



**From the Office of the Leader**

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*Dear Phil*

**GOVERNMENT SUPPORT FOR CAPITAL INVESTMENT**

Thank you for your letter of 11 January on this issue. You are, of course, correct when you say that our costs of capital investment are allowed for in the Settlement calculations of the 'Relative Needs' block and that authorities protected by the grant floors are given additional support from the 'Floor Damping' block<sup>1</sup>.

Our perception of this issue is different however. We see Floor Damping as a means of protection against the devastating effects of changes in the needs assessments methodology<sup>2</sup>. Rather than being some kind of bonus, it is a necessity to avoid devastating reductions in local services.

Capital financing costs are driven by government Supported Capital Expenditure (Revenue) (SCE(R)) allocations. The resulting costs are effectively fixed because they depend on interest rates in the economy generally and on the requirement to repay 4% of borrowing each year.

As a result of the extensive Floor Damping, we see grant as fixed and no longer clearly responsive to any changes in capital financing needs. To illustrate this:

- If we had been given less SCE(R) in 2006/07, our grant would have been the same – Floor Damping would have increased, exactly matching the reduction in Relative Needs.
- Conversely, if SCE(R) had increased<sup>3</sup>, we would have received no more grant – Floor Damping would have been reduced to match<sup>3</sup>.

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1 All Education and Social Services authorities in the SEERA area apart from the Isle of Wight, Medway and Milton Keynes are on the grant floor and benefit from Floor Damping grant.

2 If all £7.669m of it was removed from Oxfordshire for example, given your capping threats, service cuts would almost inevitably follow.

3 At some point, Damping Grant would no longer be needed but, as we are being allocated £7.669m of Damping Grant and in addition we have over £9m additional protection from the effects of change in the Younger Adults formula, there is a long way to go.

Even education authorities that do not receive Floor Damping grant are in a similar position because 84% of their increase above the grant floor is scaled back to pay for Floor Damping. If they receive extra SCE(R) their grant will only increase by 16p for every £1 increase in their Capital financing costs. Thus all education and social services authorities have grants that no longer clearly relate to changes in their capital financing needs. They are more strongly related to the grants paid in previous years.

One unintended consequence of the new system is that we now have an incentive to disregard our SCE(R) allocations and cut back capital spending. This would not affect our grant for the next two years as the system stands and it would certainly help us to keep down council tax increases. However it would deprive residents of much needed improvements and you might well withdraw future SCE(R) allocations. Even if you did though, this would merely increase our Damping Grant, leaving us no worse off, unless you made special adjustments to the system.

In Oxfordshire, in common with other authorities in the South East, we are investing heavily in new capital assets for local people – improving and repairing schools and roads. Our latest estimates are that our capital investment decisions will add £13.75 to our Band D Council tax in 2006/07 and £23.84 in 2007/08. Thus extra capital financing costs alone will add 1.4% and 2.5% to our Council tax (from our 2005/06 figure of £966.46). Your Settlement figures imply that our capital financing costs will increase by 17% to 2006/07 and a by further 11% to 2007/08. However, as we have seen, none of this increases the level of our grants for those years because we are pinned to the floor.

In a context where you are repeatedly threatening to cap authorities if the average increase is more than 5% and, as we face relentless pressure for more services from a growing and ageing population, these growing capital financing costs are significant and something we must consider.

### **Adjustments as a result of Capital Grants**

A move from funding via SCE(R) to funding via Capital Grants in 2007/08 provides further evidence of the erratic links between our capital financing requirements and the grant we will be paid. Funding via Capital Grants will save revenue costs for authorities that receive them. Investments will be paid for ‘up front’ and so there will be no ongoing capital financing costs. You claim that the revenue savings will be £106.458m<sup>4</sup> (Provisional 2007/08 Settlement Table 3). Unfortunately, you do not know which authorities will receive these grants in future. You have therefore made assumptions about how to distribute the resulting savings.

You have assumed that historical allocations of SCE(R), notably for 2005/06, can be used to allocate these savings<sup>5</sup>. These estimated savings are deducted from our actual 2006/07 grants to give adjusted base figures, to which 2.7% is added to give the 2007/08 grant floors. Thus, these estimated savings in capital financing costs do clearly feed through into reducing our grant figure for 2007/08. This contrasts with the lack of a clear connection in the case of overall capital financing needs.

Thus we are in a position where the grant calculation is not sensitive to our increasing capital financing needs but an estimate of the savings due to capital grants HAS been used to reduce our grant figure. We conclude that there is an imperfect relationship between capital financing needs and our grant.

To further complicate matters, at Consultation you used SCE(R) figures that included ‘Building Schools for the Future’ (BSF) figures to allocate the savings whereas, at Settlement, you excluded BSF. The effect of this change was to reduce grants at Settlement for most authorities but considerably increase grants for a very few authorities. All Education and Social Services authorities in the SEERA area (apart from Windsor and Maidenhead) lost grant in the Provisional 2007/08 Settlement issued in January, as a result.

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<sup>4</sup> We are not clear how this figure is arrived at. Around £1600m of Capital grants are to be made available, but £106.458m or 6.6% of that figure seems a high estimate of the savings likely in the first year of their introduction.

<sup>5</sup> The precise details of this calculation are not clear to us at present.

We can see that allowances did perhaps need to be made for BSF authorities. However, it would have been helpful if we had been more clearly informed and consulted about this issue. Settlement Working Group might have considered this issue at an earlier stage. A clear explanation of what was proposed could have been issued at Consultation. You might have clearly explained how the deduction of £106.458m arose. Then, during the Consultation period, you might have advised us that you were considering further change at Settlement. None of these things happened. Perhaps it would have been wiser to reconsider whether this was the best time to make such a large switch to capital grants? Now we find that we are, almost inexplicably, slightly worse off at the Settlement, just before we must fix our budgets.

In Oxfordshire's case we suspect that we have not done very well from this. Our 2005/06 SCE(R) figures are high compared to other councils and this is one of the factors driving up our capital financing costs in 2006/07 and 2007/08, as the full-year effects come through. However the large 2005/06 SCE(R) figure leads, as a result of your assumptions, to a lower grant for us in 2007/08. Thus, a factor that is in fact pushing up our costs is used to reduce the size of our grant. We, like you, won't know what the final impact is until we know what the capital grants are. However, at this stage, we are left with the impression that, when our costs increase, we get nothing but savings are roughly estimated and all too smartly removed. Again, we conclude that there is an imperfect relationship between capital financing needs and our grant.

The consequence is that our 2.7% grant increase promised for 2007/08 is undermined, as the following figures show:

Grant for 2006/07	£91.433m		
Change to base	£-1.598m		
Base for 2007/08	£89.835m		0.9% increase
Grant for 2007/08	£92.261m	2.7% increase	

Thus our 2.7% increase is in effect only a 0.9% increase if the large reduction to the base (mostly the estimated allowance for capital grants) is discounted.

We would like you to reconsider if these capital financing adjustments have been fair when firmer figures for the capital grants are available for 2007/08. If you find that they are less than fair, perhaps you could reconsider the grant calculations for authorities that are worse off, without making other 'gaining' authorities worse off?

**Conclusions**

As I said in our representations on the Settlement, I suspect that you are finding it increasingly difficult to square the circle of local needs and pressures with overall council tax figures at the national level. This problem is being pushed onto local authorities, behind a thick smokescreen of 'relative needs' figures and 'four-block models'. In the South East we have particular problems with so many authorities relying on the grant floor. We still have to respond to all the increasing needs and local pressures on services as well as setting affordable (or at least capping proof) council tax increases locally.

Capital financing costs are a distinctive pressure on our local taxes, very much driven by government policy. So I would also welcome your thoughts on our views of the imperfect and sometimes peculiar relationship between the capital financing arrangements and the new grant system.

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In particular, perhaps you could:

- Provide a fuller explanation of the figure of £106.458m and how it is allocated to each authority, and
- When Capital grants figures are available for 2007/08, consider whether a fairer calculation of the 2007/08 grant floors is possible, without undermining the position of any authority, keeping us more fully informed at every stage?

*As ever*

*Keith*

**Leader of the Council**

cc SE Leaders and Chief Executives