



National Audit Office

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Department for Communities and Local Government

# Methodology

**Financial sustainability of local authorities:  
capital expenditure and resourcing**

**JUNE 2016**

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# Introduction

## Background

### Structure

**1** On 15 June 2016 the NAO published *Financial sustainability of local authorities: capital expenditure and resourcing*.<sup>1</sup> This document provides a methodology for the quantitative analysis contained in the report. Information on the qualitative components of the study, such as lists of interviewees and case study local authorities, is contained in the report itself.

**2** Quantitative analysis in the report covered two main areas:

- analysis of changes in local authority capital resourcing; and
- analysis of changes in local authority capital expenditure

**3** The data sources and analytical approaches for each of these areas are covered in the following sections.

**4** This methodology report follows the same structure as the main report. Descriptions of the methods used in each section of the main report are covered under the same headings in the methodology report.

## Defining local authorities

**5** By 'local authorities' we mean the 353 councils in England. Other types of local authority including National Park Authorities, Police and Crime Commissioners, Fire and Rescue Authorities and the Greater London Authority are excluded.

<sup>1</sup> Comptroller and Auditor General, *Financial sustainability of local authorities: capital expenditure and resourcing*, Session 2016-17, HC 234, National Audit Office, June 2016.

## Groups of local authorities by function

6 There are five types of councils making up the 353 local authorities covered by this report:

- **Unitary authorities** are a single-tier form of local authority, responsible for all services within their administrative boundary. There are 56 unitary authorities across England.
- **Metropolitan districts** are a single-tier form of local authority, responsible for all services within their administrative boundary. There are 36 metropolitan districts across England.
- **London boroughs** are a single-tier form of local authority, responsible for all services within their administrative boundary. There are 33 London boroughs.
- **County councils** are the upper-tier authorities within a two-tier system of local government. They are responsible for most of the services, including social care, provided within their administrative boundary, with the remainder provided by the district councils. There are 27 county councils across England.
- **District councils** are the lower-tier authorities within a two-tier system of local government. They are responsible for a small number of services and do not have responsibility for social care. There are 201 district councils across England.

7 Owing to the similarities between unitary authorities, metropolitan districts, London boroughs and county councils we frequently focus on them as a distinct group of authorities called **single tier and county councils**. In some service areas, such as adult and children's social care, it is only these authorities that have responsibility for a service.

## Deflation of cash figures

8 Unless otherwise stated, all figures are in cash terms. Where we have deflated cash figures these have been done to 2014-15 prices. We have used the HM Treasury deflator series published on 15 April 2016.

9 Data for change in revenue spending power from 2010-11 to 2015-16 is in 2012-13 prices, however. These figures are drawn directly from our 2014 report *Financial sustainability of local authorities 2014*.<sup>2</sup>

2 Comptroller and Auditor General, *Financial sustainability of local authorities 2014*, Session 2014-15, HC 783, National Audit Office, November 2014.

# Part One

## Challenges to capital resourcing

### Local authority capital expenditure and resourcing

#### Capital and revenue spend

**1.1** Data for local authority assets is taken from the Department for Communities and Local Government's (the Department's) Capital Outturn Return 5 (COR5) for 2013-14.<sup>3</sup> Data is in cash terms and excludes education land and buildings.

#### Patterns of spend

**1.2** The aggregate revenue figure includes revenue spending on services and is taken from the Department's 2014-15 Revenue Outturn Summary (RS) return.<sup>4</sup> It includes spend for adult and children's social care, environmental services, central services, transport, culture and related services, housing and planning and development services. The sector breakdowns are shown in Figure 3 in the main report.

**1.3** Data for capital spend is from the Department's COR1 data set for 2014-15. The aggregate capital spend figure covers the same service areas as the revenue figures. However, we also include capital spend on 'trading' in the aggregate figure. Spend on trading is not shown in Figure 3, however, as there is no immediate equivalent on the revenue side, and capital spend in this area is relatively low.

#### Sources of and changes in capital resources

##### Changes in up-front resources for capital spending

**1.4** Data in Figure 4 on capital resources is taken from the Department's COR4 data set for 2014-15. This return includes local authority capital spending supported by government. This rolls together the full range of funding streams from all government departments including education.

<sup>3</sup> Data available at: [www.gov.uk/government/statistics/local-authority-capital-expenditure-and-receipts-in-england-2014-to-2015-final-outturn](http://www.gov.uk/government/statistics/local-authority-capital-expenditure-and-receipts-in-england-2014-to-2015-final-outturn)

<sup>4</sup> Data available at: [www.gov.uk/government/collections/local-authority-revenue-expenditure-and-financing](http://www.gov.uk/government/collections/local-authority-revenue-expenditure-and-financing)

**1.5** It is not possible to extract education funding data from the COR4 data. However, we have undertaken a separate piece of work to try and estimate changes in the scale of non-education grants provided to local authorities by departments. We did this by looking at changes from 2010-11 to 2014-15 in individual grant streams from non-education departments.

**1.6** We focused on grants provided to local authorities by the Department for Environment, Food and Rural Affairs, the Department for Communities and Local Government, the Department of Health and the Department for Transport. Our 2014 report *Local government funding: assurance to Parliament*, identified these departments as the main providers of non-education capital grants to local authorities.<sup>5</sup>

**1.7** We collected data on all capital grants from these departments to local authorities in 2010-11 and 2014-15. We aggregated funding across the four departments in each year and calculated change between the two years. Our final change figure is in 2014-15 prices.

**1.8** Our figure for the value of non-education grants as a share of non-education capital grants in 2014-15 is calculated as the value of the grants from these four departments, divided by our figure for non-education capital spending calculated in paragraph 1.3.

### **Borrowing**

**1.9** Data on change from 2010-11 to 2014-15 in spend supported by borrowing is taken from the Department's COR4 data set. Our change figure is in 2014-15 prices.

### **Other capital financing**

**1.10** Our analysis of private finance initiative (PFI) the value of contracts signed by local authorities uses HM Treasury data. This includes current PFI contracts as at 31 March 2015.<sup>6</sup>

**1.11** We used the 'Date of Financial Close' column to identify when the contracts were signed and the 'Capital Value' column to assign a value to the contract. We excluded data that did not relate to local authorities. We then took the sum of capital value of contracts signed by local authorities in each financial year. The figures presented in the report are three year averages of the capital values of contracts signed by local authorities. The data is in cash terms.

5 Comptroller and Auditor General, *Local government funding: assurance to Parliament*, Session 2014-15, HC 174, National Audit Office, June 2014.

6 Data available at: [www.gov.uk/government/publications/private-finance-initiative-and-private-finance-2-projects-2015-summary-data](http://www.gov.uk/government/publications/private-finance-initiative-and-private-finance-2-projects-2015-summary-data)

## **Capital challenges since 2010-11**

### Capital costs to revenue

#### **Debt servicing costs**

**1.12** Data in Figure 5 in the report is taken from the Department's RS data set for 2014-15. This includes debt servicing costs generated by borrowing to support education spend. It is not possible to remove the cost arising from education capital spending from these figures. We have not attempted to produce an estimate that excludes the cost of debts attributable to education.

**1.13** The interest payments shown in Figure 5 in the report include the 'HRA item 8 payments and receipts' line in the RS. This removes interest payments met via the housing revenue account (HRA).

#### **Capital costs as a share of revenue spend**

**1.14** Figure 5 in the report presents data for different elements of capital costs to revenue as a share of revenue spending. We have used a different measure of revenue spend to that set out in paragraph 1.2. We have done this because education debt costs are included in the capital costs to revenue data, but education spending is excluded in our revenue spending figure in paragraph 1.2.

**1.15** Our measure of revenue spend in this instance is drawn from line 800 of the Department's RS data set. This includes spending on education. However, we then subtract funding passed directly to schools.<sup>7</sup> While this expenditure is recorded as local authority expenditure, it is in general not available to support their capital costs and is effectively transferred directly to schools.

**1.16** Data for the excluded grants is taken from the Department's Special and Specific Grants (SSG) dataset.<sup>8</sup> This funding is not the totality of revenue funding available to local authorities to support education, it is just the amount that is unavailable to local authorities to meet the debt servicing costs of any borrowing they may have incurred for education.

**1.17** As a result, our calculation of debt servicing costs and other capital costs to revenue as a share of revenue spend includes education debt costs in the numerator. But our revenue spend denominator also includes the full range of revenue resources available to support debt costs including those for education, whilst excluding resources which are passed straight to schools and therefore not available to support debt costs.

**1.18** We also exclude Public Health grant. This was introduced as a ringfenced grant in 2013-14. In principle this is not available to support general debt servicing costs. Data for Public Health grant is taken from the Department's Special and Specific Grants (SSG) dataset.

<sup>7</sup> We exclude Dedicated Schools Grant, Diploma Specific Formula Grant, London Pay Addition, School Standards Grant (including personalisation), Standards Fund (excluding elements now in ABG), Education Services Grant and Pupil Premium Grant.

<sup>8</sup> Data available at: [www.gov.uk/government/statistics/local-authority-revenue-expenditure-and-financing-england-2014-to-2015-individual-local-authority-data](http://www.gov.uk/government/statistics/local-authority-revenue-expenditure-and-financing-england-2014-to-2015-individual-local-authority-data)



## Strategies to reduce capital costs to revenue

### **Minimising new borrowing costs**

**1.19** Data on external borrowing is gross external borrowing taken from the Department's COR4 data set. We use data for 31 March of each year in cash terms.

### **Using lower cost lenders**

**1.20** Data on sources of borrowing is taken from the Department's 'live borrowing and investment tables'. The data is in cash terms.

### **Increasing internal borrowing**

**1.21** We estimate internal borrowing in cash terms using data from the Department's COR4 data set. We calculate:

- gross internal borrowing as the cumulative capital financing requirement minus the sum of external borrowing and other long term liabilities; and,
- change in internal borrowing as the change in cumulative capital financing requirement minus the sum of the change in external borrowing and change in other long term liabilities.

**1.22** In effect this is a measure of capital spend not supported by direct funding, external borrowing or other forms of external financing. Our estimated figure of gross internal borrowing is a cumulative measure of the potential liabilities from this form of financing at any point in time. However, while there is an expectation that internal borrowing needs to be repaid, it does not represent a formal debt which necessarily needs to be settled in full in the same way as external borrowing. For instance, authorities may decide the activity original intended for the cash is no longer needed, or can be delivered at a lower cost. Our figures therefore should be seen as illustrative of the scale of internal borrowing, rather than as necessarily representing the full scale of any associated liabilities.

**1.23** We have used data for 1 April in each year. All data is in cash terms.

**1.24** In order to address data quality issues we have adjusted the data published in the COR4. As a consequence:

- data for four single tier and county councils (out of 151) has been excluded entirely from the calculations due to missing or potentially inaccurate data; and,
- we have modelled cumulative capital financing requirement data in a small number of cases to adjust for missing or potentially inaccurate data. This has involved modelling data in 15 cells in an overall data set containing 4851 cells. Where we have modelled data we have taken the average of the preceding and following cell in the sequence for each authority.

**1.25** Owing to these adjustments and the fact that we use data for 1 April, the data on external borrowing in Figure 8 in the report is slightly different to that shown in Figure 6. The data in Figure 6 should be treated as the definitive data for external borrowing.

### **Reducing minimum repayment provision (MRP) charges**

**1.26** Data on MRPs is taken from the Department's RS data set. Change is shown in 2014-15 prices. We use line 773 – provision for repayment of principal.

### **Refinancing and repaying debt**

**1.27** Figures on early repayment of PWLB debt are taken from PWLB annual reports. They are shown in cash terms. They include repayments for local authorities in the UK as a whole, not just England.

**1.28** Data on investments on deposit is taken from the Department's COR4 data set. Data is in cash terms at 31 March for each year.

### **Reducing direct payments**

**1.29** Data on direct contributions from revenue to capital is taken from the Department's RS data set. Change figures are in 2014-15 prices. We do not include direct contributions from revenue to support public health.

## **Risks to future financial sustainability**

Continued pressure from capital costs to revenue

### **Growth in debt servicing costs**

**1.30** Mandatory capital costs to revenue are as set out in Figure 5 of the report, and as discussed in paragraphs 1.12 and 1.13 of this methodology document.

**1.31** The revenue spend figure is as discussed in paragraphs 1.14 to 1.17 of this methodology document.

**1.32** All figures are in 2014-15 prices.

### **Variation in debt servicing costs**

**1.33** Debt servicing costs as a share of revenue spending are as set out in paragraphs 1.30 to 1.32 of this methodology document. However, they are broken down by type of local authority and presented as medians and quartiles in this section of the report.

**1.34** The data in this section of the report, which includes Figures 10 and 11, is based on two year averages. We sum the numerator and denominators for pairs of years, to calculate the debt servicing cost as a percentage of revenue spending.

**1.35** The calculation of debt costs per dwelling uses the calculation of debt servicing costs set in paragraphs 1.13 and 1.14 of this methodology document. Figures for dwellings are taken from data published by the Department annually as part of the local government finance settlement.

**1.36** Figure 10 contains a 'jitter plot' of change in debt servicing costs as a share of revenue spending. The vertical axis shows variation in the indicator between local authorities in each time period. However, the variation within each time period on the horizontal axis is purely diagrammatic and is used as a means to separate the results between authorities visually.

The outlook for capital costs to revenue

#### **Risks from increased interest rates**

**1.37** Data on in-year external and internal borrowing is calculated as set out in paragraphs 1.20 to 1.25 of this methodology document. However, change data is calculated by subtracting data for 1 April from data for 31 March within the same financial year. It does not show the difference between 1 April and 1 April in succeeding financial years, as before.

#### **LOBO loans**

**1.38** Data on LOBO loans is taken from the Chartered Institute of Public Finance Accountancy's capital expenditure and treasury management statistics survey. It only shows data for single tier and county council respondents to the survey for 2014-15.

#### **Pressure from further reductions in revenue income**

**1.39** Our figure for change in revenue spending power from 2010-11 to 2015-16 is taken from our 2014 report *Financial sustainability of local authorities 2014*.<sup>9</sup>

**1.40** Data for change in spending power from 2015-16 to 2019-20 is taken from data published by the Department as part of the 2016-17 local government finance settlement. It is in real terms at 2014-15 prices.

9 Comptroller and Auditor General, *Financial sustainability of local authorities 2014*, Session 2014-15, HC 783, National Audit Office, National Audit Office, November 2014.

# Part Two

## Capital expenditure in local authorities

### Change in spending

#### Aggregate change

**2.1** Data for aggregate change in revenue spend is based on service spending excluding education taken from the Department's RS data set.

**2.2** We use the definition of revenue spending set out in paragraph 1.3 of this methodology document. However, we have adjusted children's social care revenue spending in 2014-15 to reflect the transfer in reporting of spending on services for young people from education to children's social care. To do this we have subtracted spend on services for young people as reported in RO3 for 2014-15 from the children's social care figure for that year. We only make this adjustment to revenue spending when we look at **change** in spending.

**2.3** Data for change in aggregate capital spending is taken from the Department's COR1 data set and uses the same definition as set out in paragraph 1.4 of this methodology paper. However, we have excluded capital spend on housing by local authorities that lost their housing revenue accounts (HRAs) post 2010-11. We only make this adjustment to capital spending when we look at **change** in spending.

**2.4** Data for change in revenue and capital spend by service is in real terms at 2014-15 prices.

#### Types of capital spending

**2.5** Data on change in different types of capital spending is taken from the Department's COR1 data set. Data is in real terms at 2014-15 prices.

**2.6** We exclude data on housing spend by authorities that lost their HRAs post 2010-11 as set out in paragraph 2.3 above.

## Service spending changes

**2.7** Data on change in revenue spending by service is taken from the Department's RS dataset. We make the adjustment to social care spending for the transfer of services for young people as set out in paragraph 2.2 of this methodology document.

**2.8** Data on change in capital spending by service is taken from the Department's COR1 dataset. We exclude data on housing spend by authorities that lost their HRAs post 2010-11 as set out in paragraph 2.3 above.

**2.9** Data for change in both revenue and capital spend is in real terms at 2014-15 prices.

## Variation between authorities

**2.10** Data on change in capital spending by type of local authority is taken from the Department's COR1 dataset. Data is in real terms at 2014-15 prices. We exclude data on housing spend by authorities that lost their HRAs post 2010-11 as set out in paragraph 2.3 above.

**2.11** Our analysis of change in spend in relation to the scale of revenue funding reductions experienced by authorities draws on analysis from our 2014 report *The impact of funding reductions on local authorities*.<sup>10</sup> Single tier and county councils with real-terms reductions in spending power from 2010-11 to 2014-15 one standard deviation above the mean were grouped as 'high', while those with a reduction one standard deviation below the mean were grouped as 'low'. The full details of the methodology are available with the 2014 report.

<sup>10</sup> Comptroller and Auditor General, Local government, *The Impact of funding reductions on local authorities*, National Audit Office, November 2014.

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