Agenda Item No.8

MINIMUM REVENUE PROVISION POLICY

To:	**General Purposes Committee**
Meeting Date:	**22 December 2015**
From:	**Chris Malyon, Chief Finance Officer**
Electoral division(s):	**All**
Forward Plan ref:	**Not applicable** *Key decision:* **No**
Purpose:	**This is a technical report which sets out a proposal to amend the Minimum Revenue Provision (MRP) Policy included in the Treasury Management Strategy Statement 2015-16, approved by Council in February 2015.**
Recommendation:	**The General Purposes Committee is recommended to:**

a) **Consider the alternative options for the MRP Policy for 2015-16.**

b) **Agree which of the two alternative methods should be adopted.**

Subject to b)

c) **Propose the change in 2015-16 MRP Policy to Full Council for approval.**

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1. INTRODUCTION

1.1 Local authorities are required to prepare an annual Minimum Revenue Provision (MRP) Statement which is approved by Full Council as part of the Treasury Management Strategy Statement (TMSS).

1.2 The Minimum Revenue Provision is the charge that councils which are not debt free are required to make in their accounts for the repayment of debt. It is measured by the underlying need to borrow, rather than the actual debt.

1.3 This report sets out alternative options to the 2015-16 policy for General Purposes Committee and Full Council to consider, which will require Full Council approval.

2. BACKGROUND

2.1 The statute and regulations with regard to MRP are covered in The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 and the DCLG document, Capital Finance Guidance on Minimum Revenue Provision (February 2012).

2.2 Paragraph 27 of the Regulations 2003 (as amended in 2008), set out that a Local Authority has a duty to make an annual revenue provision in respect of the financing of capital expenditure incurred by the local authority in that year. It further requires (Paragraph 28) that it is for the Local Authority to determine that such provision is prudent.

2.3 Paragraphs 5 and 6 of the DCLG MRP guidance further clarify the issue of prudence, setting out that the aim is to ensure that debt is repaid over a period that is reasonably commensurate with the period over which the capital expenditure provides benefits, and providing a number of options (not exhaustive) by which this could be achieved. These options are described below.

(i) The regulatory method – this is the old system of determining MRP. This includes making a MRP of 4% of the outstanding debt, amended by Adjustment A (the difference between the credit ceiling and the Capital Financing Requirement on 1st April 2004).

(ii) The CFR method – a simplification of the above and involved setting MRP equal to 4% Capital Financing Requirement at the end of preceding financial year.

(iii) The asset life method – this method requires MRP to be charged of over the asset life using equal instalments or annuity calculation. The asset life is determined in the year MRP commences and is not subsequently revised.

(iv) The depreciation method – this requires depreciation accounting to be followed, including impairment should the asset last for a shorter life than originally set.

2.4 While Councils are required to have regard to the guidance, they are allowed to set their own policy outside of the options given if it can be demonstrated that this would be prudent.

2.5 For unfunded capital expenditure incurred before 1st April 2010 the Council continues with the Options 1 the ‘Regulatory Method’. From 1st April 2010 MRP is based on Options 3, the asset life method.

2.6 For the purpose of this discussion, Paragraph 68 of the Prudential Code 2011, sets out that debt refers to the sum of Borrowing and Other Long Term liabilities, and that the latter term covers Lease Payments and PFI contracts.

2.7 Such are the regulations for MRP that a range of options exist to alter the existing MRP profile, which are explored in detail in the next section of the report.

3. EVALUTATION OF ALTERNATIVE OPTIONS

Adapt ‘regulatory method’

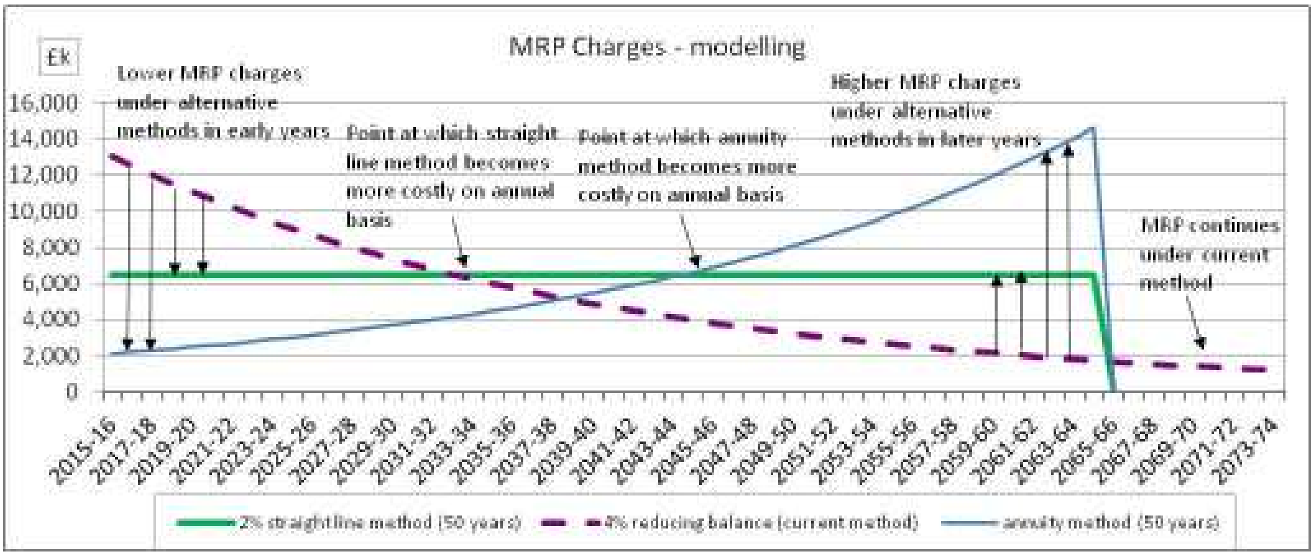
3.1 Officers have explored the impact of changing its policy in respect of the current ‘Regulatory Method’ (4% reducing balance) to either:

1. straight line basis over 50 years, or
2. annuity method over 50 years

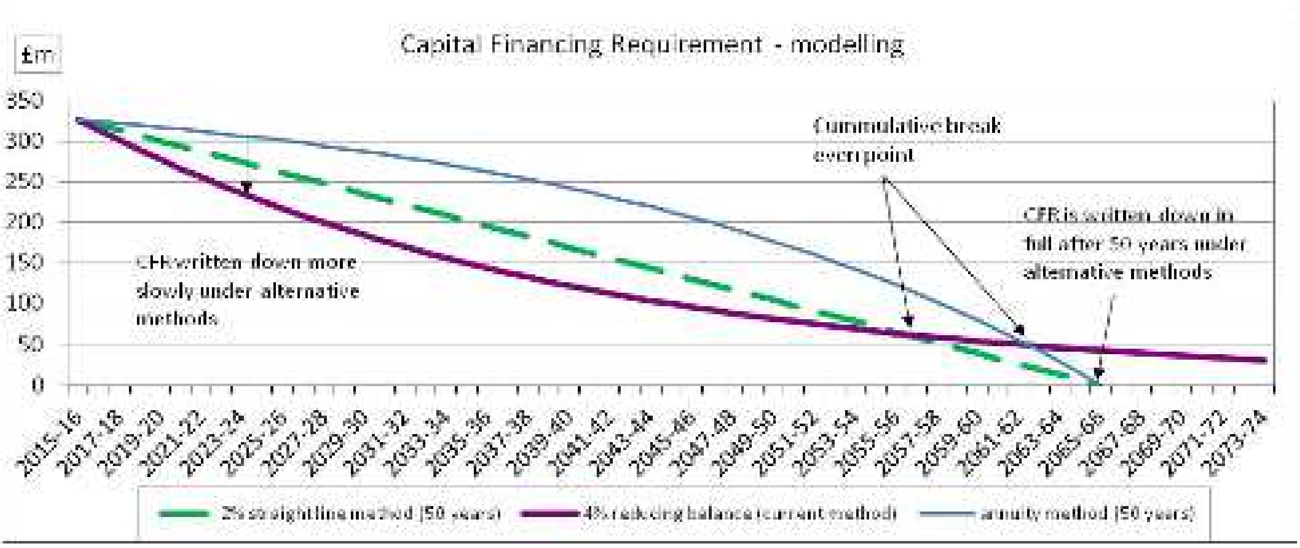
3.2 The advantage of the alternative approaches is that MRP will fully cover capital expenditure incurred over this finite timeframe. Because the current method is based on a reducing balance, the debt is never fully repaid, and it would take over 200 years for it to reduce to near zero. The alternative methods would result in budget savings over the short and medium term, however overall the amount charged to the General Fund in the long term remains the same.

Graphical Representation

3.3 The chart overleaf compares annual MRP charge for the current method and the two alternatives. This shows that MRP would be considerably lower for this proportion of the total annual charge in the early years, if one of the alternative methods was adopted. In latter years the MRP would be significantly higher to compensate for lower MRP in earlier years. Overall the amount of MRP charged to the General Fund remains the same.



3.4 This next chart shows how the Capital Financing Requirement (CFR) is impacted under the alternative methods. The CFR is the total amount of capital expenditure that has not yet been financed from resources such as capital grants, capital receipts or MRP, and represents the total amount debt. The CFR is written down more slowly under the alternative methods (as annual MRP is lower) until the cumulative break even point is reached, at which point the annual charge is substantially greater than the existing method. The graph also shows that the total debt (CFR) is written down in its entirety after 50 years.



3.5 Crucially, using the straight line method or the annuity method ensures that the CFR is written down in full within the specified timeframe which is considered a more prudent approach overall. In contrast, by year 50, the 4% reducing balance method still has more than 13% or (£42m) of the total debt from day one, still to write down.

Straight Line Method over 50 years

3.6 The straight line method spreads the total debt in equal instalments over 50 years. The graph at para 3.3 shows that MRP would half (from approx £13.0m to £6.5m), for this proportion of the total annual charge in the first year, if the straight line method was adopted. Saving then tapper out over the next 17 years. When the time value of money is considered the total actual impact will be a benefit of £21.7m in cash terms overall.

3.7 The method is consistent with manner in which MRP is calculated for the post-2010 prudential borrowing. The weighted average write down period of the CFR under this method would remain at 25 years, the same as the current 4% reducing balance approach.

3.8 This policy would bring MRP into line with the concept of matching the debt repayment with the useful economic life of an asset and the Council's own depreciation policy for land and buildings, which estimates the useful life of these assets to be up to 50 years. At the Council (and at most local authorities) borrowing to support capital expenditure incurred before April 2008 was not attributed to specific assets, so it is not possible to apply the asset life method to this expenditure.

Annuity Method over 50 years

3.9 The annuity method works in a similar way to a household repayment mortgage. The graph at para 3.3 shows an increasing MRP charge, starting from a low base, and ending with significantly higher charges in future years.

3.10 The weighted average write down period of the CFR under this method would increase to approximately 33 years (from 25 years) which reflects the fact that debt repayments are substantially higher in latter years.

3.11 This policy does not meet the concept of the matching principles described in paragraph 3.8 in the same way that the straightline basis does, as greater proportion of the debt is repaid towards the end of the period. In addition this method is not consistent with way in which MRP is calculated for post-2010 prudential borrowing, but it is allowable under the DCLG Guidance.

Other areas of MRP Policy for consideration

3.12 In addition, there are other areas of MRP policy under investigation which if implemented may require formal approval. These include:

- Reviewing existing asset lives – ensuring that the asset lives used in the calculation of MRP are appropriate and realistic. This may include splitting land from building to optimise the useful life.

- Revisit method for PFI and Finance Leases – the current method ensure that MRP is charged in line with the contract term rather than the asset life itself, which may be longer.

- MRP holiday for new assets – ensuring that MRP is only charged in the year following the asset become operational.

- Capital receipts – ensuring that capital receipts are applied to assets with the shortest lives, thereby allocating borrowing to those assets with longer lives.

4. ALIGNMENT WITH PRIORITIES AND WAYS OF WORKING

4.1 Developing the local economy for the benefit of all

There are no significant implications for this priority.

4.2 Helping people live healthy and independent lives

There are no significant implications for this priority.

4.3 Supporting and protecting vulnerable people

There are no significant implications for this priority.

5. SIGNIFICANT IMPLICATIONS

5.1 Resource Implications

The budgetary implication of the proposed policy change is explained in the main body of the report, the impact over the life of the Business Plan is set out in the table below.

Year	Straight Line Method (50 years) Budget Saving	Annuity Method (50 years) Budget Saving
2015-16	£6.5m	£10.9m
2016-17	£6.0m	£10.3m
2017-18	£5.5m	£9.7m
2019-20	£5.5m	£9.1m
2020-21	£4.6m	£8.6m
2021-22	£4.1m	£8.0m

5.2 Statutory, Risk and Legal Implications

The Council continues to operate within the statutory requirements and MRP regulations and considers the policy to be prudent.

5.3 Equality and Diversity Implications

There are no significant implications for any of the prompt questions within this prompt category.

5.4 Engagement and Consultation Implications

There are no significant implications for any of the prompt questions within this prompt category.

5.5 **Localism and Local Member Involvement**

There are no significant implications for any of the prompt questions within this prompt category.

5.6 **Public Health Implications**

There are no significant implications for any of the prompt questions within this prompt category.

Source Documents	Location
The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 DCLG document, Capital Finance Guidance on Minimum Revenue Provision (February 2012)	Box OCT1114 Shire Hall Cambridge