

Title: **Needs & Redistribution Technical Working Group**

Paper: **NR TWG 16/24 – Capital Finance Relative Needs formula**

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Venue: **DCLG - 2 Marsham Street - Fry Building - 4th Floor - Room 4C**

POLICY DEVELOPMENT: NOT A STATEMENT OF GOVERNMENT POLICY

Introduction

1. Local authorities use capital money primarily for buying, constructing or improving physical assets, such as:
 - buildings (including schools, houses, libraries, museums, fire stations);
 - land for development, roads, playing fields; and
 - vehicles, plant and machinery (including street lighting and road signs).
2. Capital expenditure also includes grants and advances made to the public or private sector for capital purposes, such as advances to Registered Social Landlords.
3. Until 31 March 2004 the capital finance system was set out in Part 4 of the Local Government and Housing Act 1989. The basic principle of this system was that authorities could borrow or use credit only up to the limits specified by the Government through the issue of credit approvals – Basic Credit Approvals (BCAs) and Supplementary Credit Approvals (SCAs).
4. Funding for this borrowing was provided through the Local Government Finance Settlement, unless it was accounted for within the Housing Revenue Account. This funding allowed for both the payment of interest on the loan together with repayment of the principal.
5. Part 1 of the Local Government Act 2003 introduced a different capital finance system with effect from 1 April 2004, known as the '*Prudential Capital Finance System*'. The key feature of this system was that authorities no longer need government approval to finance capital expenditure by borrowing or credit. Local authorities continued to receive central government support for a major part of their capital programmes, but were now free to borrow to fund additional investment, provided they can afford to service the debt without extra government support. The funding support under this system came from either capital grants – Supported Capital Expenditure (Capital) (SCE(C)s) – or via the Local Government Finance Settlement as revenue payments – Supported Capital Expenditure (Revenue) (SCE(R)s).
6. SCE(R)s continued to be provided until 2011-12; from 1 April 2011 government support for capital projects came exclusively in the form of capital grants.

The 2013-14 Capital Financing Relative Needs Formula

7. The Capital Financing RNF covered the following classes of authority in 2013-14:
 - district councils,
 - county councils,
 - London borough councils,
 - Common Council of the City of London,
 - Greater London Authority,
 - police authorities/bodies other than the Common Council of the City of London and the Metropolitan Police Authority,
 - metropolitan county fire and rescue authorities,
 - combined fire and rescue authorities.
8. The main determinant of the assumed cost of financing capital expenditure incurred prior to 1990-91 is the assumed level of outstanding debt at the beginning of the 1990-91 financial year. This is the larger of a notional debt figure, based on elements of the grant-related expenditure assessments for the financial year 1989-90 which relate to the cost of financing capital expenditure for the authority and/or its predecessors, or an estimate of actual debt, based principally on the adjusted initial credit ceiling¹ for the authority and/or its predecessors.
9. For capital expenditure incurred on or after 1 April 1990 and before 1 April 2004 the main determinant of the assumed cost of financing capital expenditure is an estimate of Basic and Supplementary Credit Approvals for the authority and/or its predecessors, or in the case of the Greater London Authority, aggregate and additional credit approvals.
10. For capital expenditure incurred on or after 1 April 2004 the main determinant of the assumed cost of financing capital expenditure is an estimate of SCE(R) for the authority.
11. There were no new SCE(R) allocations from Central Government from 1 April 2011, and hence the debt is gradually reducing. However there is still a large amount of historical debt that is funded through the Local Government Finance Settlement.
12. The assumed cost of financing capital expenditure comprises interest charges and repayments of debt. Interest charges are calculated by applying a notional pool rate of interest to each authority's assumed mid-year outstanding debt.
13. The pool rate is calculated on the basis of:
 - (i) the latest available information about the outstanding PWLB and non-PWLB long term and short term local authority debt, and
 - (ii) the average interest rates associated with that debt.
14. The full formula is given at Annex A.
15. The detailed methodology used to calculate the pooled interest rate in 2013-14 is described at Annex B.

New Capital Financing Relative Needs Formula

16. What are the views of the Working Group on the existing 2013-14 Capital Finance Relative Needs Formula?

¹ The adjusted initial credit ceiling has the same meaning as it had in regulation 24 of the Local Authorities (Capital Finance) Regulations 1990 (S.I. 1990/432).

Annex A: 2013-14 Capital Financing Relative Needs Formula

The RNF element for Capital Financing for a particular authority was calculated as follows:

| <i>Capital Financing</i> | |
|--------------------------|---|
| (a) | DEBT I multiplied by 0.98; |
| (b) | The result of (a) is then <i>multiplied by</i> INTEREST RATE ; |
| (c) | The result of (b) is then <i>added to</i> DEBT I multiplied by 0.04; |
| (d) | The result of (c) is then <i>multiplied by</i> the scaling factor given in Annex E for <i>Capital Financing</i> . |
| (e) | The result of (d) is then divided by 10,000,000,000. |

where:

| | |
|---------------|--|
| DEBT I | <p>Assumed outstanding debt at 1 April 2013, as calculated by the Secretary of State. Assumed outstanding debt at 1 April 2013 is based generally on assumed outstanding debt at 1 April 1990, credit approvals for the financial years 1990/91 to 2003/2004, Supported Capital Expenditure (Revenue) amounts for 2004/2005 to 2010/2011 and assumed capital repayments.</p> <p>Assumed outstanding debt at 1 April 1990 is the larger of a notional debt figure, based principally on the capital financing components of 1989/90 grant-related expenditure assessments, or an estimate of actual debt, based principally on the adjusted initial credit ceiling.</p> <p>In deriving the notional debt figures, notional debt for the Inner London Education Authority has been reallocated to the City and the inner London boroughs and notional debt for the passenger transport authorities has been reallocated to the relevant metropolitan districts. Adjustments have been made to the notional debt figures for all London boroughs in respect of part of the debt (the “deemed debt”) of the former Greater London Council which was transferred to the London Residuary Body on 1 April 1986 (this adjustment covers the Housing Revenue Account part of debt associated with Thamesmead Housing, debt associated with Seaside and Country Homes, and debt associated with the 1971-73 Transfers).</p> <p>The estimate of actual debt excludes HRA debt, estimated non-HRA debt associated with trading activities, and an estimate of debt associated with capital financing related grants. Adjustments have been made in respect of transfers made under the 1982 HRA Directions, the debts of former metropolitan county councils held by debt administering authorities designated under the Local Government Act 1985, the debt of the former Inner London Education Authority held by the London Residuary Body, parts of the “deemed debt” which were transferred from the Housing Revenue Account to the General Fund, and the debt held by Luton Borough Council for which Bedfordshire County Council is responsible.</p> |
|---------------|--|

Assumed outstanding debt at 1 April 1990 has been reallocated amongst the West Midlands districts to reflect their financing arrangements in respect of waste disposal. Assumed outstanding debt at 1 April 1990 has been reallocated amongst the West Yorkshire districts to reflect their financing arrangements in respect of waste disposal. For the Receiver for the Metropolitan Police District assumed outstanding debt at 1 April 1990 is estimated by the Secretary of State for Transport, Local Government and the Regions on the basis of 1989/90 expenditures.

Assumed outstanding debt at 31 March 1991 is calculated by subtracting the assumed capital repayment (4 per cent of the debt at 1 April 1990) and adding on approved new borrowing (obtained from the credit approvals for 1990/91, as estimated by the Secretary of State in the manner described below in the definition of **CREDIT APPROVALS** but substituting "1990/91" for 2003/2004 and excluding any credit approvals for the London Waste Regulation Agency). Applying this process to each of the financial years for the period 1991/92 to 2003/2004 yields assumed outstanding debt at 1 April 2004. Assumed outstanding debt at 1 April 2013 is then calculated by an analogous process but using **SUPPORTED CAPITAL EXPENDITURE (REVENUE)** amounts instead of **CREDIT APPROVALS**.

Adjustments have been incorporated in respect of assumed outstanding debt at 31 March 1993 in respect of which the Further Education Funding Council makes payments under section 38 of the Further and Higher Education Act 1992.

Where functions have been transferred to new or reorganised local authorities on 1 April in a financial year by or in consequence of an order under section 17 of the Local Government Act 1992, or under section 7 of the Local Government and Public Involvement in Health Act 2007, assumed outstanding debt at 31 March in the preceding financial year has been reallocated to the relevant new or reorganised authorities by applying the following principles:

- (a) where shire county and shire district functions for the whole of a county area are transferred to a single shire county council the debt of the predecessor districts is transferred to the county council;
- (b) where shire county and shire district functions throughout a county council area are transferred to two or more shire district authorities the debt of the shire county council will be apportioned among the reorganised shire district authorities on the basis of taxbase², and the debt of any predecessor shire districts will be transferred to the reorganised shire districts, distributed where necessary among two or more reorganised shire district authorities on the basis of taxbase¹;
- (c) where part of the area of one shire district is transferred to another shire district a portion of the debt of the first district, based on

² The taxbase used for apportioning debt is the Council Tax Base for Revenue Support Grant purposes for the financial year in which the new or reorganised authority takes on its new or additional functions.

| | |
|--|---|
| | <p>taxbase¹, is transferred to the second district; and</p> <p>(d) where county functions for part of the area of a shire county are transferred to a shire district a portion of the debt of the county, based on taxbase¹, is transferred to that district, except in the following three cases concerning:</p> <p>(e) Derbyshire County Council and Derby City Council where 25.54 per cent of the assumed outstanding debt of Derbyshire County Council at 31 March 1997 is transferred to Derby City Council;</p> <p>(f) Bedfordshire County Council and Luton Borough Council where 29.06 per cent of the assumed outstanding debt of Bedfordshire County Council at 31 March 1997 is transferred to Luton Borough Council; and</p> <p>(g) Hampshire County Council, Portsmouth City Council and Southampton City Council where 9.74 per cent of the assumed outstanding debt of Hampshire County Council at 31 March 1997 is transferred to Portsmouth City Council and 10.78 per cent of the assumed outstanding debt of Hampshire County Council at 31 March 1997 is transferred to Southampton City Council.</p> <p>(h) where shire district or shire county functions are transferred to a single unitary authority, the debt of the predecessor districts or county is transferred to the unitary.</p> <p>(i) where shire district or shire county functions are transferred to two or more unitaries, the debt of the predecessor district or county will be apportioned among the reorganised unitaries on the basis of taxbase, except in the following case concerning:</p> <p style="padding-left: 40px;">Cheshire County Council, where 50.8 per cent of the assumed outstanding debt at 31 March 2009 was transferred to Cheshire East Unitary Authority, and 49.2 per cent of the assumed outstanding debt at 31 March 2009 was transferred to Cheshire West and Chester Unitary Authority.</p> <p>For the county councils of Bedfordshire³, Cambridgeshire, Cheshire³, Cleveland, Cumbria, Derbyshire, Dorset, Durham, Essex, Gloucestershire, Hampshire, Hertfordshire, Humberside, Kent, Lancashire, Leicestershire, Lincolnshire, Norfolk, Northamptonshire, North Yorkshire, Nottinghamshire, Staffordshire, Suffolk, Surrey, Warwickshire and Wiltshire assumed outstanding debt at 1</p> |
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³ Bedfordshire County Council was abolished at 1 April 2009 and replaced by Bedford Unitary Authority and Central Bedfordshire Unitary Authority. Cheshire County Council was abolished at 1 April 2009 and replaced by Cheshire East Unitary Authority and Cheshire West and Chester Unitary Authority.

| | |
|---|---|
| | <p>April 1995 is assumed outstanding debt at 31 March 1995 less an amount estimated by the Secretary of State in respect of police debt. This estimate of assumed outstanding police debt at 31 March 1995 forms the 1 April 1995 assumed outstanding debt for the police authority within whose police area the county council was situated (assumed outstanding police debt in respect of the county councils of Essex, Hertfordshire and Surrey forms the assumed outstanding debt for the Essex, Hertfordshire and Surrey police authorities, respectively).</p> <p>For the Receiver of the Metropolitan Police District assumed outstanding debt at 31 March 2000 has been divided between police and non-police services, with the police element being transferred to the Greater London Authority. The Receiver's assumed outstanding non-police debt at 31 March 2001 has been re-allocated to the inner London boroughs.</p> <p>For the London Fire and Civil Defence Authority assumed outstanding debt at 31 March 2000 has been transferred to the Greater London Authority.</p> <p>For the combined fire authorities assumed outstanding debt at 1 April 2008 is based on credit approvals and Supported Capital Expenditure (Revenue) amounts issued to the relevant CFA since it came into existence.</p> <p>For Devon and Somerset Fire and Rescue Authority assumed outstanding debt at 1 April 2007 is the assumed outstanding debt held by Devon Fire and Rescue Authority at 31 March 2007 plus a share of the assumed outstanding debt held by Somerset County Council at 31 March 2007. Somerset County Council's assumed debt at 31 March 2007 has been consequently adjusted.</p> <p>For City of London the assumed outstanding non-police debt at 1 April 1990, is assumed outstanding debt for City of London at 31 March 1990 less an amount estimated by the Secretary of State in respect of police debt. The assumed outstanding police debt at 1 April 2012 is based on credit approvals and Supported Capital Expenditure (Revenue) amounts issued to the City of London for police programmes since 1 April 1990. The assumed outstanding non-police debt at 1 April 2012 is based on credit approvals and Supported Capital Expenditure (Revenue) amounts issued to the City of London for non-police programmes since 1 April 1990.</p> |
| <p>SUPPORTED CAPITAL EXPENDITURE (REVENUE)</p> | <p>There were no new Supported Capital Expenditure (Revenue) ('SCE(R)') allocations from Central Government from 1 April 2011.</p> |

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|--------------------------------|--|
| | <p>SCE(R) for an authority for the financial years 2008/09, 2009/10, 2010/11 was estimated by the Secretary of State on the basis of the aggregate of any amounts which the Secretary of State decided by 5 November 2007 was capital expenditure for that authority that should be supported by RSG or HRA subsidy⁴. Where the Secretary of State did not decide such an amount in relation to any area of his responsibility by that date, the Secretary of State estimated the amount, if any, on the basis of information available to him on 5 November 2007 and used that estimate when calculating the aggregate of the amounts for the purposes of formula grant in 2008/09, 2009/10 and 2010/11.</p> <p>SCE(R) amounts for statutory waste authorities and the Lee Valley Regional Park Authority are divided between their constituent authorities in proportion to their taxbase used in the 2007/08 Settlement.</p> <p>SCE(R) amounts for passenger transport authorities⁵ are divided between their constituent authorities as a common amount per head of their projected population used in the 2007/08 Settlement.</p> |
| <p>CREDIT APPROVALS</p> | <p>Basic Credit Approvals (BCAs) for 2003/2004; plus Supplementary Credit Approvals (SCAs) so far as they apply to 2003/2004, as estimated by the Secretary of State⁶.</p> <p>For both BCAs and SCAs, a reduction is made to take account of trading activities. Any SCAs issued as a result of receiving support from the European Regional Development Fund, or in respect of Specified Capital Grants, or credit approvals relating to local authority projects undertaken through the Private Finance Initiative⁷, or which are not expected to give rise to additional long-term borrowing, are excluded.</p> <p>For housing authorities, reductions are made to the BCA to take account of any part of the BCA issued to cover Specified Capital Grants and of an assumed portion of the BCA to be used in relation to local authority rented housing. Any SCAs issued for services accounted for within the Housing Revenue Account are also excluded.</p> |

⁴ HRA subsidy means Housing Revenue Account subsidy payable to a local housing authority under section 79 of the Local Government and Housing Act 1989.

⁵ Passenger Transport Authorities were abolished and replaced with Integrated Transport Authorities on 9 February 2009.

⁶ Aggregate and Additional Credit Approvals for the Greater London Authority.

⁷ The Private Finance Initiative (PFI) and its applicability to the local authority sector were originally explained in section 1 of the booklet *The Private Finance Initiative and Local Authorities – An Explanatory Note* published jointly by the Department of the Environment and the Welsh Office in October 1996. Current advice on the PFI and public/private partnerships is available on the Office's web site at www.local.communities.gov.uk/pfi/index.htm.

| | |
|----------------------|---|
| | <p>Credit Approvals for statutory waste authorities and the Lee Valley Regional Park Authority are divided between their constituent authorities in proportion to their taxbase used in the 2007/08 Settlement.</p> <p>Credit Approvals for passenger transport authorities are divided between their constituent authorities as a common amount per head of the projected population used in the 2007/08 Settlement.</p> |
| INTEREST RATE | <p>A notional pool rate of interest calculated by the Secretary of State using a 12 month average of short and long term interest rates up to September 2012. This is 4.4 per cent.</p> |

Annex B: How the Pooled Interest Rate was calculated in 2013-14

| | <u>£ Million</u> | <u>Associated interest figures</u> | |
|--|------------------|------------------------------------|--------------|
| | | <u>Interest paid (£ M)</u> | <u>Rate</u> |
| PWLB debt at 31 March 2012 | £50,743 | £2,254 | 4.443 |
| <u>Add</u> Non-PWLB debt at 31 March 2012 | £20,664 | £906 | 4.384 |
| <u>Add</u> Temporary debt at 31 March 2012 | £465 | £5 | 0.993 |
| Equals Total debt at 31 March 2012 | £71,872 | £3,165 | 4.404 |
| <u>Less</u> 1 year PWLB debt | £1,104 | £45 | 4.088 |
| <u>Less</u> 1 year Non-PWLB debt | £438 | £17 | 3.841 |
| <u>Add</u> new PWLB debt in 2012-13 | £0 | £0 | 4.098 |
| <u>Add</u> new Non-PWLB debt in 2012-13 | £0 | £0 | 3.150 |
| Equals Total debt at 31 March 2013 | £70,329 | £3,103 | 4.412 |
| <u>Less</u> 1 year PWLB debt | £1,204 | £59 | 4.865 |
| <u>Less</u> 1 year Non-PWLB debt | £251 | £12 | 4.952 |
| <u>Add</u> new PWLB debt in 2013-14 | £0 | £0 | 4.098 |
| <u>Add</u> new Non-PWLB debt in 2013-14 | £0 | £0 | 3.150 |
| Equals Total debt at 31 March 2014 | £68,874 | £3,032 | 4.402 |
| Average position in 2013-14 | £69,602 | £3,068 | 4.4 |

PWLB debt at 31 March 2012: This was obtained from PWLB. In order to calculate the outstanding balance for the 2-3 years, 3-4 years and 4-5 years data on the outstanding balance for 2-5 years was split based on the average of the last five years data. The 15 and over years data is an average of the all the data in this category.

| | <u>Balance Outstanding at 31/3/12</u> | <u>Average Interest Rate (%)</u> | <u>Total interest</u> |
|-------------------|---------------------------------------|----------------------------------|-----------------------|
| Maturity within: | | | |
| 1 year | 1,104,476,902.61 | 4.088 | £45,154,591 |
| 1-2 years | 1,204,394,451.40 | 4.865 | £58,596,056 |
| 2-3 years | 1,246,298,668.85 | 5.376 | £67,003,030 |
| 3-4 years | 1,324,192,335.65 | 5.376 | £71,190,719 |
| 4-5 years | 1,324,192,335.65 | 5.376 | £71,190,719 |
| 5-10 years | 6,013,334,499.92 | 4.336 | £260,751,774 |
| 10-15 years | 5,663,201,752.48 | 4.685 | £265,305,880 |
| 15 and over years | 32,862,837,270.33 | 4.307 | £1,415,241,068 |
| Total | 50,742,928,216.90 | 4.443 | £2,254,433,837 |

Non-PWLB debt at 31 March 2012: Non-PWLB debt was calculated as follows:

| | Balance Outstanding at 31/3/12 | Average Interest Rate (%) | Total interest |
|--|---|--|---------------------------|
| CIPFA survey: | | | |
| Maturity | | | |
| within: 1 year | £238,544,000 | 3.611 | £8,613,848 |
| 1-2 years | £326,929,000 | 3.841 | £12,557,961 |
| 2-5 years | £434,468,000 | 4.952 | £21,515,223 |
| 5-10 years | £353,368,000 | 8.038 | £28,402,863 |
| 10-20 years | £728,244,000 | 6.123 | £44,590,688 |
| 20-30 years | £265,673,000 | 5.231 | £13,898,561 |
| 30-40 years | £971,969,000 | 4.965 | £48,260,541 |
| 40-50 years | £2,361,223,000 | 4.291 | £101,330,139 |
| 50+ years | £4,937,480,000 | 4.413 | £217,872,805 |
| Total | £10,617,898,000 | 4.681 | |
| QBLI: | | | |
| Maturity | | | |
| within: 1 year | £319,900,395 | 3.611 | £11,551,636 |
| 1-2 years | £438,429,456 | 3.841 | £16,840,904 |
| 2-5 years | £582,645,066 | 4.952 | £28,853,076 |
| 5-10 years | £473,885,584 | 8.038 | £38,089,774 |
| 10-20 years | £976,614,558 | 6.123 | £59,798,522 |
| 20-30 years | £356,281,850 | 5.231 | £18,638,722 |
| 30-40 years | £1,303,462,953 | 4.965 | £64,719,993 |
| 40-50 years | £3,166,527,641 | 4.291 | £135,889,192 |
| 50+ years | £6,621,427,497 | 4.413 | £292,179,206 |
| Total | £14,239,175,000 | 4.681 | |
| | £ m | Interest paid (£ m) | Rate |
| Activity in 2010-11 : | | | |
| Non-PWLB debt at 31 March 2011 | 14,239 | 666.561 | 4.681 |
| <u>Less</u> repayment of debt under 1 year | 320 | 11.552 | 3.611 |
| <u>Less</u> other debt repayment | 100 | 4.681 | 4.681 |
| <u>Add</u> new debt in 2011-12 | 6,845 | 255.657 | 3.735 |
| Non-PWLB debt at 31 March 2012 | 20,664 | 905.985 | 4.384 |

The CIPFA data is taken from the Treasury Management Survey Part B: Maturity Structure of Long Term Debt. It uses cells 30 to 48 for all authorities. These are then aggregated.

The Quarterly Borrowing and Lending Inquiry data provides data on the total England long-term borrowing together with the total borrowed through PWLB. The total borrowing less PWLB borrowing provides data on the borrowing from other institutions. Data on inter local authority borrowing is then added to give a total for non-PWLB borrowing. Data for both

2010-11 and 2011-12 was used for the 2013-14 calculations. This borrowing is then split by date of maturity based on the CIPFA data described above.

The other debt repayment is estimated by DCLG.

The new debt data then becomes the balancing item in the activity section of the above table.

Temporary debt at 31 March 2012: This is the aggregate of the data from the Quarterly Borrowing and Lending Inquiry.

| | 2012 |
|---|----------------|
| | (£ 000) |
| Securities - LA Revenue Bills | 0 |
| Loans Temporary - Banks in UK | 58,603 |
| Loans Temporary - Building Societies | 4,000 |
| Loans Temporary - Other financial intermediaries | 182,975 |
| Loans Temporary - Public corporations | 106,262 |
| Loans Temporary - Private non-financial corporation | 4,731 |
| Loans Temporary - Central Government | 37,594 |
| Loans Temporary - Households sector | 35,345 |
| Loans Temporary - Source not known | 35,685 |
| Total | 465,195 |

1 year PWLB debt: This comes from the CIPFA data for the appropriate year.

1 year non-PWLB debt: This comes from the QBLI data for the appropriate year.

New debt: As there have been no SCE(R)s issued since 2010-11 this is set to zero.