

Briefing Paper

CAPITAL PROGRAMME

Adrian Waite – July 2004

What is Capital Expenditure?

Accountants define capital expenditure as being on items that give a benefit and retain their value over a number of years. There is also an accountancy concept called 'materiality' that excludes items of small value from the definition. Capital expenditure in the private and public sectors is often financed by loan, firstly because resources are often not available 'up front' to finance it, and secondly so as to spread the cost of the capital expenditure across all the years during which the benefit is experienced.

However, in local government there is also a specific legal definition of capital. The legal definition of Capital Expenditure is contained in Part IV of the Local Government and Housing Act 1989. The key principle is that all expenditure must be charged to revenue unless it meets the criteria laid down in the 1989 Act.

The Act defines the following as being capital:

- a) the acquisition, reclamation, enhancement or laying out of land;
- b) the acquisition, construction, preparation, enhancement or replacement of roads, buildings and other structures;
- c) The acquisition, installation or replacement of moveable or immovable plant, machinery, apparatus, vehicles and vessels.

Note the word enhancement. This means that the expenditure must:

- lengthen substantially the life of the asset;
- Or • increase substantially the market value of an asset;
- Or • increase substantially the extent to which the asset can or will be used for the Local Authority function.

The important point to note here is that if your spending meets the criteria for Capital, you can finance it using the authority's capital or revenue resources, but if the spending does not satisfy the criteria, it must be met from revenue.

An important change to local government capital finance was made in 2000/2001. Councils can now accrue capital expenditure in their accounts in the same way as they could always accrue revenue expenditure.

Housing Capital Programme – an Example

What follows is an example of a capital programme.

| Council Housing (Housing Revenue Account) | £m | £m |
|---|-------|--------------------|
| a) Modernisation Schemes | 3.0 | |
| b) Decent Homes Programme | 2.5 | |
| c) Environmental Improvements | 0.5 | |
| d) Energy Saving | 1.5 | |
| e) Improvements to Sheltered Accommodation | 0.5 | |
| f) Adaptations for the Disabled | 0.1 | |
| | <hr/> | 8.1 |
| <u>Non Council Housing (General Fund)</u> | | |
| a) Renovation Grants | 1.2 | |
| b) Disabled Facilities Grants | 0.5 | |
| c) Group Repair Schemes | 0.5 | |
| d) Minor Works and Home Repair Schemes | 0.3 | |
| | <hr/> | 2.5 |
| <u>TOTAL CAPITAL PROGRAMME</u> | | <u>10.6</u> |

- a) Modernisation Schemes - Expenditure could include central heating, new windows, new bathrooms or kitchens, re-roofing or re-wiring. Most programmes include some expenditure under this heading. However, in some authorities scarcity of resources does not permit the more desirable expenditure and efforts are concentrated on more basic needs.
- b) Decent Homes Programme – This is work that is required so that the authority can achieve the government's decent homes standard. This is discussed in more detail below.
- c) Environmental Improvements - Provision for car parking and improvements to layout are included.
- d) Energy Saving - Sometimes referred to as 'Affordable Warmth' the intention is to reduce the use of energy and running costs whilst ensuring that homes are kept warm. Expenditure may include new or replacement heating systems, cavity wall insulation or double-glazing.
- e) Improvements to Sheltered Accommodation - Schemes that concentrated on bedsit accommodation, making use of shared bathroom facilities, are now difficult to let. Expenditure includes updating accommodation and converting it to one or two bedroom self-contained units of accommodation.

- f) Adaptations for the Disabled - Expenditure includes minor items such as widening doorways to give access to wheelchairs, or major extensions of the home. The objective is the same in both cases and that is to enable the elderly and / or the disabled to remain in their home.

Non-Council Housing (General Fund)

- a) Private Sector Renovation Grants - Grants that local authorities have the discretion to make to the private sector for the improvement or repair of dwellings, houses in multiple occupation or the common parts of buildings containing one or more flats.
- b) Disabled Facilities Grants - Mandatory grants are paid to people who need adaptations so that they may gain access to and move around their home freely, or use essential facilities within the home so that they can manage as independently as possible. Discretionary grants are paid to make dwellings suitable for the accommodation, welfare or employment of a disabled person.
- c) Group Repair Schemes - These seek to achieve renovation of whole blocks or terraces of housing drawing in a mixture of public sector funding and contributions from owners. They are often used in an area-based strategy both within and outside renewal areas.
- d) Minor Works and Home Repair Assistance - Minor work carried out to private sector houses to enable the occupants to remain in their own homes. Available only to the elderly or those in receipt of benefits or income support.
- e) Warm Zones - Government has set a target of ending fuel poverty by 2010. Five "Warm Zone" pilots lasting three years, with funding of £1,500million have been identified. The pilots will create partnerships between local authorities, energy companies, health authorities, energy efficiency advice centres, local business and community organisations.

The Financing of Housing Capital Expenditure

There are five main sources of Capital Finance:

1. Capital Receipts
2. Revenue Contributions to Capital Outlay (RCCOs)
3. Government Grants
4. Borrowing – supported by Credit Approvals until 2003/2004 and subject to the prudential borrowing rules from 2004/2005
5. Major Repairs Allowance

Appleby Business Centre, Bridge Street, Appleby in Westmorland, Cumbria CA16 6QH
Telephone: 017683-52347 or 52165 Mobile: 07971-321863. Fax: 017683-52546.
E-Mail: Adrian.waite@awics.co.uk. Website: www.awics.co.uk.

Director: Adrian Waite MA CPFA ACIH FIPSM
Company Number: 3713554. VAT Registration Number: 721 9669 13

Capital Receipts

The amount of the Capital Receipts that can be used (known as the “usable part”) is limited to:

- 25% of the money received from the sale of council dwellings
- 50% of the money from the sale of housing land, and other housing assets

There is no ‘Ring Fence’ round usable Capital Receipts – a local authority can use Housing Receipts to build leisure centres. Usable receipts are transferred to the Council’s General Fund and thus the Housing Revenue Account does not benefit from any investment income pending their use.

Until 2003/2004, unless an authority was ‘debt free’ it had to use the rest of the capital receipt (the ‘reserved part’) to repay existing outstanding loans from earlier borrowings, or “set it aside” as if it intended to repay loans at some future date. If it was debt-free it could spend the whole of the capital receipt.

From 2004/2005 the government has introduced ‘capital receipts pooling’ whereby local authorities pay the ‘reserved part’ of the capital receipts into a national pool that the government then distributes to local authorities and housing associations on the basis of need. This will apply to debt-free authorities as well as an authority with debt, and it is calculated that the debt-free authorities stand to lose £120million a year as a result. However, transitional arrangements are in place to allow debt-free authorities to retain annually decreasing portions of their capital receipts provided that they are used for housing.

Local authorities are able to retain receipts that are exempt from capital receipts pooling if they are to be used for one of the following purposes:

- Affordable housing
- To meet the housing needs of people on low incomes in local authority’s area
- New or replacement social housing by authority or RSL
- Improvement of existing stock – decent homes
- Regeneration
- Preparing property for disposal
- Planning permission
- Restrictive covenants
- Preparing land for development
- Carries forward

Revenue Contributions to Capital Outlay

There are no limits on revenue contributions to capital outlay. A council can finance as much Housing Revenue Account capital expenditure as it wants from tenants’ rent money, and General Fund capital expenditure as it wants from Council Tax. However, the housing subsidy system limits the amount of ‘spare’ money that a council will have for this purpose.

Appleby Business Centre, Bridge Street, Appleby in Westmorland, Cumbria CA16 6QH
Telephone: 017683-52347 or 52165 Mobile: 07971-321863. Fax: 017683-52546.
E-Mail: Adrian.waite@awics.co.uk. Website: www.awics.co.uk.

Director: Adrian Waite MA CPFA ACIH FIPSM
Company Number: 3713554. VAT Registration Number: 721 9669 13

Government Grants

Some capital expenditure which local authorities incur on housing is financed directly by the Government. This includes some expenditure on economic regeneration as outlined in detail below.

Government also provides Disabled Facilities Grants to meet 60% of the expenditure incurred. Local authorities have a statutory duty to provide Disabled facilities Grants to eligible claimants. 'Guideline allocations' are given to authorities as part of each year's HIP allocations. DFG allocations are derived in two stages. First, at regional level on a formulaic basis, and second, to individual authorities 50% on a formulaic basis and 50% at Ministerial discretion following recommendations of Government Offices. The provision for Disabled Facilities Grants was set at £88million in 2002/2003 and £89million in 2003/2004.

Borrowing

Credit Approvals were issued to local authorities until 2003/2004. A 'Credit Approval' is not a grant, but a "borrowing allocation" (otherwise known as a permission to borrow) from Government. Local Authorities borrow most of their money from the Public Works Loans Board (PWLB) which is government controlled. The local authority then uses the money borrowed to pay for schemes of a "Capital" nature.

Credit Approvals were issued by the Government and took two forms: -

a) Basic Credit Approvals that are a general consent to borrow. The authority can spend them as it wishes on Housing Revenue Account Housing, General Fund Housing or even other General Fund schemes such as Leisure or Economic Development. Regardless as to how the approvals are spent the authority will be allocated a sum which will be 'Admissible' for Subsidy purposes. The revenue effect of this 'Admissible' allocation can be taken into the Notional Housing Revenue Account for subsidy purposes as part of the capital financing charges.

b) Supplementary Credit Approvals are issued for a specific purpose such as those linked to the 'Specific Capital Grant' which is paid in respect of Disabled Facilities Grants. The reason for this is that the expenditure has to be incurred and financed before the grants are paid. The main point to note is that Supplementary Credit Approvals are for a 'Specific' purpose whereas Basic Credit Approvals are for general use. Their use is in decline.

From 2004/2005 authorities are free to borrow as much as they wish as long as they can afford to meet the debt repayments. The rules that cover this are included in the 2003 Local Government Act and the prudential code of accounting. These are both described in section seven. Local authorities are required to set and publish certain prudential indicators and are no longer required to make a minimum repayment provision.

**Appleby Business Centre, Bridge Street, Appleby in Westmorland, Cumbria CA16 6QH
Telephone: 017683-52347 or 52165 Mobile: 07971-321863. Fax: 017683-52546.
E-Mail: Adrian.waite@awics.co.uk. Website: www.awics.co.uk.**

**Director: Adrian Waite MA CPFA ACIH FIPSM
Company Number: 3713554. VAT Registration Number: 721 9669 13**

Major Repairs Allowance

From 2001/2002 all local authorities receive a 'Major Repairs Allowance' that is paid as part of the Housing Subsidy. How this is paid is described in the section on Housing Subsidy. The 'Major Repairs Allowance' is paid into the Major Repairs Reserve through the making of a depreciation charge in the manner that is outlined in the section on the Housing Revenue Account. Funds that are in the Major Repairs Reserve are available for the authority to spend on Major Repairs.

To qualify to be funded from the Major Repairs Allowance, expenditure must meet the definition of capital that is outlined above, and must be spent in accordance with the Housing Revenue Account Business Plan. Under the Local Government Act 2003 they must not be spent on demolition costs.

Are Capital Resources Ring-Fenced?

Basic credit approvals, and capital receipts, no matter how they arise, actually belong to the local authority (not to any particular account) and therefore can be used for any local authority purpose.

However, revenue contributions to capital outlay can only be used to finance schemes belonging to the account that supplies the revenue. In other words these are strictly 'Ring Fenced' as are grants which must be used for the purpose for which they are given. The same applies to prudential borrowing.

Financing the Programme

Having considered the resources available to it, the financing of the 'Specimen' capital programme could be summarised as follows:

| |
|---------------------------------|
| Financing the Housing Programme |
|---------------------------------|

| | £m | £m |
|--|-----|-------------|
| Major Repairs Allowance | | 4.4 |
| Basic Credit Approvals | | 1.2 |
| Supplementary Credit Approvals linked to Specific Capital Grants | | |
| - Disabled Facilities Grants | | 0.3 |
| Other Supplementary Credit Approvals | | 0.1 |
| Capital Receipts | | |
| - B/F 1 st April | 0.2 | |
| - Received in year | 1.4 | 1.6 |
| Revenue Contributions to Capital | | |
| - From balances (Housing Revenue Account) | 1.0 | |
| - Charged to Housing Revenue Account | 1.5 | |
| - Charged to General Fund | 0.5 | 3.0 |
| TOTAL FINANCE TO MATCH PROGRAMME | | 10.6 |

NOTE: The Grant of £0.3 million for disabled facilities covers 60% of expenditure. The authority is obliged to find the balance from other sources of finance and is therefore committed to financing £0.2 million in other ways.

The 'Right to Buy'

Since 1979 council tenants have had the 'right to buy' their council house. The purchase price has been set on the basis of the market value of the individual property less a discount. The discount has been dependent on an number of factors, especially the length of time that the purchaser has been a tenant.

Appleby Business Centre, Bridge Street, Appleby in Westmorland, Cumbria CA16 6QH
Telephone: 017683-52347 or 52165 Mobile: 07971-321863. Fax: 017683-52546.
E-Mail: Adrian.waite@awics.co.uk. Website: www.awics.co.uk.

Director: Adrian Waite MA CPFA ACIH FIPSM
Company Number: 3713554. VAT Registration Number: 721 9669 13

A considerable number of council houses and flats, especially in the more desirable locations, have been sold under 'right to buy'. This has benefited local authorities financially in that they have generated capital receipts and have avoided the need to spend money on the modernisation and improvement of dwellings that have been sold. However, 75% of capital receipts have been 'set aside' and housing subsidy has been reduced to reflect reduced levels of council housing stock and levels of capital receipts that have been 'set aside' so most of the financial advantage can be considered to have accrued to the government. It is also considered by some that the discounts have been generous meaning that the new owner-occupier makes a 'windfall gain' at the expense of continuing tenants and the council taxpayer.

There are now concerns that the 'right to buy' is reducing the stock of social housing in areas where affordable housing is already in short supply. There are also concerns about dwellings being sold under 'right to buy' in regeneration areas prior to demolition, and then being sold back to the local authority at a much greater cost. As a result, the policy of 'right to buy' is under review.

In January 2003 the Office for the Deputy Prime Minister announced restrictions on 'right to buy' in selected high-pressure areas in London and Southeast England. Maximum discounts in 42 local authority areas are to be reduced from £38,000 to £16,000 from March 2003. However, individual authorities will be allowed to apply for exemptions

The Housing Investment Programme (HIP) Process

The Housing Investment Programme (HIP) process determined the allocation of basic credit approvals to local authorities, and therefore determines the extent of their capital resources.

Housing capital resources – apart from those for Disabled Facilities Grants and the Major Repairs Allowance – since 2002/2003 were allocated as part of the 'Single Capital Pot'. This provided a cross-service allocation for most government supported capital expenditure by local authorities. The purpose of this was to encourage local authorities to take a more cross-service strategic approach to capital expenditure and asset management.

The product of this calculation was an 'Annual Capital Guideline' for each local authority. This was the amount of money that the government believed a local authority should spend on capital purposes. Credit Approvals were issued to cover this level of borrowing – until 2002/2003 less a reduction to reflect available capital receipts.

Conclusions

While the government does not provide all the capital resources that are available to local authorities, it does effectively control the level of capital resources that are available, The level of government grants, major repairs allowance and credit approvals are set directly by government. The majority of capital receipts are 'set aside' and the usable proportion is taken into account when setting basic credit approvals. The ability to make revenue contributions to capital is determined by the status of the Housing Revenue Account that, as we have seen is becoming under increasing central government control.

Adrian Waite
July 2004.

Appleby Business Centre, Bridge Street, Appleby in Westmorland, Cumbria CA16 6QH
Telephone: 017683-52347 or 52165 Mobile: 07971-321863. Fax: 017683-52546.
E-Mail: Adrian.waite@awics.co.uk. Website: www.awics.co.uk.

Director: Adrian Waite MA CPFA ACIH FIPSM
Company Number: 3713554. VAT Registration Number: 721 9669 13