well below the 60 per cent EMU threshold). Equally important are concerns to ease the pressure of debt charges on other revenue spending, and to improve French competitiveness by reducing rates of tax and interest.

190. However, France’s public debt problem, and the debate about it, relate to borrowing by central authorities, not by local government. The growth of state indebtedness since the early 1980s, described by the CES study, has been dramatic. Between 1975 and 1994 the stock of state debt multiplied 11 times in real terms, while its ratio to GDP more than doubled from 16 to 39 per cent. Since 1992 the trend has accelerated. The state’s budget for 1996, with a 1.8 per cent rise in total expenditure compared with 1995, shows an 8.3 per cent rise in its debt. Meanwhile, the social security agencies, devolved from state administration in the French system, began to contribute heavily to the mounting debt problem after 1991: their total ‘financing requirement’ rose almost fourfold at current prices from 1991 to 1995.

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1 Ref. 4, p22.
2 Indications from this study suggest that the Conseil might, in UK terms, be characterised as something between the one-time tripartite National Economic and Social Council, a Royal Commission and a Commons Select Committee.
Local authorities, on the other hand, despite investing massively since the early 1980s, have not accumulated debt at a rate any faster than national economic growth. The CES study points out how their high level of capital spending in the 1980s was supported both by rising local taxation and by an increase in state funding, limiting their need to borrow. While recession forced them into greater use of borrowing after 1991, as shown above, this trend was reversed by 1994. The result is that between 1984 and 1994 state indebtedness as a proportion of GDP was soaring from 22 to 39 per cent, but the ratio of local authority debt to GDP altered minimally from 8.3 to 8.7 per cent.

These trends are illustrated by a series of diagrams, reproduced from the CES study. The local government sector has a stable debt/GDP relationship, compared with the steep rise for that of the state after 1982 (Exhibit 18). There has been a steady rise in local tax revenues which has helped authorities to avoid excessive indebtedness (Exhibit 19, overleaf) – and this contrasts with the downturn in the state’s tax take (which is partly explained by the transfer of fiscal powers to local authorities that accompanied decentralisation). The state’s borrowing requirement has reversed over the 1990s, with particular difficulties caused by the social security sector’s move into deficit; in contrast to this trend, local authorities’ need to borrow has remained remarkably stable over three decades (Exhibit 20, overleaf). The CES reasonably concludes that: ‘... local authorities’ debt has only a slight influence on the major economic aggregates’ (Ref. 5).

Exhibit 18
Debt as a percentage of GDP by government sector, 1970–93.

The local government sector has a stable debt/GDP relationship compared with the steep rise for that of the state after 1982.

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Exhibit 19
Tax revenues as a percentage of GDP by government sector, 1970–93

There has been a steady rise in local tax revenues, which has helped authorities to avoid excessive indebtedness.

Exhibit 20
Surplus/deficit as a percentage of GDP by government sector, 1959–93

Local authorities’ need to borrow has remained remarkably stable over three decades.

References

District Auditors were first appointed in the 1840s to inspect the accounts of authorities administering the Poor Law. Auditors ensured that safeguards were in place against fraud and corruption and that local rates were being used for the purposes intended. The founding principles remain as relevant today as they were 150 years ago. Public funds need to be used wisely, as well as in accordance with the law. The task of today’s auditors is to assess expenditure, not just for probity and regularity, but for value for money as well.

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