Committee: Financial Monitoring Task Group

Date: 5 November 2015

Agenda item: 7

Wards: All

Subject: Capital Programme

Lead officer: Caroline Holland – Director of Corporate Services

Lead member: Councillor Mark Allison – Cabinet Member for Finance

Contact Officer: Paul Dale - AD Resources

Key decision reference number: This is an information item.

Recommendations:

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1. The Financial Monitoring Task Group are recommended to note this briefing paper

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1. Purpose of report and executive summary

1.1 This report outlines to members the nature of capital in local government and briefly explains the processes followed by Merton.

2. Background

2.1 Local Government capital matters are at one level very simple but the regularity framework and the more obscure elements of accounting practice add a substantial degree of complexity. Merton spends £35m - £40m p.a. on capital items. Local Government in England spends c. £20b p.a. on capital items

2.2 At its simplest capital is any item of expenditure with a life of more than one year. All items are to be charged to revenue unless it is permitted to charge them to capital

2.3 The major types of capital expenditure are buildings (schools, housing etc.), acquisition of land for development, vehicles plant and machinery and IT hardware and software. It also includes grants and advances to landlords for capital purposes. The costs of repairing, running and maintaining such capital assets are revenue items unless it can be demonstrated that the asset is being enhanced

2.4 Capital expenditure is regulated by the Local Government Act 2003. This removed the previous complex set of controls where central government limited the extent to which local government could borrow to finance capital spending. Authorities are now free to borrow for capital purposes provided that they can afford to service the debt.

3 Funding Local Authority Capital Expenditure

3.1 All revenue (non capital) expenditure must be funded from revenue income as part of setting the council tax each year. Local Authorities in the UK cannot borrow for revenue purposes (except for temporary cash flow within year)

3.2 There is greater flexibility on funding capital expenditure. This can be funded from the following sources

- Government Capital Grants. These are allocated by Government departments to finance Central government policy priorities. Some of these are ring fenced to specific projects others can be spent at the council's discretion. The main area of support in recent years has been for school expansion.
- Contributions from other third parties
- Grants from GLA and TfL for regeneration and transport infrastructure.
- Capital Receipts. The cash generated from the disposal of capital assets can only be used to finance capital expenditure not revenue items. (The rules are complex around Housing capital receipts but Merton no longer has a housing stock so this is not relevant to this council.)
- External borrowing. This has to be financed by charging the interest payments and a provision to repay the debt to the revenue budget, on a prescribed basis.
- Contributions from Council Reserves.
- Direct funding from the revenue budget.

4 External Borrowing.

4.1 Although the government no longer directly controls Local Authority external borrowing Local Authorities are required to demonstrate that decisions made around the capital programme are affordable, prudent and sustainable. To demonstrate that this is the case the s.151 officer has professional responsibilities and indicators must be used and reported to the members for decision as part of the annual budget setting process.

5 Capital Finance Process

5.1 Merton plans its revenue finances over a 4 year period and its capital investment over an even longer period. There is an annual bidding process for capital investment.

5.2 The standard view of setting the capital budget is that the main factors that should be considered are:

- Capital spend must be linked to other resources – mainly the revenue running costs and the costs of borrowing. In recent years Merton has received significant Government funding towards schools. It has been able to minimise the costs of debt by utilising internal cash balances as a source of internal borrowing. This will be exhausted over the medium term and more expensive external borrowing will have to be resumed.
- The spending should be linked to wider asset management planning. In Merton's case the priorities have been: school

expansion, enhancing basic infrastructure, regeneration and a replacement leisure centre.

- Capital spending should be integrated into service planning. For Merton the crucial requirement has been to ensure that enough school places are available and in addition significant investment has been put into IT based change to drive efficiency improvement.

5.3 Capital expenditure is managed on a multiyear basis. This means that indicative budgets are approved for some years into the future, unlike the revenue budget which is approved for the following year only. Subject to certain internal rules the capital programme allocations (capital budgets) can be moved between years once schemes are underway.

5.4 Although not directly a part of capital programming, treasury management – cash flow management, borrowings and investments – is to a major extent driven by the capital programme.

6. Financial, resource and property implications

6.1 As contained in the body of the report

7. Legal and statutory implications

7.1 As outlined in the report.

8. Human rights, equalities and community cohesion implications

8.1 None for the purposes of this report.

9. Risk Management and health and safety implications

9.1 None for the purposes of this report.

10. Background Papers

10.1 Various CIPFA and DCLG publications

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