



Leicester
City Council

CABINET

21 JULY 2003

HYPOTHECATION OF CAPITAL RESOURCES

Report of the Chief Finance Officer

1. Introduction

- 1.1 On 26 June, the Finance, Resources & Equal Opportunities Scrutiny Committee resolved that “the Committee express their concern to Cabinet that changes should not be made to the Education capital programme in order to fund the highways capital programme; and that the relevant Cabinet member be invited to discuss his views on the Cabinet’s request to consider hypothecation of the capital programme”.

2. Recommendations

- 2.1 The Cabinet is asked to agree that:
- (a) any decision on hypothecation (or otherwise) of capital resources is deferred until the next 3 year capital programme (2005/06 to 2007/08) is being considered;
 - (b) the comments of the scrutiny committee be noted, and taken into consideration at the above time.

3. Hypothecation and the Council’s Capital Strategy

- 3.1 Hypothecation is a term used to denote the itemisation of specific sources of funding for specific purposes, without going through the usual process of prioritisation. Hypothecation can happen for 2 reasons:
- (a) where resources are hypothecated by central government;
 - (b) where resources are hypothecated through local policy.
- 3.2 Where resources are hypothecated by central government, the Council has no choice but to spend the money for the purpose for which it is given. Into this category come a large number of grants; and supplementary credit approvals, which convey permission to borrow for a specific reason only.

- 3.3 The Council has decided, as a matter of local policy, to hypothecate:
- (a) housing capital receipts (i.e. the proceeds of selling Housing properties), which are automatically used for the housing service;
 - (b) certain aspects of the "single capital pot".
- 3.4 The single capital pot is a borrowing approval given to local authorities to spend on any purpose for which they choose. It is a recent innovation, and is intended to give authorities greater flexibility to determine their own spending needs than was previously the case. Government policy has been to increase the amount of resources allocated through the single capital pot, and reduce the amount of resource which government hypothecates itself (however, this has not happened in practice to the extent we had hoped, and in particular the Department for Education and Science is resistant).
- 3.5 The single capital pot consists of sums notionally allocated for a range of services, by various government departments. These notional allocations are aggregated, to result in a single borrowing approval, which the Council can use to fund **any** capital projects it wishes (in theory). In other words, it is not tied to the programmes of the government departments which notionally allocated the funding (and hence it is not hypothecated by the Government).
- 3.6 In addition to the sums allocated by government departments, adjustments are made for:
- (a) a discretionary element;
 - (b) our ability to generate capital receipts.
- 3.7 These adjustments have **both** been abolished, and will not feature in 2004/05.
- 3.8 The Council's single capital pot for 2003/04 is shown in the table below:

	£000s
<u>Allocated by Government Departments</u>	
Housing	8,604
Transport - Local Transport Plan	6,747
Transport - Maintenance	3,237
Social Services	182
Education	2,328
Other Services	282

Total Service Allocation	21,380
 <u>Other Allocations</u>	
Discretionary element	719
Capital Receipts Adjustment	(619)

Total Single Capital Pot	21,480
	=====

3.9 Whilst the Council can (in theory) use the single capital pot for any purpose it wishes, the theory does not carry through into practice to the full extent. As will be seen from the table, by far the biggest elements of the capital pot are for Housing and Transport; and there are obligations on these services to deliver certain outcomes (in respect of decency standards of homes and delivery of the local transport plan). As a consequence, the Council's capital strategy provides that 80% of sums notionally allocated to Housing, 100% of sums notionally allocated to the local transport plan, and 80% of sums notionally allocated for transport maintenance should be hypothecated (through local policy) to those services. The remainder is regarded as "corporate", and all services have been able to bid to spend those resources (including Housing and Transport, who have been entitled to bid to "top up" the resources they get as of right). In respect of the Education element of the single capital pot, the discretion is largely illusory, as the DFES expects the money to be spent on the purpose for which it was intended (and Cabinet has approved a spending programme accordingly). It is clearly an option for members to review the above policies and decide to hypothecate a greater amount than is hypothecated at present.

3.10 The Council's capital programme for 2002/03 to 2004/05 was approved in March 2002 and revised in March 2003. In terms of resources available for the overall capital programme, the elements of the single capital pot which were regarded as corporate are as follows (including an estimate of resources in 2004/05):

	2002/03 £m	2003/04 £m	2004/05 £m	Total £m
Other Services	0.5	0.3	0.3	1.1
Education	0.1	-	-	0.1
Social Services	0.2	0.2	0.2	0.6
Housing (20%)	2.0	1.7	1.7	5.4
Transport - maintenance (20%)	0.9	0.6	0.6	2.1
Discretionary element	0.8	0.7	*0.5	2.0
Less capital receipts adjustment	0.5	(0.6)	-	(0.1)
Total allocation	5.0	2.9	3.3	11.2

*The government decision to abolish this was taken after the capital programme was set.

3.11 The total of £11.2m over 3 years is a significant part of the £26m of corporate resources available for the period 2002/03 to 2004/05.

3.12 At its last meeting, the Cabinet asked that the Link Member for Finance work towards the principle of hypothecation of government resources in the single capital pot. In doing so, members will need to have regard to the impact. The precise impact depends on when this is given effect:

(a) the 2002/03 to 2004/05 capital programme has already been set. Hypothecation **with effect from next year** would therefore result in more money being allocated to Housing and Transport and less to other schemes. After allowing for money from the corporate programme which has been "given back" to Transport and Housing, hypothecation in 2004/05 would benefit transport schemes by £0.5m and housing schemes by £1.0m. It would leave members to decide which schemes in the present capital programme (to the value of £1.5m) should not proceed;

(b) if hypothecation was to take effect in 2005/06, there is more discretion available to members as the programme for that year has not been set.

3.13 Members are also asked to note that, when considering the Cultural Quarter proposals in March, Cabinet agreed that it would identify resources for use in dealing with any shortfall of funds which might arise. A decision to hypothecate capital resources would have an impact on this risk strategy which would need to be reconsidered.

4. Capital Programme 2005/06 to 2006/07

4.1 It is my view that the most appropriate time to consider hypothecation of capital resources is when the capital programme for 2005/06 to 2007/08 is considered. This gives members an opportunity to consider precisely how any change to existing policy would impact upon other capital aspirations. In particular, members will wish to consider whether existing policies provide sufficient resources to meet targets

for improving roads and homes; and balance this with needs elsewhere.

- 4.2 The Government is currently planning to introduce a new “prudential framework” for capital spending. This will enable authorities to increase their capital programmes, provided they can pay the costs of servicing the additional debt. It is expected that any increase will have to be demonstrably “affordable and sustainable”. The Government still hopes to introduce the prudential framework in 2004/05, but most observers now consider that 2005/06 is more likely. The prudential framework will, in particular, give the authority the opportunity to invest money where such investment will generate savings; and is another factor which will inform the debate about hypothecation at the appropriate time.
- 4.3 Notwithstanding the fact that 2004/05 is the final year of the existing 3 year capital programme, it is likely that members will wish to have some form of review of the 2004/05 programme. In doing so, members may wish to consider increasing resources for transport (if this is a priority) prior to any formal decision on hypothecation. In doing so, of course, savings will need to be identified in other capital schemes.

5. Financial Implications

This report is solely concerned with financial issues.

6. Other Implications

<u>Other Implications</u>	<u>Yes/No</u>	<u>Paragraph References within Supporting Papers</u>
Legal	No	
Equal Opportunities	No	
Policy	No	
Sustainable and Environmental	No	
Crime & Disorder	No	
Human Rights Act	No	
Elderly People/People on Low Income	No	

7. Report Author/Officer to Contact

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