

## Capital Financing Adjustments and Three-year capital exceptions

When the Government decided to introduce three year settlements, it was clear that several aspects of the current formula grant system would have to change. One of these was supported borrowing. In previous years we received allocations for capital programmes and these fed into the annual local government finance settlements. However, many of these programmes were reactive i.e. bid-based, and so Departments were not able to provide several years' forward allocations in time for the first multi-year settlement. These were:

£ millions

Capital programmes transferred out	SCE(R)	
	06-07	07-08
Transport: Highway Maintenance	37.00	37.00
Transport: Integrated	0.00	138.00
Transport: Large Projects	0.00	200.00
Education: Schools Targeted	300.00	500.00
Education: 16-19	120.00	180.00
Communities and Local Government: Housing	416.00	507.00
Health: AIDS/HIV	1.55	1.55
Environment: Contaminated Land	18.00	18.00
Environment: Air Quality	2.40	2.40
Environment: Flood Defence	17.00	17.00
<b>TOTALS</b>	<b>911.95</b>	<b>1600.95</b>

These programmes were therefore transferred out of the formula grant system, to be paid as capital grant for 06-07 and 07-08.

Due to the nature of the calculations within the formula grant system, it was necessary to reduce the capital financing RNF control total. There are two reasons for this. First, the change effectively switches the burden of financial borrowing from the authorities to HM Treasury, so these funds have to be transferred to them. Secondly, so that authorities were not being compensated twice – once through capital grants and once through supported borrowing – for those programmes that have been excepted from formula grant. Also, because of the floor damping system, which guarantees a minimum increase on the previous year's grant **on a like-for-like basis**, we had to make corresponding adjustments to the base years (05-06 for 06-07 and 06-07 for 07-08).

### Calculation of transfers and adjustments for capital exceptions

There are several stages in translating the capital exceptions into adjustments to the capital financing RNF.

Firstly, the total exceptions for each year (£911.95m for 06-07 and £1,600.95m for 07-08) are used to generate a total transfer for 07-08. This is done in the same way as the capital financing RNF is calculated, based on the level of outstanding debt at the start of the year and the SCE(R) allocations in the year.

For new debt, there is an allowance that is based on 6 months interest with no capital repayment. For debt from previous years, assumed borrowing cost is based on 12 months interest, using the same average pool rate as for new debt, plus an allowance for repayment of capital. This allowance is the 4% Minimum Repayment Provision and is based on debt at the start of the grant year. It therefore uses the 'reducing balance' method, meaning old debt gradually declines, rather than being repaid at a fixed rate over 25 years. Interest on old debt accounts for the debt repayment being made during the grant year, so is equivalent to 12 months interest on 98% of the outstanding debt at the start of the year.

The full calculation is:

For the 06-07 exceptions:

$$(a) \text{ 4\% repayment on start of 07-08 debt} = 911.95\text{m} * 0.04 = 36.478\text{m}$$

$$(b) \text{ 5.9\% interest on mid 07-08 debt} = 5.9\% * (\text{start year debt} + \text{end year debt}) / 2 \\ = 5.9\% * (911.95\text{m} + 911.95\text{m} - 36.478\text{m}) / 2 \\ = 52.729\text{m}$$

$$(a)+(b) \text{ revenue support grant consequences} = 36.478\text{m} + 52.729\text{m} = 89.207\text{m}$$

For the 07-08 exceptions:

$$(c) \text{ 5.9\% interest on new debt} = 5.9\% * 0.5 * 1600.95 = 47.228\text{m}$$

$$\text{Therefore, we have a total transfer for 07-08 of } 89.207\text{m} + 47.228\text{m} = \mathbf{136.435\text{m}}$$

£ millions	
<b>Revenue Support Grant Consequences</b>	
06 – 07 SCE(R)	89.207
07 – 08 SCE(R)	47.228
<b>Total SCE(R)</b>	<b>136.435</b>
06 – 07 Adjustments	106.458

We then produce a corresponding adjustment to the base years for this transfer, so that we can make floor comparisons on a consistent like-for-like basis. To do this, we deflate the difference between the adjustments for 06-07 and 07-08 by the GDP deflator:

$$(136.435m - 27.3585m)/1.0246\% = 106.458m$$

£ millions

Capital programmes transferred out	SCE(R)		Pro-rata Adjustment to base year		
	06-07	07-08	06-07	07-08	Total
Transport: Highway Maintenance	37	37	2.824	0.852	3.676
Transport: Integrated	0	138	0.000	3.177	3.177
Transport: Large Projects	0	200	0.000	4.604	4.604
Education: Schools Targeted	300	500	22.898	11.509	34.407
Education: 16-19	120	180	9.159	4.143	13.303
Communities and Local Government: Housing	416	507	31.752	11.670	43.422
Health: AIDS/HIV	1.55	1.55	0.118	0.036	0.154
Environment: Contaminated Land	18	18	1.374	0.414	1.788
Environment: Air Quality	2.4	2.4	0.183	0.055	0.238
Environment: Flood Defence	17	17	1.298	0.391	1.689
<b>Total</b>	<b>911.95</b>	<b>1,600.95</b>	<b>69.61</b>	<b>36.85</b>	<b>106.458</b>

Finally, in order to distribute these (negative) adjustments between authorities in the fairest way, the total exceptions in each programme were distributed on a pro-rata basis to authorities' using the 05-06 SCE(R) figures. However, education: Building Schools for the Future (BSF) allocations were removed, as these were very large allocations distributed amongst a small number of authorities, and for Housing, where allocations showed a high degree of volatility, three year averages were used. Tables showing the 06-07 capital financing RNF adjustments and 05-06 SCE(R) totals for each local authority by programme have been placed on the website.

Note: The 06-07 adjustment table is expressed in terms of RNF numbers and not £s, as in 05-06. This is because formula spending shares were used previously and these ceased to exist from 06-07 onwards.

LGF – FGD  
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