Department for Communities and Local Government

Capitalisation Directions 2013-14 Policy and Procedures

Guidance note

July 2013
Department for Communities and Local Government

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1. Introduction and general policy

1.1. Introduction

1.1.1. This guidance note sets out the criteria that the Secretary of State will apply to capitalisation requests for 2013-14, and the procedures for the issue of capitalisation directions. The Local Government Finance Settlement announced that £100m of capitalisation would be available in 2013-14, to support local authorities. Any provision not allocated will be distributed to local authorities in accordance with their share of the 2013-14 Start-Up Funding Assessment.

1.1.2. While capitalisation will provide important support in 2013-14 to help local authorities meet unexpected one-off costs, it will be for local authorities themselves to assess how they can best manage costs overall from their own resources - including, as appropriate, from reserves.

1.2. What is capitalisation?

1.2.1. Capitalisation is the means by which the Government, exceptionally, permits local authorities to treat revenue costs as capital costs. It is a relaxation of the accounting convention that revenue costs should be met from revenue resources.

1.2.2. Permission is given through capitalisation directions, which the Secretary of State has the power to issue under section 16(2)(b) of the Local Government Act 2003.

1.2.3. The effect of a direction is that specified revenue expenditure becomes treated as capital expenditure, so that instead of having to be charged to revenue, it may be funded from capital sources (e.g. borrowing or capital receipts), thereby increasing a local authority's financial flexibility.

1.2.4. Ministers have discretion under Section 20 of the Local Government Act 2003 to impose other conditions: for example, that the capitalised expenditure is to be met out of capital receipts rather than by external borrowing. That section also confers power to revoke and vary directions already issued.

1.3. Why is capitalisation controlled?

1.3.1. Since capitalisation is a relaxation of the normal accounting requirement that long-term borrowing or capital receipts should only be used to finance capital expenditure, it has always been subject to an application process, with applications assessed against strict criteria.

1.3.2. The Government's top priority is to reduce the budget deficit. Regardless of whether the capitalised expenditure is funded through borrowing or the use of receipts (eg. from asset sales), capitalisation scores as Public Sector Current Expenditure in the national accounts. It therefore impacts directly on the deficit reduction programme.

1.3.3. Given these macro-economic considerations, it is all the more important that capitalisation is strictly controlled, and that the Government is able to monitor closely and control the degree and use of capitalisation.

1.3.4. It is also important to note that, from the viewpoint of local authorities, capitalisation runs counter to the principles of prudent financial management. It can never permanently solve financial difficulties, but simply postpones the need to deal with them. For example, debt incurred to meet revenue costs will have to be serviced from revenue resources over many years, and using capital resources for revenue expenditure tends to reduce long-term investment in capital assets. All these issues should be carefully considered before making an application for a capitalisation direction.

1.4. How the guidance has changed since 2011-12

1.4.1. The capitalisation criteria have been revised since 2011-12. This is set out in Section 2 of the guidance.

1.4.2. Please note that for 2013-14 it has been decided to assess all capitalisation applications under the same guidance, regardless of the type of costs for which capitalisation is sought. In particular, local authorities should note that this guidance also covers capitalisation requests to cover equal pay liabilities.

1.4.3. This guidance supersedes that issued by the Department for Communities and Local Government in March 2011 for non-equal pay capitalisation, and that issued in July 2011 for equal pay capitalisation.

1.5. Authorities that can apply

1.5.1. Although any authority can apply for capitalisation, we will not be providing capitalisation funding to Local Policing Bodies. The Home Office have a well established process by which the police can apply for additional funding in the event of significant and exceptional events (known as Special Grant). Local Policing Bodies should contact the Home Office with regard to this funding, in the first instance.

1.6. Reserves

1.6.1. As set out in Section 2 of the guidance, consideration of the level of reserves will be a key part of the assessment process. The Government will look at the total reserves for each authority (excluding schools reserves), including both “earmarked” and unallocated reserves, since earmarking of reserves in itself does not exclude use for other purposes.

1.6.2. Within the statutory and regulatory framework, it is for local authorities to assess what the appropriate level of reserves should be, taking into account all of the relevant factors. These factors are best assessed at the local level, and in the context of both the budget for a particular year, and medium term financial planning.

1.6.3. As the Secretary of State said in his statement in November 2010, Ministers believe that it is sensible - as part of wider financial planning - for local authorities to consider drawing on their reserves to help them manage transformational change, where it is appropriate to do so. A local authority might decide that a prudent and managed approach to using reserves would be appropriate to help to manage the costs of internal restructuring.

2. Applying for capitalisation

2.1. General capitalisation criteria and basic policy

2.1.1. In view of the considerations set out in Section 1 above, capitalisation is only likely to be agreed where an extremely strong case can be made. The tests outlined below are designed to examine the justification for it.

2.1.2. Capitalisation should be sought only for costs which are due largely to factors beyond the local authority's control. It should not be requested for routine planned schemes, no matter how beneficial the long-term effects.

2.1.3. It should be noted that capitalisation is only appropriate for one-off costs. It would be most imprudent for a local authority to keep borrowing to meet indefinitely continuing payments.

2.1.4. It should also be noted that applications should only be submitted for the financial year in which the expenditure is to be incurred.

2.1.5. It may be helpful to consider the following examples of costs for which capitalisation has been refused in previous years:

- lost interest on investments made in Icelandic Banks;
- consultancy fees;
- publicity and public consultation costs;
- costs of tenants' ballots on proposed large-scale voluntary transfers of housing;
- legal costs arising from contractual disputes;
- development and procurement costs of capital projects and PFI schemes;
- costs of re-engineering administrative processes;
- sunk project costs;
- workforce efficiency training;
- discretionary and enhanced redundancy costs; and
- concessionary fares.

2.1.6. For 2013-14, capitalisation requests will be assessed against two different sets of criteria, determined by the type of expenditure to be capitalised.

2.1.7. Applications for costs arising from restructuring or service transformation expenditure will be assessed against the following affordability test (see Section 2.5 below for full details):

The costs to be capitalised must exceed *both:*
(a) 20% of General Fund available reserves; *and*
(b) 1% of budgeted expenditure for the year in which the expenditure is incurred.

2.1.8. Applications for all other costs, not related to restructuring or service transformation, will be assessed against the following financial difficulty criteria (see Section 2.7):

(a) the capitalised expenditure is unavoidable (for example, because it relates to statutory duties or contractual or other commitments);
(b) the local authority could not meet the expenditure out of revenue resources without there being an unacceptable adverse impact on those who use or pay for its services; and
(c) there is no alternative way of ensuring that the expenditure could be met.

2.2. The timetable

2.2.1. In order to fairly assess all requests within the limits of the amount available for capitalisation in 2013-14, all applications should be submitted to the Department for Communities and Local Government by 31 October 2013. All applications received by the deadline will be considered against the criteria set out in this guidance.

2.2.2. The precise amount to be capitalised will be determined by the Secretary of State once all the applications have been assessed. Where applications that meet the criteria are received in excess of the available funding the amounts allowed under capitalisation may be scaled back.

2.2.3. Decisions on requests made in line with this timetable, will be issued as early as possible in January 2014. We would expect the majority of the capitalisation limit for 2013-14 to be allocated in line with this timetable. Any provision not allocated will be distributed to local authorities in accordance with their share of the 2013-14 Start-Up Funding Assessment.

2.2.4. Any applications received after the deadline of 31 October 2013 will be assessed in the possible context of no identified funding remaining for capitalisation. It is important therefore that local authorities who consider that they may have applications that meet the criteria should submit applications by 31 October 2013.

2.2.5. Following final decisions, a summary list of applications will be published on the Department's website, indicating the type of expenditure for which each application was made and the amount for which a direction was given.

2.2.6. In order to ensure that all the available capitalisation is used, local authorities who receive directions will be asked to confirm to the Department as soon as they receive the direction that they intend to use their allocation in its entirety. This will allow for any capitalisation not used to be made available for late applications received after 31 October 2013.

2.3. The assessment process

2.3.1. The process for 2013-14 will not be subject to the two-stage approach undertaken in previous years. All applications will be assessed against the criteria set out below and final decisions and/or directions will be issued in line with the timetable set out above.

2.3.2. The overall total that local authorities are seeking to capitalise will be considered against the eligibility criteria and in the context of the total level of capitalisation available. The overall process will take account of the implications of capitalisation across the board.

2.3.3. For 2013-14 we propose to limit the amount allowed to be capitalised to the amount above the percentage of non-allocated schools funds. For example, where the criteria percentage is 20% and a local authority has a restructuring cost of £2.5m, worth 25% of their non-school reserves, we will only allow capitalisation of up to £0.5m.

2.3.4. We consider this to be fair to local authorities not in receipt of capitalisation, especially those who do not qualify because costs to be capitalised are less than 20% of their non-school reserves and so would not be able to capitalise at all, and who are effectively paying for another local authorities' capitalisation through the top-slice of capitalisation funding from Revenue Support Grant.

2.3.5. If, after that initial scaling back, the total amount meeting the criteria is greater than the total level of capitalisation available, consideration will be given to the method of distributing the amount available between applicants. The approach adopted may be influenced by the scale of any reduction needed. As well as considering a possible pro-rata scaling back of directions, the Secretary of State may also consider whether a sliding scale approach, based on an assessment of the level of need, might be appropriate.

2.4. Information required

2.4.1. In order to consider applications as fairly as possible, the Department is seeking a range of information that must be provided with all applications. Annexed to this document is a checklist to assist the application process.

2.4.2. Applications should indicate whether they relate to the General Fund, where the costs relate to non-housing expenditure, or the Housing Revenue Account for housing expenditure.

2.4.3. Where an application relates to housing expenditure, councils will be expected to provide details of the amount held in their Housing Revenue Account in addition to the information required for all other requests.

2.4.4. Local authorities should consider sending applications both electronically and in hard copy, or, if in hard copy only, by registered post. Applications by email should be sent to the following address: capitalisation@communities.gsi.gov.uk.

2.4.5. All applications must be received by 31 October 2013. Any applications received after the deadline of 31 October will be assessed in the possible context of no identified funding remaining for capitalisation.

2.4.6. All applications will be acknowledged by the Department by email within 14 days of receipt. Applicant local authorities who do not receive an acknowledgement email within 14 working days after submitting should contact the Department to confirm that the application has been received.

2.4.7. Applications should present all the required information as fully as possible, in the order given on the checklist. Failure to do so may result in consideration of the application being delayed whilst the Department seeks clarification and, where clarification is not forthcoming in a timely manner, the application not being considered.

2.4.8. The Department expressly reserves the right to seek further information where this may be required. There is, however, no guarantee that supplying the requested information will lead to a direction being issued. It is the local authority's responsibility to ensure that all the relevant information is submitted, including any additional information which it wishes to be taken into account.

2.5. Restructuring and service transformation

2.5.1. Capitalisation is meant to help authorities deal with one-off costs that would otherwise be unaffordable. Therefore, the use of capitalisation for 13-14 may be appropriate to assist local authorities meet the one-off up-front revenue costs from organisation restructuring, such as redundancy payments, or service transformation, such as 'invest to save' projects[1], required to deliver savings for 14/15 and in future years.

2.5.2. To test whether capitalisation is necessary to help a local authority manage unaffordable costs, applications will be considered against an affordability test.

The costs to be capitalised must exceed *both:*
(a) 20% of General Fund available reserves; *and*
(b) 1% of budgeted expenditure for the year in which the expenditure is incurred.

2.5.3. There has been an increase in the percentage of reserves and budgeted expenditure thresholds in comparison to the affordability test applicable to the 2011/12 process. This takes account of the fact that the available funding for capitalisation in 13-14 is greatly reduced from that available in 2011/12.

2.5.4. General Fund available reserves are the total unallocated and other earmarked reserves as predicted for 31 March 2014, as supplied to the Department on the Revenue Account Budget Estimate (a combined total of lines 1015 and 1016).

[1] See examples 1 and 2 of 50 Ways to save - https://www.gov.uk/government/publications/50-ways-to-save-examples-of-sensible-savings-in-local-government plus examples of transformation in Transformation Challenge Award - https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/175549/TCA_Letter_to_Leaders_27_March__final_.pdf

2.5.5. Budgeted expenditure is Revenue Expenditure (on a non-IAS 19 basis) calculated from the figures supplied to the Department on the Revenue Account Budget Estimate. The calculation is Revenue Expenditure plus appropriation to/from pensions reserve (line 799).

2.6. Financial difficulty

2.6.1. All other applications for capitalisation, not related to restructuring or service transformation, will be considered against the financial difficulty test.

2.6.2. The following three conditions must be met. Authorities will need to demonstrate clearly how their application meets these conditions:

(a) the capitalised expenditure is unavoidable (for example, because it relates to statutory duties or contractual or other commitments);
(b) the local authority could not meet the expenditure out of revenue resources without there being an unacceptable adverse impact on those who use or pay for its services; and
(c) there is no alternative way of ensuring that the expenditure could be met.

2.6.3. Evidence will be required that financial difficulties are of an extreme nature. Relevant factors might include, for example, the issuing of a Section 114 report, or use by the Government of its statutory intervention powers. Capitalisation would need to be part of a package of measures to get the local authority back onto a sound financial footing. Capitalisation by itself could make the situation worse rather than better by prolonging and extending the problem.

2.6.4. In order to meet condition (b) above, we would normally expect the costs to be capitalised to exceed 40% of available reserves. General Fund available reserves are the total unallocated and other earmarked reserves as predicted for 31 March 2014, as supplied to the Department on the Revenue Account Budget Estimate (a combined total of lines 1015 and 1016). Where the application relates to housing expenditure we would consider that the 40% of available reserves also includes reserves held in the Housing Revenue Account.

2.6.5. Evidence will be required to support conditions (a) and (c) above. Councils may provide supporting evidence as they see fit in justification of their request for capitalisation.

2.7. Equal pay liabilities

2.7.1. Local authorities are advised that before making any applications for capitalisation they should have regard to the amendments made via the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2013. These amendments permit local authorities to use capital receipts received on or after 1st April 2012 to make back payments in respect of unequal pay liability as well as allowing authorities to score liabilities when payments are made.

2.7.2. The Secretary of State's expectation is that approval for capitalisation of equal pay costs will not be granted if, in his view, a local authority has not made sufficient use of this flexibility to manage equal pay costs. We would expect a local authority to provide justification as to why it was retaining an asset base.

2.7.3. When submitting an application for capitalisation of equal pay costs, a local authority would need to clearly demonstrate why they could not make use of the flexibilities introduced with the amended regulations. If an application does not provide sufficient evidence to clearly demonstrate this point then it is unlikely that a direction will be granted.

2.8. Payments into pension funds

2.8.1. Any applications made for capitalisation of lump-sum payments into pension funds will be considered against the conditions set out in paragraphs 2.6.1 to 2.6.5 above.

2.8.2. As part of the supporting evidence for capitalisation of pension costs, the cause of the deficit will need to be explained and the application will need to be accompanied by the LGPS Pension Fund's last triennial actuarial valuation report and the latest Funding Strategy Statement.

2.8.3. The following conditions will also usually apply:

(a) capitalisation is unlikely to be allowed unless the local authority is able to demonstrate that it has taken all the steps allowed under the Local Government Pension Scheme, including 'spreading' and 'stepping' options;

(b) capitalisation is unlikely to be allowed if the funding difficulties arise from a decision by the local authority itself either to make provision over a shorter period than is recommended by its fund's actuary, or to exceed a limit on early retirements agreed as part of the actuarial valuation inputs; and

(c) in addition, any directions issued are likely to require the capitalised payment into the fund to be met only out of capital receipts and not by borrowing.

2.8.4. Advice issued by the Department in connection with the Local Government Pension Scheme and associated legislation can be accessed online in the 'available documents' section at: www.clg.heywood.co.uk.

2.9. Returns to the Department

2.9.1. Local authorities receiving capitalisation directions for 2013-14 will be asked to let the Department know upon receipt of the direction that they intend to use the direction in its entirety. This is to ensure that any capitalisation that is not intended to be used may be made available to late applications.

2.9.2. Where local authorities notify the Department before the end of the financial year that they have not used the full amount of their direction, the Department will issue a revised capitalisation direction for the appropriate amount.

2.9.3. All direction letters issued will contain a requirement that local authorities inform the Department of how much of their allocation was subsequently used in the financial year. These returns enable the Department to monitor the operation of the system. Authorities should therefore inform the Department, at the address below, no later than July 2014. There is no template returns form: an email or hard copy return will suffice.

2.10. Contacts

2.10.1. Queries and applications in respect of capitalisation requests should be directed to the Department for Communities and Local Government Capital Finance and Reserves Team as follows:

Nikki Sarton
Capital Finance and Reserves Team
Department for Communities and Local Government
Zone 5/J3
Eland House
Bressenden Place
London
SW1E 5DU

Tel: 0303 444 2085   Fax: 0303 444 3294

Email: capitalisation@communities.gsi.gov.uk

Annex A

Checklist of information required in support of capitalisation requests

1. **Name of local authority**

2. **Name and position of official**

3. **Address**

4. **Telephone number**

5. **Email address**

6. **Purpose of costs for which capitalisation is sought.**

   Delete as appropriate
   Restructuring – please also state reason

   Financial Difficulty - please state reason

7. **Financial year in which costs are to be incurred**

8. **Amount which your local authority is applying to capitalise**

9. **Is the application figure the final figure or an estimate**

10. **Detailed description of application**

11. **Restructuring / service transformation -** Evidence provided that the purpose is a one off cost relating to restructuring / service transformation.

12. **Financial Difficulty** – Please provide evidence that the financial difficulties are of an extreme nature. For example - is the local authority subject to the Government's intervention powers?

Local authorities will need to provide evidence that their application meets these conditions:

- the capitalised expenditure is unavoidable (for example, because it relates to statutory duties or contractual or other commitments);

- there is no alternative way of ensuring that the expenditure could be met.

13. **Pension costs -** If applying for pensions costs, have you provided explanation of the cause of any deficit, and have you included the LGPS Pension Fund's last triennial actuarial valuation report and the latest Funding Strategy Statement?

Have you excluded pension fund "strain on" costs? ("Strain on fund" payments mean those payments the authority would make into its pension fund in order to eliminate any deficits resulting from premature retirements. If applied for, these should be subject of a separate application, and should only be applied for on the grounds of exceptional financial difficulties.)

14. **Equal Pay -** If applying for equal pay costs, have you included full details of why the flexibilities introduced by amendments to the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2013, cannot be used to meet the expenditure? Why is the authority maintaining an asset base?

15. Total unallocated and other earmarked revenue reserves predicted for 31 March 2014, as submitted on the DCLG Revenue Account Budget (a combined total of lines 1015 and 1016)

Application Amount £	Total Non School Revenue Reserves £	Application Amount as %

Please provide any additional information which you consider to be relevant to your application.

Requests to capitalise statutory redundancy costs should be submitted to the Department for Communities and Local Government no later than **31 October 2013**.