Explanatory Note on Capital Financing

- The Capital Programme is financed as a whole and not as individual assets.

- The programme can be funded from various sources:
  - Capital Receipts from sales of existing assets
  - Capital Grants – prior to the Coalition government these were a general allocation based on a formula. Since then, there have only been occasional one-off grants for specific projects
  - Direct Revenue Funding (DRF) also still well known by its earlier name as RCCO.
  - Use of Earmarked Reserves built up and held for this purpose. These are treated as RCCO funded by a transfer from reserves.
  - Borrowing – this can either be in the form of actual external borrowing or by internal borrowing from own cash balances.

- The overall level of borrowing is managed over the long-term balancing changes in interest rates against the cost of early redemption, and the level of internal borrowing reflects the total cashflow.

- There are no internal interest rates calculated or charged but experience over many years shows that the loss of interest received on cash balance is always lower than borrowing rates.

- Statutory Accounting requires that there are two charges to the General Fund Revenue Account *(note that this is not the same as the CIES reported under IFRS in the Statement of Accounts):*
  - Interest Charges
  - Minimum Revenue Provision – an amount set aside to repay borrowing for capital expenditure purposes – it is required even if external borrowing is not undertaken.

- To provide an appropriate amount for the MRP charge capital financing is notionally allocated to Individual groups of assets:
  - Capital Receipts from the sale of buildings are allocated to new build
  - Capital Receipts from sale of vehicles are allocated to vehicles
  - It should be noted that receipts from sale of Fire appliances are minimal
  - Since the withdrawal of general capital grant, when RCCO is applied this is usually in relation to long life assets, so as not to create a financial cliff edge when short term assets become due for cyclical replacement.

- Interest Charge – some of this will be in relation to actual external borrowing and some will relate to forgone interest where cash balances are used in lieu of external borrowing and at a lower cost. It cannot be explicitly attributed to individual assets.

- The actual net interest rate is variable dependent on the capital and revenue cash-flow and prevailing investment rates, as well as the timing and actual value of the capital cashflow. The budget and MTFP make an estimate of all these variables.

- For the purposes of the Resource Review the assumption was made that the assets would be funded from net borrowing and an appropriate MRP calculation and net interest rate used to reflect a potential mix of borrowing.

- Given that the actual cost and timing of capital payments was unknown it was always recognized as an estimate only.

- This estimate is not necessary for other asset types and has not been carried out and is therefore not held.

- Details of the MRP calculations for each year's capital expenditure are attached.

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