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Dear Colleague

LOCAL GOVERNMENT CAPITAL FINANCE SYSTEM AMENDMENTS TO REGULATIONS

Local Authorities (Capital Finance and Accounting) (Amendment) (England) (No 2) Regulations 2004 [S.I. 3055]

My letter of 27 August 2004 invited comments on draft amendment regulations. We are most grateful for the responses, which we took into account when finalising the provisions. The regulations will come into force on 16 December 2004 and will amend the *Local Authorities (Capital Finance and Accounting) (England) Regulations 2003* [SI 3146], made under Part 1 of the *Local Government Act 2003*.

I enclose a copy of the Statutory Instrument, which is available online at:
<http://www.legislation.hmsso.gov.uk/si/si2004/20043055.htm>

Also enclosed is an informal commentary explaining the intention of the regulations and indicating how they differ from the consultation draft. The effects of the regulations, which are all beneficial to authorities, are broadly to:

- relax the rules on the **pooling of housing capital receipts** arising from small scale stock transfers and sales of former new town housing (regulations 2, 3, 4 and 5)
- clarify the calculation of **minimum revenue provision** (regulation 6)
- clarify the arrangements under which **debt-free authorities** may spend amounts set aside for debt-redemption (regulation 7).

Please address any queries to my colleague Ross Buchanan here at:
ross.buchanan@odpm.gsi.gov.uk

Yours sincerely

Trevor Emmott

The Local Authorities (Capital Finance and Accounting) (Amendment) (England) (No 2) Regulations 2004 [SI 3055]

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

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

<http://www.legislation.hmsso.gov.uk/acts/acts2003/20030026.htm>

<http://www.legislation.hmsso.gov.uk/si/si2003/20033146.htm>

<http://www.legislation.hmsso.gov.uk/si/si2004/20040534.htm>

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

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

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

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

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

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

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

7. From 1 April 2004, set-aside has been replaced by pooling. However, there will still be occasions when authorities selling houses have to make clawback payments to English Partnerships, as well as being subject to the pooling rules.

8. **Regulation 4** mitigates this double impact, by inserting a new regulation (20A) in the 2003 regulations. Authorities will first treat the capital receipt as reduced by any payment due to English Partnerships; then, the percentage due to the Secretary of State under pooling will be calculated on the basis of whatever balance is left. The drafting of the regulation has been revised slightly since consultation, but the effect is the same.

Calculation of minimum revenue provision (Amendment regulation 6)

9. In the 2003 regulations, regulation 28 sets out the rules for calculating minimum revenue provision (MRP) - the annual revenue provision that authorities have to make in respect of their debts and credit liabilities.

10. The effect of **regulation 6(a)** is to provide a replacement for the whole of regulation 28(1). It is expected that this will be clearer than the approach used in the consultation draft of simply specifying the amendments - but the effect is the same. This revises the definition of two factors in the MRP formula as applied to **non-housing** authorities. The first is **factor "A"**, which is the adjustment to ensure that the new MRP regime introduced on 1 April 2004 does not produce a more severe revenue impact than the former rules. The 2003 Regulations failed to deal explicitly with non-housing authorities (such as county councils), which were covered by a different formula under the old rules, based on the "relevant amount". The new definition clarifies the treatment of non-housing authorities in this context, providing them with a separate formula for determining "A".

11. The new regulation 28(1) secondly clarifies the definition of **factor "HC"** (the opening Housing Revenue Account capital financing requirement for the current year). The amendment makes clear that, for non-housing authorities, HC always has the value of nil.

12. **Regulation 6(b)** makes two changes. It first provides a replacement for regulation 28(3), dealing with the circumstances in which MRP is to be nil. When, under the former system, authorities were, exceptionally, allowed to borrow for revenue expenditure, they could be required to provide for repaying that debt over a very short *amortisation* period (normally 7 years). Some amortisation periods are still running and regulation 28(2) in the 2003 Regulations ensures that authorities continue to make this **additional amount** of MRP at the specified rate. However, it remains the policy that an authority may stop making MRP once the amount it has set aside for debt redemption equals or exceeds its debts. This position is achieved when the *capital financing requirement* (CFR) is nil or negative. But regulation 28 currently requires the amortisation component of MRP still to be provided for in those circumstances. The amendment therefore ensures that, in relation to a financial year, *all* MRP ceases once the CFR is nil or negative.

13. **Regulation 6(b)** secondly provides a replacement for regulation 28(4) of the 2003 Regulations, which defines various terms used in regulation 28. Definitions are inserted of three terms: "housing amount for 2004", "non-housing amount for 2004" and "relevant amount for 2004". The definitions make clear that these amounts are to be calculated in relation to the financial year beginning on 1 April 2004. Previously, the regulation referred to the value of the housing, non-housing and relevant amounts at 31 March 2004. But because of the way these concepts were defined under the former system, their value would then have been determined as on the last day of the *preceding* financial year - in other words, 31 March 2003 [see regulations 141 and 152 in the *Local Authorities (Capital Finance) Regulations 1997* (SI 319 as amended)]. To refer to their most recent value, it is necessary to calculate this as it would have been on 1 April 2004 (as if the old system

were still in force). These modifications were not included in the consultation draft, but the need for them was identified by respondents.

Use of amounts set aside under the Local Government and Housing Act 1989 (Amendment regulation 7)

14. **Regulation 7** amends regulation 33 in the 2003 regulations. This concerns amounts set aside as provision for debt redemption under the former capital finance system. The former rules allowed debt-free authorities to use set-aside amounts for capital expenditure. However, authorities which were debt-free on 31 March 2004 (the last day of the former system) may not have had time to spend all the set-aside amounts they were entitled to under the old rules. So regulation 33 provides for such amounts to be treated as capital receipts and thus remain available for capital expenditure.

15. **Regulation 7(a)(ii)** clarifies that authorities may choose to convert all or, if they prefer, just part of the relevant amount of set-aside into capital receipts.

16. **Regulation 7(b)** inserts two new paragraphs at the end of regulation 33, clarifying the timing of the conversion of set-aside into capital receipts. **New paragraph (4)** gives authorities until 1 October 2005 to decide on the amount of the conversion (thus allowing them up to six months to take their decision). **New paragraph (5)** provides that the conversion is to be treated as taking place during 2004-05.

Differences between the regulations and the consultation draft

17. Some minor differences between the final text and the consultation draft are noted above (see paragraphs 8, 10 and 13). Also, the following measures on which we consulted have not been included in the regulations as now made.

18. **Loans and grants to officers** [see paragraphs 9 to 11 in the Commentary annexed to the 27 August letter]. Under regulation 25(1)(b) in the 2003 regulations, a loan or grant made by a local authority for capital expenditure normally counts as capital expenditure for the authority making it. However, regulation 26 provides that loans or grants to an authority's own officers may *not* be so treated. The consultation draft proposed the revocation of regulation 26. Some authorities expressed concern, mainly on the grounds that this treatment could be difficult to apply to numerous small transactions. ODPM is prepared to consider the issue further if local government wishes, but the measure has been omitted from the amendment regulations, leaving regulation 26 in force.

19. **Limit on spending of set-aside by debt-free authorities** [see paragraph 19 in the Commentary of 27 August]. Regulation 33(3) carries forward the limit imposed by the former capital finance system on the amount of set-aside which debt-free authorities may spend. The consultation draft included a modification of this rule, to assist a small number of debt-free authorities for whom there appeared to be a problem. ODPM now considers that the amendment is not necessary and it has been omitted.

20. A proposed change to the MRP rules linked to regulation 33 [paragraph 16 in the 27 August Commentary] is also no longer considered necessary and has been omitted.