EXPLANATORY MEMORANDUM

THE LOCAL AUTHORITIES (CAPITAL FINANCE) (FURTHER CONSEQUENTIAL AND SAVING PROVISIONS) ORDER 2004 No. 2044

1. This explanatory memorandum has been prepared by the Office of the Deputy Prime Minister and is laid before Parliament by Command of Her Majesty.

2. Description

This Order makes provision consequential on Part 1 of the Local Government Act 2003 (capital finance etc and accounts) and related provisions in that Act. By virtue of Part 1 of that Act a new system of capital finance applies to financial years beginning on or after 1st April 2004.

3. Matters of special interest to the Joint Committee on Statutory Instruments

None.

4. Legislative Background

4.1 The Order is made under sections 123(1) and (2) and 127(3) of the Local Government Act 2003 (c.26). It makes provision consequential on Part 1 of the Local Government Act 2003, which deals with capital finance and accounts of local authorities. Part 1 of the Act replaces the old capital finance system under Part IV of the Local Government and Housing Act 1989, which was repealed on 1st April 2004.

4.2 Other consequential and saving provisions were included in the Local Authorities (Capital Finance) (Consequential, Transitional and Saving Provisions) Order 2004 (S.I. 2004/533). There were also transitional provisions and savings in the Schedule to the Local Government Act 2003 (Commencement No. 1 and Transitional Provisions and Savings) Order 2003 (S.I. 2003/2938 (C. 107)) and in Schedule 2 to the Local Government Act 2003 (Commencement) (Wales) Order 2003 (S.I. 2003/3034 (W.282) (C.113)).

5. Extent

This instrument extends to England and Wales.

6. European Convention on Human Rights

This instrument is subject to negative procedure and does not amend primary legislation. Therefore no statement as to compatibility is required.

7. Policy background

7.1 This Order is made necessary by the move to the new "prudential" local government capital finance system, implemented on 1 April 2004 by the Local Government Act 2003 (“the 2003 Act”). This replaced the old capital finance

system under Part IV of the Local Government and Housing Act 1989 ("the 1989 Act").

7.2 The new capital finance legislation makes provision on a variety of important matters. It defines capital expenditure and establishes the framework within which local authorities may fund it. It confers powers to borrow and includes measures on providing for debt repayment. It also contains power to invest surplus funds. The old capital finance system covered broadly the same ground, but the new provisions differ in major respects, in particular, enabling authorities to borrow without central Government consent. The policy aim of the new system is generally to allow local authorities much greater freedom to manage their own finances, subject to safeguards ensuring that they do so prudently.

7.3 There are various references to the old system in other legislation. This gave rise to the need for certain consequential provisions, included in the Local Authorities (Capital Finance) (Consequential, Transitional and Saving Provisions) Order 2004, which came into force on 1 April 2004. The further Order deals with all remaining consequential provisions which are believed to be needed.

7.4 Articles 3 and 4 concern regulations made under the Local Government Act 1992 dealing with the capital finance implications of the reorganisation of local government in the 1990s. Article 3 revokes the Local Government Changes for England (Capital Finance) Regulations 1995 (and provisions amending those Regulations), which were of a purely transitional nature and are no longer relevant.

7.5 Article 4 is concerned with the Local Government Changes for England (Payments to Designated Authorities) (Minimum Revenue Provision) Regulations 1995 ("the 1995 Regulations"), and provisions that amended the 1995 Regulations. The 1995 Regulations concern the management of debt following reorganisation. Where county councils were abolished, one of the district councils in the former county area was designated to take responsibility for the outstanding county debt. That "designated authority" will have since managed the debt on behalf of the other district councils in the area, subject to the others paying it a regular annual contribution to its debt charges. In areas where county councils remained but district councils took over former county functions (such as education) and associated assets, the county council retained its historic debt but the district councils have since been required to contribute annually to the county council's debt charges attributable to the transferred assets.

7.6 Debt charges in this context cover both interest payments and the revenue provision regularly made for the repayment of the principal of loans (the latter being known technically as "minimum revenue provision").

7.7 Normally, the arrangements for making these ongoing contributions to debt charges will have been agreed voluntarily between the authorities concerned at the time of reorganisation. However, the 1995 Regulations make provision for a default framework where agreement cannot be reached or later breaks down. Though the 1995 Regulations as a whole are being revoked, these default

provisions are of continuing relevance and are therefore saved. These parts of the 1995 Regulations are also amended to take into account certain changes in the new system. Some components of the original calculations in the Schedule to the 1995 Regulations have become obsolete and are omitted.

7.8 Article 5 amends the Local Authorities (Contracting Out of Investment Functions) Order 1996 ("the 1996 Order"). The 1996 Order empowered authorities to contract out the investment of their funds to private-sector managers, subject to certain conditions. The main requirement was that the investment should fall within the category of "approved investments". Such investments were defined in great detail in regulations made under the 1989 Act, with the aim of ensuring that authorities used only investment options which offered relatively high security and easy access. The 1996 Order specified that it was only such investments which could be undertaken by external fund managers.

7.9 The former highly prescriptive approach to investments would be out of place in the new system, which seeks to offer increased flexibility and simplicity. Accordingly, the concept of "approved investments" has not been preserved. Under the new system, there is a simple power to invest (section 12 of the 2003 Act), supplemented by broad guidance on prudent investment practice (issued under section 15 of the 2003 Act), to which authorities are to have regard. The main effect of article 5 therefore is to replace references to "approved investments" with references to investments which the authority is permitted to make under section 12. A similar change is made in relation to parish and community councils.

7.10 Articles 6 and 7 amend the Uncertificated Securities Regulations 2001 and the Uncertificated Securities (Amendment) (Eligible Debt Securities) Regulations 2003. These Regulations make provision for various financial instruments to be held and transferred by electronic means rather than in paper form. References in these Regulations to the 1989 Act and secondary legislation made under the 1989 Act, in particular those regarding "loan instruments" which had to be registered under the 1989 Act, are revoked.

7.11 There is no need for any replacement references, because the new system no longer makes explicit mention of loan instruments. Discussions between the Office of the Deputy Prime Minister, the Treasury and the Bank of England concluded that these intricate rules were superfluous. Local authorities are now required to have regard to the code of practice in the document entitled "Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes" issued by the Chartered Institute of Public Finance and Accountancy, which will ensure that they deal professionally and prudently with all kinds of financial instruments (and other aspects of debt management).

7.12 However, article 7 makes certain savings needed to cover the transition from the old to new systems. The savings first ensure that the definition of "approved investments" continues to include uncertificated units of eligible Treasury bills and uncertificated units of a dematerialised loan instrument, for the purposes of transitional provisions and savings in respect of the 1989 Act. There is also a saving so that a reference to a loan instrument includes a

reference to uncertificated units of a dematerialised loan instrument. This is for the purposes of the meaning of expenditure for capital purposes under section 40 of the 1989 Act, which still has effect in relation to expenditure incurred before 1st April 2004.

8. Impact

8.1 A Regulatory Impact Assessment has not been prepared for this instrument as it has no impact on business, charities or voluntary bodies.

8.2 The impact on the public sector is neutral. The Order simply preserves the effect of existing provisions insofar as they are still needed and brings other provisions in line with the new capital finance system in the 2003 Act. It implements no new policy.

9. Contact

Trevor Emmott at the Office of the Deputy Prime Minister [telephone: 020 7944 4226 or e-mail: trevor.emmott@odpm.gsi.gov.uk] can answer any queries regarding the instrument.