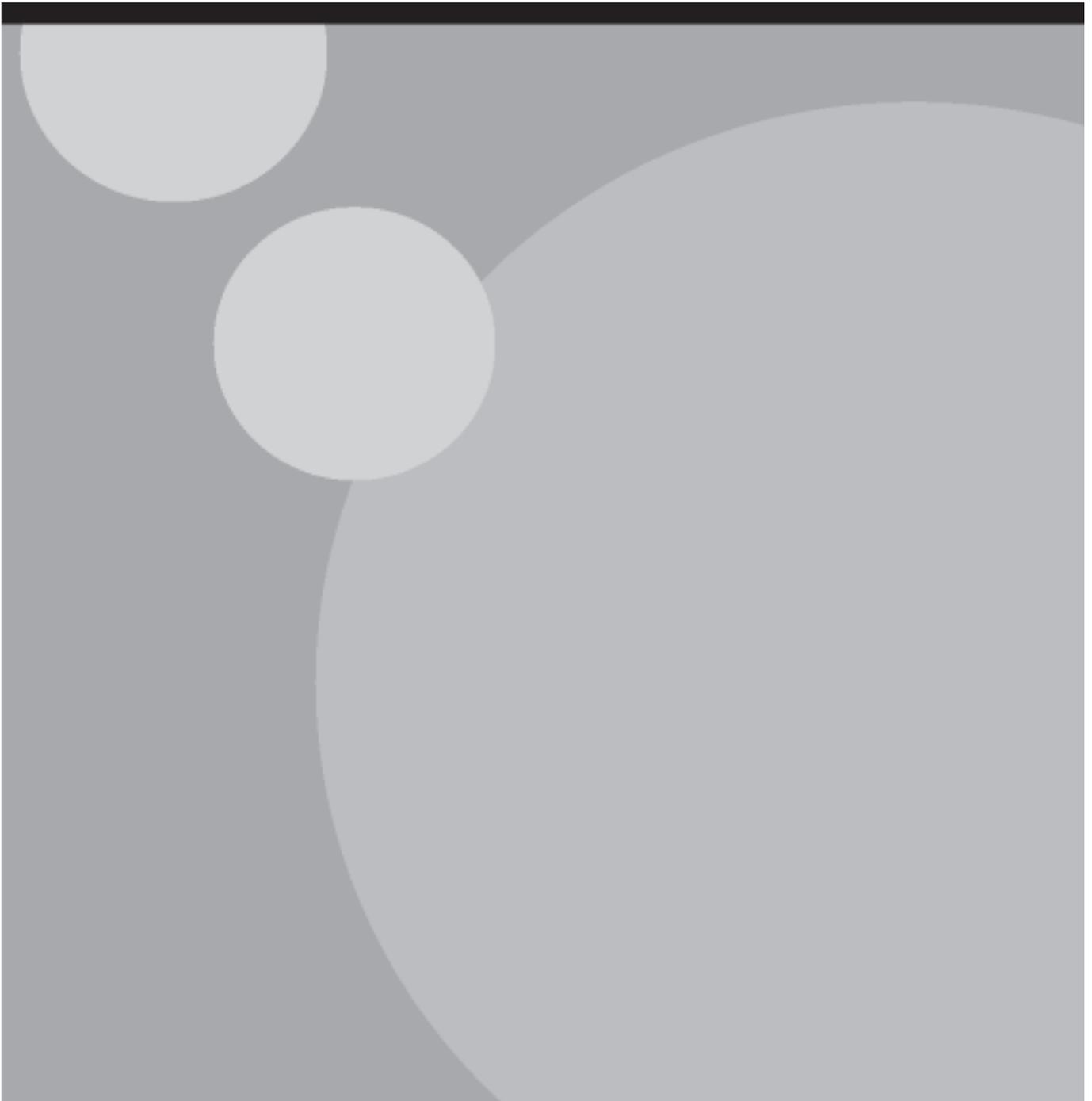




Changes to the capital finance system – consultation

Summary of responses





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Introduction

1. On 11 October 2011 the Department issued a consultation document entitled **Changes to the Capital Finance System**, which was sent to all local authorities in England and other interested parties. The consultation period ran for 6 weeks until 22 November 2011. The respondents are listed in Annex A. The consultation material is available online at:

<http://www.communities.gov.uk/publications/localgovernment/capitalfinancechangescons>

2. The consultation sought views on the following issues:
 - Proposals to make the **Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2012**.
 - Proposals to revise the **DCLG Minimum Revenue Provision Guidance**.
3. This document summarises the main points made by respondents, gives the Department's comments and indicates what action, if any, the Department intends to take.

Capital finance amendment regulations

Securitisation

Issue: To amend the 2003 Regulations, so that if securitisation is ever lawfully used, it will be on an equal footing with borrowing. “Securitisation” as used in this context means the disposal of future revenues in exchange for an immediate lump sum payment.

Proposals:

(a) The proposed definition of the term “**securitisation transaction**” is the sale or assignment by a local authority, for consideration, of its entitlement to all or part of specified revenues.

(b) **Securitisation transactions will become credit arrangements.** The prudential system controls apply not only to conventional borrowing but also to the use of “credit arrangements” – i.e. financing options which serve as substitutes for borrowing. Securitisation does not fall within the current definition of credit arrangements. However, section 7 of the 2003 Act gives the power to extend that definition. Therefore, securitisation transactions will become credit arrangements. This will make securitisation subject to the affordability requirement.

(c) **Securitisation transactions will generate capital receipts.** The sum received by a local authority under a securitisation transaction will be treated as a capital receipt, using the power in section 9 of the 2003 Act.

Consultation responses: Respondents were content with the proposals. Comments raised in the consultation gave rise to the additional measure described below. Other queries about legal issues and accounting treatment will be dealt with in the informal commentary which the Department will issue when the regulations are laid.

DCLG comments: As well as introducing the provisions consulted on, the Department intends to make an additional provision to specify the cost of a credit arrangement. This is so that a credit arrangement’s affordability can be assessed under the prudential system and so that the value-for-money of securitisation can be compared with that of the alternative of borrowing. The existing regulation 6 says that the cost is the amount of the *liability* in respect of the arrangement in the authority’s accounts. However, a securitisation transaction would not lead to any such liability. The additional provision will specify the cost of the securitisation transaction is to be equal to the sum received by the authority as a result of the securitisation transaction.

Investment in bonds

Issue: If local authorities buy the shares or bonds of an *individual* company, the regulations require them to treat this transaction as “capital expenditure”, so reducing the resources available for actual expenditure (regulation 25(1)(d)).

Proposal: To amend regulation 25 so that purchases of the bonds of individual companies will no longer be capital expenditure. This will be achieved by deleting the words “*or loan capital*” in paragraph (1)(d). Also, when a bond is either sold in the market or reaches maturity and is redeemed by the borrower, the proceeds are to be treated as revenue. The exception to this is if the acquisition of the bond was prior to 1 April 2012 then the proceeds are to be treated as capital receipts and count as capital expenditure.

Consultation responses: Respondents were content.

DCLG comments: The proposed regulation will be introduced.

Code of Practice on Accounting

Issue: Existing **regulation 3**, on credit arrangements, quotes a technical term (“fixed asset”) which is no longer used in the Chartered Institute of Public Finance and Accounting’s code of practice on local authority accounting.

Proposal: To replace the term (“fixed asset”) in the regulation with an equivalent expression (“non-current asset which is not a financial asset”).

Consultation responses: Respondents were content.

DCLG comments: The proposed regulation will be introduced.

Best Value Accounting Code

Issue: Existing regulation 31 lists the codes which constitute proper accounting practices, including the Chartered Institute of Public Finance and Accountancy’s “Best Value Accounting Code of Practice”. This has now been renamed “Service Reporting Code of Practice for Local Authorities”.

Proposal: To change the name of the code in regulation 31.

Consultation responses: Respondents were content.

DCLG comments: The proposed regulation will be introduced.

Expenditure to be Capital Expenditure

In addition to the proposals in the consultation document, the Department intends to make a further amendment which was suggested by local authority comments made during the consultation exercise. This is to amend Regulation 25(1)(ea) to clarify that expenditure on the construction of assets for the purpose of disposal may be treated as capital expenditure. As now drafted, that regulation modifies the standard definition of “capital expenditure” to include expenditure on the acquisition or production of assets for use by a person other than the local authority which would be capital expenditure if those assets were acquired or produced for use by the authority.

Doubts were raised about whether “production” includes the construction of an asset (such as a house), and whether “use by” includes a disposal to. The Department accepts that such expenditure should count as capital expenditure, so that the cost can properly be met out of capital resources rather than having to be charged as a revenue cost. Uncertainty about the present wording could hinder, for example, vital affordable housing initiatives. The intention therefore is to amend regulation 25(1)(ea) so that it refers to expenditure on the “acquisition, production or construction of assets for use by, or disposal to, a person other than the local authority”.

DCLG Minimum Revenue Provision Guidance

Issue: To ensure that authorities taking on new debt in the course of Housing Revenue Account (HRA) reform do not face disproportionate increases in their Minimum Revenue Provision (MRP) liability.

Proposal: Additional guidance is to be included in the Minimum Revenue Provision guidance as follows:-

In Part 1 (informal commentary), after paragraph 39, the following paragraph is to be inserted-

“ HRA Reform Exercise

39A. This initiative, on 1 April 2012, entails new debt being incurred by certain authorities, some with a previously negative HRA CFR (Capital Financing Requirement). The ensuing increase in their overall CFR would potentially raise their MRP liability - in some cases from nil to a significant level. The Secretary of State considers that, given the special circumstances of the exercise, such a consequence should not be imposed upon authorities. He therefore makes the formal recommendation (Part 2, paragraph 19(b) below) that, for the purposes of determining MRP, this increase in the CFR may be ignored, and so avoiding any impact on the revenue budget.”

In Part 2 (statutory guidance), at the end of paragraph 19(b), the following sentence is to be added-

“Any increase in the CFR arising from the HRA reform exercise undertaken on 1 April 2012 may be ignored for the purposes of determining MRP.”

Consultation responses: Respondents were content.

DCLG comments: The guidance will be amended as proposed. A revised version of the guidance will be placed on the website as soon as possible but in the meantime authorities should use the proposal as the basis for their statements, where applicable.

Annex A

List of respondents

1. Adur District Council
2. Allerdale Borough Council
3. Arlingclose Ltd
4. Basildon Borough Council
5. Basingstoke and Deane Borough Council
6. Birmingham City Council
7. Blackburn and Darwen Borough Council
8. Blackpool Council
9. Cambridgeshire County Council
10. Chartered Institute of Public Finance and Accountancy
11. Corby Borough Council
12. East Sussex County Council
13. East Sussex Fire Authority
14. GriffithsMorley
15. Lancashire County Council
16. Lichfield District Council
17. London Borough of Brent
18. London Borough of Croydon
19. London Borough of Enfield
20. London Borough of Haringey
21. London Councils
22. National Association of Local Councils
23. North Yorkshire Fire and Rescue Service
24. Northampton Borough Council
25. Sector Treasury Services Ltd
26. Shepway District Council
27. South Somerset District Council
28. South Tyneside Council
29. Southend-on-Sea Borough Council
30. Sterling Consultancy Services
31. Westminster City Council
32. Worthing Borough Council