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Capital Context: Budget 2012

Table A.1: Public spending aggregates

	£ billion							
	Forecasts						Average annual real growth: *Spending Review 2010 period*	Average annual real growth: *2015–16 and 2016–17*
	2011–12	2012–13	2013–14	2014–15	2015–16	2016–17		
CAPITAL EXPENDITURE								
Capital Annually Managed Expenditure[2]	7.1	-25.0	5.6	5.7	6.1	6.5	*-12.0%*	*4.6%*
Capital Departmental Expenditure Limits	42.0	43.8	40.9	41.3	40.4	41.1	*-6.9%*	*-2.7%*
Public sector gross investment (PSGI)	**49.1**	**18.8**	**46.4**	**47.0**	**46.5**	**47.7**	*-7.6%*	*-1.8%*

From 2014–15 onwards, capital spending, excluding the one-off investments in infrastructure announced at Autumn Statement 2011, is held constant in real terms.

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Fiscal Consolidation: Forecasting Tightrope

Fiscal consolidation requires HMG to deliver reductions in public sector net borrowing leading to reductions in public sector net debt.

Table D.5: OBR forecast of the components of net borrowing

	£ billion						
	Outturn	Forecast					
	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Current budget							
Current receipts	550.8	570	592	623	658	692	735
Current expenditure	629.2	647	665	674	686	697	709
Depreciation	20.3	21	22	23	24	25	26
Surplus on current budget	**-98.7**	**-98**	**-95**	**-74**	**-52**	**-30**	**1**
Capital budget							
Gross investment[1]	58.4	49	19	46	47	47	48
Less Depreciation	-20.3	-21	-22	-23	-24	-25	-26
Net investment	38.1	28	-3	23	23	22	22
Net borrowing	**136.8**	**126**	**92**	**98**	**75**	**52**	**21**

[1] *Net of asset sales.*

But much of LA spending (current & capital) is locally determined. Forecasting this plays an important role in supporting wider fiscal consolidation. Forecast TOO HIGH and scarce resources are unallocated, TOO LOW and fiscal targets may not be met in-year or over time. Stocks of LA reserves and capital receipts also pose future spending risks.

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Fiscal Consolidation: Forecasting Tightrope (2)

Forecasting has increasingly taken centre stage. See these recent statements about local government from the OBR:

Public Sector Finances: September 2012 *(19th October 2012)*

"Overall, there continues to be significant uncertainty around the prospects for full year borrowing.... Local government and public corporations data are similarly liable to revision."

Forecast Evaluation Report: October 2012

"Firm data on departmental spending and borrowing by local authorities and public corporations is only available some months after the initial outturn estimates have to be made. In both years the latest outturn data now show a smaller deficit than the initial outturn data did."

"...our over-prediction of spending again reflected significant under-spending against budgets by local authorities..."

Certainty Rate Discount

It was against this forecasting backdrop that Budget 2012 announced the intention to develop the certainty rate discount:

"The Government will introduce in 2012-13, a 20 basis points (bps) discount on loans from the Public Works Loan Board (PWLB) under the prudential borrowing regime for those principal local authorities providing improved information and transparency on their locally-determined long-term borrowing and associated capital spending plans."

Working closely with DCLG, CIPFA, PWLB and LGA, HM Treasury sought to implement an information mechanism that was voluntary and presented a limited burden but provided maximum information to support forecasting. The resulting pro-forma and advice were published in the HMT letter of 2 August to LA Finance Officers.

Data was requested by 17 September, a final list of qualifying local authorities published on the PWLB website on 16 October and the certainty rate will be available to those qualifying authorities from 1 November 2012 to 31 October 2013.

DCLG are currently sifting the English data and we expect it to inform the next round of OBR forecasts for Autumn Statement 2012.

Why are we being asked to fill this in?

The rationale behind this was that the Office of Budget Responsibility are concerned about the accuracy of the Treasury's estimates of local authority borrowing, and this will provide a more reliable basis for those estimates. The information is required in time to inform the Autumn Forecast 2012 and in advance of the introduction of the certainty rate on 1 November 2012 and is therefore required by September 17 at the latest.

The Chartered Institute of Public Finance & Accountancy

Should I include LOBOs with a call coming up in the maturing debt figure in part B of the form?

We are trying to provide the best quality information we can subject to the normal capital financing framework within which local authorities operate. In line with their Treasury Strategy and assumptions for the year, Authorities should make a reasonable value judgement on whether a LOBO is likely to require to be re-financed, and if so include it in part B, and if not, exclude it.

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Certainty Rate Discount: Lessons

•A positive response from the sector. Allowed some flexibility around deadlines on this occasion but most LAs choosing to complete returned it on time.

•DCLG follow-up helpful in flushing out late returns.

•In some cases an interesting interpretation of “Local authorities should have due regard to returning best quality information in line with annual budget plans.” (from 2 August letter). We suggest elected members should be made aware that significant LOBO holdings will be called before telling HMT this is a central/best case.

•Some responses seemed to try and second guess HMT. This does not help forecasting and can work to the detriment of the sector.

•We will be keeping a watching eye on “zero” returns – this will not become the certainty rate access default.

•Some further work necessary to clarify the pro-forma in the light of questions raised. This will be in good time for the next information request.

2012-2013	2013-2014	2014-2015	Total
179	95	0	**274**
0	1,000	0	**1,000**
1,778	20	5,072	**6,870**
12,000	41,725	15,000	**68,725**
51,900	46,900	47,900	**146,700**
22,500	7,000	0	**29,500**
32,916	20,000	0	**52,916**
232	5,236	1,000	**6,468**
67,500	56,400	56,400	**180,300**
10,000	0	0	**10,000**
199,005	**178,376**	**125,372**	**502,753**

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Beyond The Certainty Rate Discount

With the introduction of the certainty rate discount, there are now two PWLB interest rate models available to local authorities operating the prudential code:

•**Standard Rate:** Currently gilts +100bps (kept under review). Minimal 4 question access. Low transaction costs.

•**Certainty Rate:** Standard rate minus 20bps. Voluntary annual qualification. Short up-front pro-forma summarising existing LA capital expenditure/borrowing plans. Low transaction costs.

And Budget 2012 also announced:

"The Government will also work with the local authority sector to consider the potential for an independent body to facilitate the provision of PWLB lending at a further reduced rate, to authorities demonstrating best quality and value for money."

The introduction of a "scrutiny" rate (not official nomenclature) could therefore complement the existing PWLB models and provide further choice to the LA sector. Hence the change in title to Certainty & "Scrutiny".

Developing A "Scrutiny" Rate: Principles

In making available a further interest rate discount to support the delivery of best value local capital projects, changes to the PWLB rate should be guided by the following:

•Delivering maximum value for the public sector (including local authorities).

•Incentivising high quality and highest value for money LA capital projects.

•Ensuring the balance between differential reporting requirements and interest rates remains proportionate.

•Improving the level of information the centre has on LA borrowing and expenditure both to inform Ministers and public finance forecasts.

•Protecting HMT Permanent Secretary's position as Accounting Officer for the National Loans Fund; and

•Limiting the operational impact on the DMO/PWLB.

Developing A “Scrutiny” Rate: Questions

In identifying for HMT Ministers the potential for a “scrutiny” rate consistent with the principles described, there are a wide range of issues to consider:

- **HOW SHOULD ACCESS BE DETERMINED?**
- **WHAT MEASURE OF VALUE FOR MONEY?**
- **WHO WILL UNDERTAKE THE SCRUTINY?**
- **HOW SHOULD FEES/CHARGES BE DETERMINED?**
- **WHAT INTEREST RATE SHOULD BE MADE AVAILABLE?**

This is not an exhaustive list and more issues may come to light as we consider this further…….WATCH THIS SPACE.

Local Government Collective Agency

The joint LGA/WLGA/LP publication of June 2012 set out the case for a local borrowing solution "developed by local government for local government" recommending an independent agency.

From an HMT perspective:

•We welcome sector led exploration of alternative capital funding models.

•Recognise the honest assessment of risks and challenges associated with introducing an independent agency identified in the publication.

•Support official and political engagement between the LGA and HMG on this issue and, in particular, next steps.

BUT

With limited direct levers over LA borrowing (effectively PWLB interest rates and/or a National Limit), HMG is highly unlikely to give up future flexibility on PWLB interest rate movements.