



14 March 2006

Chief Executives
Directors of Finance
Directors of Housing

Local Authorities in England

Dear Colleague

LOCAL GOVERNMENT CAPITAL FINANCE SYSTEM AMENDMENTS TO REGULATIONS

Local Authorities (Capital Finance and Accounting) (Amendment) (England) Regulations 2006 [SI 521]

1. My letters of 16 December 2005 and 20 January 2006 sought views on drafts of the ***Local Authorities (Capital Finance and Accounting) (Amendment) (England) Regulations 2006***. In finalising the Regulations, we took careful account of the responses, for which we are most grateful. The Regulations have now been laid before Parliament and can be viewed online at:

<http://www.opsi.gov.uk/si/si2006/20060521.htm>

2. The attachment to this letter explains the intention of the regulations in detail. This is only an informal commentary and, if you need legal advice about the meaning of the Regulations, it is suggested that you consult your own legal advisers.

3. The Regulations come into force on **1 April 2006** (except for Regulations 1 and 15 which will be in force on 31 March 2006 - see paragraphs 1 and 26 of the commentary).

4. The main effects are broadly as follows:

- **Social HomeBuy** capital receipts are exempt from pooling if recycled into affordable housing schemes or spent on Social HomeBuy running costs.
- **Mortgage portfolio** capital receipts are subject to pooling at the rate of 75%.
- **Minimum Revenue Provision** is adjusted to ensure that housing expenditure funded by borrowing does not increase this liability.

5. Contacts for queries are shown at the end of the commentary.

Yours sincerely

Trevor Emmott
Prudential System and PFI Team

Local Authorities (Capital Finance and Accounting) (Amendment) (England) Regulations 2006

Statutory Instrument No. 521

***An informal commentary on the Regulations ("the amendment Regulations")
by the Office of the Deputy Prime Minister***

INTRODUCTION

1. These Regulations amend the *Local Authorities (Capital Finance and Accounting) (England) Regulations 2003* ("the 2003 Regulations"). The dates of coming into force of the amendment Regulations are 31 March 2006 (regulations 1 and 15) and 1 April 2006 (all the other regulations). The 2003 Regulations implement the "prudential" capital finance system, introduced under the *Local Government Act 2003*, and have been revised by two earlier sets of amendments. Web links to all these documents are as follows:

Local Authorities (Capital Finance and Accounting) (Amendment) (England) Regulations 2006 [SI 521]

<http://www.opsi.gov.uk/si/si2006/20060521.htm>

Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [SI 3146]

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

Previous amendment regulations

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

<http://www.opsi.gov.uk/si/si2004/20043055.htm>

Local Government Act 2003

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

SOCIAL HOMEBUY

[Amendment Regulations 2-13 & Schedule]

Background

2. Social HomeBuy is an important part of the Government's policy of making low cost home ownership simpler, fairer and more affordable. It is targeted at social tenants who cannot afford the Right to Buy. The scheme offers them an opportunity to buy at a discount a share in the home that they currently rent.

3. Social HomeBuy will be available from 1 April 2006. The Government's final proposals were set out in *HomeBuy - Expanding the Opportunity to Own: Government's Response to Consultation* (September 2005): <http://www.odpm.gov.uk/index.asp?id=1157066>.

4. The Government intends that Social HomeBuy should both lead to increased levels of home ownership and contribute to the provision of more affordable housing where needed. So it is allowing local authorities to retain in full the receipts from Social HomeBuy sales if these are invested in the provision of affordable housing or if they use them to cover the

costs of running the scheme. If receipts are not used for these purposes, they will be subject to pooling in the usual way (but existing ways in which receipts can be treated as reduced will not apply), which means that 75% will need to be paid to the Secretary of State. The amendment Regulations make these modifications to the pooling regime.

Social HomeBuy Disposals

5. The **Schedule** inserted by Amendment Regulation 2(2) sets out the essential features of a Social HomeBuy disposal. The main points are that tenants can buy a minimum 25 per cent "share" and can "staircase up" - ie, buy further "shares" - as and when they can afford to. The scheme will be voluntary in that local authorities will be able to decide whether to offer it to their tenants.

Capital Receipts and Pooling

6. The Amendment Regulations ensure that Social HomeBuy disposals come within the pooling regime set out in regulations 12 and 13 of the 2003 Regulations. **Amendment Regulation 3** therefore confirms that the proceeds of Social HomeBuy disposals are to be *capital receipts*. And **Amendment Regulation 4** provides that this applies even if the sum received does not exceed £10,000 (thus disapplying the normal concession in regulation 10 of the 2003 Regulations).

7. **Amendment Regulation 5** then inserts a new paragraph (ab) in existing regulation 12(4), making clear the default position: any Social HomeBuy receipt will in principle be subject to pooling at the rate of 75%.

Social HomeBuy Allowance

8. The pooling requirement is however then modified through the Social HomeBuy allowance. This is created by **Amendment Regulation 8** (which inserts new regulations 16A and 16B in the 2003 Regulations) and **Amendment Regulation 6(b)** (which amends existing regulation 14).

9. Broadly speaking, the Social HomeBuy allowance is a kind of "pot" which is "topped up" by expenditure on affordable housing or on administration of the Social HomeBuy scheme. It may be drawn upon to reduce Social HomeBuy receipts before calculating the amount to be pooled.

Expenditure

10. The expenditure which feeds in to the Social HomeBuy allowance must have been already incurred or the authority must have decided to incur it. The main kinds of eligible expenditure are set out below.

(a) Expenditure on **affordable housing** (which, as **Amendment Regulations 2(1)(a)** and **9** make clear, has the meaning given in existing regulation 17). The kinds of expenditure include: acquiring, constructing, improving and repairing dwellings; converting other buildings into dwellings; acquiring land and preparing land for development; paying grants to other parties to undertake the foregoing activities [16B(1)(a)].

(b) **Grants** under s129 of the Housing Act 1988 to encourage tenants or licensees to vacate council dwellings to be used for affordable housing [16B(1)(b)(i)]

(c) Expenditure on the **administrative costs** of Social HomeBuy disposals and the overall running of the Social HomeBuy scheme, including collection of rent from the purchaser [16B(1)(b)(ii), (iii) & (iv)]

11. The expenditure must have been made out of Social HomeBuy capital receipts or, in the case of future expenditure, the authority must have decided to use such receipts [new regulation 16B(2), inserted by **Amendment Regulation 8**]. Existing regulation 23 is also amended to ensure that Social HomeBuy capital receipts may be used for the specified kinds of expenditure [**Amendment Regulation 14**].

Other Rules

12. The available Social HomeBuy allowance falls each time it is drawn upon to treat a receipt as reduced [new regulation 16A, inserted by **Amendment Regulation 8**].

13. Social HomeBuy receipts may not be treated as reduced under existing regulations 14(1)(a) to (c) [new regulation 14(2B), inserted by **Amendment Regulation 6(c)**].

14. Note in particular that the new Social HomeBuy allowance is separate from the existing **capital allowance**, by which receipts from (eg) vacant dwelling sales are reduced by costs of affordable housing and regeneration [regulations 14(1)(c), 15, 16, 17 and 18]. A Social HomeBuy receipt may not be treated as reduced by the capital allowance, but only by the Social HomeBuy allowance; and the Social HomeBuy allowance may only be applied to reduce Social HomeBuy receipts [new regulation 14(2C), inserted by **Amendment Regulation 6(c)**; and **Amendment Regulation 7**].

15. It should also be noted that Social HomeBuy receipts may not be reduced under existing regulations 19, 20, 20A and 21 [**Amendment Regulations 10, 11, 12 and 13(b)**].

Example

16. A local authority receives £15,000 in respect of its very first Social HomeBuy disposal. The authority decides that it will spend £11,000 of that receipt on affordable housing. Its available Social HomeBuy allowance therefore becomes £11,000. The capital receipt may then be treated as reduced to £4,000, of which the authority is required to pool £3,000 (75%). The remaining £1,000 may be used like any other capital receipt in accordance with regulation 23. The available Social HomeBuy allowance then falls to nil as the full £11,000 of the allowance has been used to treat Social HomeBuy receipts as reduced.

MORTGAGE PORTFOLIO DISPOSALS

[Amendment Regulations 5 & 6(c)]

17. These amendments make further changes to the rules on the pooling of housing capital receipts, currently set out in regulations 12 and 14 of the 2003 Regulations. The amendments are relevant where authorities have granted mortgages to former tenants buying council homes and later decide to sell the outstanding debts to a bank or other financial institution.

18. The aim is to put beyond doubt the pooling rate that applies to the capital receipt generated in such circumstances. As the regulations stand, there may be room for uncertainty and a minority of authorities may be unsure about the correct pooling percentage. **Amendment Regulation 5** inserts a new paragraph (aa) in existing regulation 12(4), making clear that **75% of the receipt from the disposal of a mortgage portfolio must be pooled**. This is the same rate that applies to receipts from disposals of dwellings and the change will bring the regulations explicitly into line with the understanding of the majority of authorities.

19. **Amendment Regulation 6(c)** inserts new paragraph (2A) in regulation 14, with the effect that a capital receipt of this kind may not be treated as reduced by the capital allowance under regulation 14(1)(c).

MINIMUM REVENUE PROVISION

[Amendment Regulation 15]

20. This regulation amends regulation 28 of the 2003 Regulations. For a small number of authorities, the present regulation may not work in the way envisaged, requiring them to make significantly more Minimum Revenue Provision (MRP) than was intended.

21. The basic idea in regulation 28 is that MRP should equal 4% of the Capital Financing Requirement (CFR), subject to certain adjustments. One adjustment relates to *housing* debt/credit, since the policy is that MRP should not be made in respect of such liabilities. Because the balance sheet covers *all* debt, the normal CFR will include amounts relating to housing. So, before MRP can be derived from the CFR, the latter must be adjusted to strip out the housing elements.

22. In the formula, this is achieved by deducting **HC** from the CFR. The regulations at present define HC for housing authorities as either equal to the HRA Capital Financing Requirement for the current year or, if that is a negative amount, equal to nil.

23. It is this latter rule, making HC equal to nil for a housing authority, that creates the need for amendment. Problems may arise if there is a positive overall CFR but a negative HRA CFR. Any HRA capital expenditure financed by credit would register as an increase in the overall CFR, but would normally be cancelled out by an increase in HC, as the HRA CFR would also rise. But if the HRA CFR is negative, HC will be nil, and all or part of the rise in the HRA CFR will not carry through to an increase in HC.

24. This is not the policy intention. What is required is that HC should capture any change in the HRA CFR since 31 March 2004. The obstacle to this is the negativity of the HRA CFR at the start of the new system. Amendment regulation 15 neutralises this negativity, by redefining HC on the following lines:

In the case of a housing authority, **HC** is to be calculated in accordance with the formula **HD - HE** (see definitions below). For a non-housing authority, HC will, as now, be nil.

HD is the opening HRA CFR for the current financial year.

HE is relevant where a housing authority had a *negative* opening HRA CFR for the financial year beginning on 1 April 2004. In such case, HE is equal to that negative amount. In any other case, HE is nil.

25. Example

At 1 April 2004, an authority has a negative HRA CFR of **-200**.
During 2004/05, it finances housing capital expenditure by borrowing **100**.
So, at 1 April 2005, the HRA CFR is **-100**.
Applying the new element in the formula:
 HD = **-100**
 HE = **-200**
Therefore, HD - HE [i.e. HC] = **-100 - (-200) = 100**.

As a result of the expenditure of 100, the overall CFR rises by 100. But HC (which would have been nil without the expenditure) also rises by 100. Thus, the increase in the CFR is exactly offset by the increase in HC, which is the desired outcome.

26. Because it is believed that some authorities are affected in the current financial year, it is proposed that amendment regulation 4 comes into force on **31 March 2006** and thus applies to the MRP calculation in the financial year 2005-06 and in subsequent financial years. This minor change to the MRP rules has no bearing upon the Government's examination of options for introducing depreciation accounting in local government, which would supersede the MRP system; that longer term exercise is continuing.

TECHNICAL CORRECTION

27. **Amendment Regulation 13(c)** corrects a minor omission in Regulation 21(c).

QUERIES

28. Queries on the Regulations and this commentary should be directed as follows.

General queries and technical queries on Amendment Regulation 15:

Paul Goodwin [Paul.Goodwin@odpm.gsi.gov.uk Direct Line: 020 7944 4234]

Technical queries on any of the **housing amendments**:

Stephen McAllister [Stephen.Mcallister@odpm.gsi.gov.uk 020 7944 3582]

Social HomeBuy policy queries:

Chris Meader [Chris.Meader@odpm.gsi.gov.uk 020 7944 3422]