monmouthshire
sir fynwy

SUBJECT:	**Proposal to revise the Policy on Minimum Revenue Provision (MRP) for 2016/17**
MEETING:	**Audit Committee**
DATE:	**3rd December 2015**

1. PURPOSE:

1.1 To appraise the Audit Committee of an opportunity to revise the Minimum Revenue Provision Policy Statement for 2016/17.

1.2 To outline the budget consequences of the proposed changes.

2. RECOMMENDATIONS:

2.1 It is recommended that Audit Committee:

a) Scrutinise the proposed change to the MRP Policy and if agreed
b) Endorse the submission of the revised Policy to Council for approval which changes the approach concerning the Minimum Revenue Provision on Unsupported Borrowing moving it from an equal instalment basis to an annuity basis.

2.2 To continue to work on reviewing the approach adopted concerning the Minimum Revenue Provision for supported borrowing, and bring back further proposals on the options available.

3. BACKGROUND

Legislative framework and guidance

3.1 The concept on the Minimum Revenue Provision (MRP) was introduced when the Local Government Capital Finance System was changed on 1 April 1990. This required local authorities to assess their outstanding debt and to make an annual charge to the General Fund of 4% of the General Fund Debt (capital financing requirement CFR).

3.2 The arrangements were further endorsed in Wales, under regulation 22 of the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 , which required local authorities to charge to their revenue account for each financial year MRP to account for the cost of their unfinanced capital expenditure i.e their borrowings.

3.3 The 2008 Regulations revised the former regulation 22, in favour of replacing detailed rules with a simple duty for an authority each year to make an amount of MRP which it considers to be **"prudent".** The regulation does not itself define "prudent provision". However, the MRP guidance makes recommendations to authorities on the interpretation of that term.

3.4 The broad aim of a prudent provision was to ensure that debt is repaid over a period that is reasonably commensurate with that over which the capital expenditure provides benefits or in case of borrowing supported by government, reasonably commensurate with the period implicit in the determination of the grant, although Councils retain a discretion to pay more than the minimum calculated sum.

3.5 The issue of statutory MRP guidance has been made possible by section 238(2) of the Local Government and Public Involvement in Health Act 2007, which amends section 21 of the Local Government Act 2003. Section 21 already allowed regulations to be made on accounting practices and is the power under which the existing MRP regulations were made. The amendment inserts a new section 21(1A) into the 2003 Act, enabling Welsh Ministers also to issue guidance on accounting practices and thus on MRP. Authorities are obliged by new section 21(1B) to "have regard" to such guidance – which is exactly the same duty as applies to other pieces of statutory guidance including, for example, the CIPFA Prudential Code, the CIPFA Treasury Management Code.

3.6 Welsh government has issued statutory guidance that councils are required to "take account of" in deciding what is "prudent". Authorities are also asked to prepare an annual statement of their policy on making MRP for submission to their full council. In Monmouthshire this is included with the Treasury Strategy report to full Council before the start of each financial year.

Options for Prudent Provision in the statutory guidance

3.7 The guidance envisages that authorities can distinguish between borrowing that is "supported" (through the RSG system) and other borrowing. The guidance also sets out four options for making MRP;

Option 1 - the regulatory method – this is basically the "old" system for determining MRP as though the 2003 regulations had not been revoked in 2008. So it involves making a 4% of outstanding debt provision, amended by a calculation on the credit ceiling and capital finance requirement on 1 April 2004, and the "commutation adjustment" which arises because authorities incurred losses when the Government commuted annual grant related an adjustment to home improvement grants in 1992.

Option 2 - the CFR method - this is a simplification of the above and involves simply setting MRP equal to 4% of the non housing CFR at the end of the preceding financial year.

Note: Capital Financing Requirement (CFR) is a measure of the underlying need to borrow for capital purposes. When capital expenditure is not paid for immediately, by resources such as capital receipts, capital grants or other contributions, then the CFR increases.

Option 3 - the asset life method – this method requires MRP to be charged over the asset life using either an equal instalment method or annuity method, and permits an additional voluntary provision in any year which may be matched by an appropriate reduction in a subsequent year's MRP. Equal instalment involves paying the same amount each year. Annuity method involves smaller payments in the early years and larger payments in the latter years. The asset life is determined in the year MRP commences and is not subsequently revised. The guidance suggests freehold land should be treated as having a 50 year life, but that where a building or other structure is constructed the life may be treated as matching the structure where this would exceed 50 years. Commencement of MRP can be made in the financial year following the one in which the asset becomes operational.

Option 4 - the depreciation method – this requires depreciation accounting to be followed, including impairment should assets last for a shorter period than originally envisaged, until the element of the asset funded by borrowing has been paid in full.

Conditions for using the options

3.8 The guidance suggests the options 1 regulatory and options 2 CFR methods are to be used for expenditure prior to 2008/09, or that which is "supported". It goes on to observe that the options 3 asset life methods and option 4 depreciation methods are prudent approaches for capital expenditure which does not form part of the authority's Supported Capital Expenditure. However options 3 and 4 can also be used for all capital expenditure at the authority's discretion. In some technical cases (including expenditure capitalised by direction, software and purchase of shares), the asset life method is suggested with assumed lives.

3.9 The guidance makes some assumptions; firstly that we can easily distinguish between schemes funded by "supported" borrowing and other borrowing (sometimes referred to as "prudential borrowing").

3.10 In addition it appears to assume that where there is borrowing on a scheme it is either "supported" or not. Neither of these assumptions are necessarily true, although the guidance does recognize that it is conventional where depreciation approaches have been used not to start depreciation until the asset comes into use. (We have used this convention (which has also been included within MRP regulations) to delay the commencement of MRP on the borrowing funded costs of any capital development.

3.11 It is important to highlight that whilst Authorities must always have regard to the guidance, having done so, they may in some cases consider that a more individually designed MRP approach is justified. That could involve taking account of detailed local circumstances, including specific project timetables and revenue-earning profiles.

Current Policy

3.12 Currently the Authority uses Option 2 the CFR method in respect of supported capital expenditure funded from borrowing. Under this option, MRP is calculated at 4% on a reducing balance basis. MRP amounts repaid are recalculated each year on the revised balance so it can take a long time to pay any liability in full. Option 3, the Asset Life method based on equal instalments, is used for unsupported borrowing.

Revised Approach

3.13 Increasingly Local authorities are relooking at their MRP calculation to reduce the pressure on the revenue budget whilst still ensuring that a prudent level of provision is set aside. It should be stressed the change to MRP calculation should not be regarded as a saving, it is more accurately just a beneficial change in cash flows in the front half of any annuity and results in larger costs to be incurred in latter years.

3.14 The Council has a series of choices concerning its MRP calculation.

Options for Unsupported Borrowing

3.15 The Council has adopted Option 3 of the Welsh Government's MRP Guidance for unsupported capital expenditure. Within option 3, two methods are identified. The first of these is the equal instalment method where MRP is charged on a straight line basis over the estimated life of the asset. The method allows an authority to make voluntary extra provision in any year. The Council has adopted the equal instalment method in its MRP Statement.

3.16 The alternative under Option 3 is the annuity method, which tends to evidence a trend of smaller payments in early years and larger payments on later years and has the advantage of linking MRP to the flow of benefits from an asset where the benefits are expected to increase in later years. An annuity can be structured to pay out funds for a fixed amount of time so like straight line this approach is designed to pay off a liability in a set period. Cipfa's Guidance states '*the informal commentary on the statutory guidance suggests that the annuity method may be particularly attractive in projects where revenues will increase over time. However, it is arguably the case that the annuity method provides a fairer charge than equal instalments as it takes account of the time value of money, whereby paying £100 in 10 years' time is less of a burden than paying £100 now. The schedule of charges produced by the annuity method thus results in a consistent charge over an asset's life, taking into account the real value of the amounts when they fall due. The annuity method would then be a prudent basis for providing for assets that provided a steady flow of benefits over their useful life'*

3.17 Given the above, consideration has been given to assessing the impact of adopting the annuity method for the council since the new regulations came into force. Calculations have been undertaken on the Council's unsupported borrowing using average PWLB Annuity Rates for each year since 2008/09 with the asset life linked to the appropriate PWLB loan period. MRP has commenced in line with the Welsh Government's MRP Guidance i.e. in the year following that in which the asset became operational in all cases (in a few specific cases the Council has commenced MRP in the year capital expenditure was incurred and also adopted an annuity approach).

3.18 Under the revised calculations £1.832 million less would have been set aside as MRP. This represents the combination of using the Annuity Method along with commencing MRP in line with the Welsh Government's MRP Guidance. The Council would also gain a positive cash flow against current approach until 2027-28.

3.19 Going forward any projections of new unsupported borrowing would also be calculated on an annuity basis and therefore alter the amounts set aside in the revenue MTFP. For 2016/17 the positive cashflow benefit would be £304k. The table in the resource implications section of this report outlines the adjustments that would be made.

3.20 An MRP Statement for 2016/17 based on the alternative options contained in this report is attached as Appendix 2

Options for supported borrowing

3.21 The Council has adopted Option 2 of the Welsh Government's MRP Guidance for its supported capital expenditure. Under this Option MRP has historically been calculated at 4% on a reducing balance basis.

3.22 The percentage charge i.e 4% for supported borrowing could be reviewed. Ignoring any reducing balance aspect to the calculation, this 4% could be simplistically attributed to a useful economic life of circa 25 years. A review of the asset register is required to assess an average asset life in order to consider if 4% could be reduced based on a longer average asset life. Also consideration can been given to adopting an Annuity based calculation for MRP on the supported capital expenditure element of the CFR, whilst also amending the percentage charged. Further work is required on this aspect and will be brought back before the Committee at a future meeting.

External Audit view

3.23 Given that the external auditor will need to sign off the accounts as "presenting fairly" the authority's financial position, the proposed approach will need to demonstrate that it is "prudent" in WAO's view. They are currently considering the report and will provide a response in due course.

5. RESOURCE IMPLICATIONS:

5.1 Based on the options explored above the Council could derive the following beneficial cash flow implications.

	2016-17	**2017-18**	**2018-19**	**2019-20**	**Total**
	£'000	**£'000**	**£'000**	**£'000**	
Option C: Move to annuity based on asset life on unsupported borrowing - retrospective	**(1,832)**	**1,832**	**0**	**0**	**0**
Option D: Move to Annuity based on asset life on unsupported new capital expenditure	**(304)**	**(6)**	**(24)**	**(38)**	**(372)**
Total	**(2,136)**	**1,826**	**(24)**	**(38)**	**(372)**

6. SUSTAINABLE DEVELOPMENT AND EQUALITY IMPLICATIONS

6.1 Whilst the adoption of the revision to the MRP Policy could have a favourable effect on the Council's 2016/17 Medium Term Financial Plan, it needs to be stressed that these cash flow adjustments should not be considered as savings, the change merely pushes expenses towards the latter half of repayment schedule. However it can be argued that the annuity method takes account of the time value of money, whereby paying £100 in 10 years' time is less of a burden than paying £100 now. It therefore provides a consistent charge over an asset's life.

7. SAFEGUARDING AND CORPORATE PARENTING IMPLICATIONS

None

8. CONSULTEES:

Head of Finance
Chief Executive
Executive Member for Resources
Audit committee

9. BACKGROUND PAPERS:

Appendix 1 Annual Forecast of Existing and Modelled MRP changes
Appendix 2 proposed MRP Statement for 2016/17

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Appendix 2 - MRP Statement 2016/17

The Welsh Government's Guidance on Minimum Revenue Provision (issued in 2010) places a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision has been issued by the Welsh Ministers and local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.

The four MRP options available are:

- Option 1: Regulatory Method
- Option 2: CFR Method
- Option 3: Asset Life Method
- Option 4: Depreciation Method

Note: This does not preclude other prudent methods.

MRP in 2016/17:

Options 1 and 2 may be used only for supported (i.e. financing costs deemed to be supported through Revenue Support Grant from Central Government) Non-HRA capital expenditure funded from borrowing. Methods of making prudent provision for unsupported Non-HRA capital expenditure include Options 3 and 4 (which may also be used for supported Non-HRA capital expenditure if the Authority chooses).

The MRP Statement will be submitted to Council before the start of the 2016/17 financial year. If it is ever proposed to vary the terms of the original MRP Statement during the year, a revised statement should be put to Authority at that time.

The Authority will apply Option 2 in respect of supported capital expenditure funded from borrowing and Option 3 in respect of unsupported capital expenditure funded from borrowing. There are 2 calculation methods which are available within option 3.

- The equal instalment method and
- The annuity method – whereby the MRP is the principal element for the year of the annuity required to repay the capital expenditure over the life of the asset

The annuity method will used for unsupported borrowing. This is a change to previous policy, which was to use an equal instalment method.

MRP in respect of leases and Private Finance Initiative schemes brought on Balance Sheet under the CIPFA Accounting Code of Practice will match the annual principal repayment for the associated deferred liability.