monmouthshire
sir fynwy

SUBJECT:	**Proposal to revise the Policy on Minimum Revenue Provision (MRP) for 2016/17**
MEETING:	**Full Council**
DATE:	**17th December 2015**

1. PURPOSE:

1.1 To provide Full Council with a proposal to revise the Minimum Revenue Provision Policy Statement for 2016/17.

1.2 To outline the budget consequences of the proposed changes.

2. RECOMMENDATIONS:

It is recommended that Full Council approve:

2.1 The revised MRP Policy Statement attached as Appendix 2, 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 That work on reviewing the approach adopted concerning the Minimum Revenue Provision for supported borrowing is undertaken, and further proposals on the options available are brought back to Council.

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's accounting policy on MRP is simply to set aside a prudent level of resources, and the method for achieving this is through the use of an accounting estimate. Changing the basis of the MRP calculation represents a change to the estimation technique employed within the options provided in the Guidance. As with any provision, calculations can be reviewed on a cumulative basis and any over-provisions made in previous years can be corrected in the year that they were identified. This revision would not lead to a prior period adjustment in the Statement of Accounts, but provides a benefit in the year the change takes place. In relation to the historic unsupported capital financing requirement, the Council would also gain a positive cash flow in MRP payments against current approach until 2025-26, as shown in Appendix 1.

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, complies with Statute and takes into account implications in relation to the future generations. The WAO 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)**	**0**	**0**	**0**	**(1,832)**
Option D: Move to Annuity based on asset life on unsupported new capital expenditure	**(304)**	**(310)**	**(334)**	**(372)**	**(1,320)**
Total	**(2,136)**	**(310)**	**(334)**	**(372)**	**(3,152)**

6. FUTURE GENERATIONS 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.

6.2 In addition reducing payments now means we can continue to keep services open now for the benefit of future generations rather than have to cut services now that may never get reinstated. The Future Generations Evaluation is contained in Appendix 3.

7. SAFEGUARDING AND CORPORATE PARENTING IMPLICATIONS

None

8. CONSULTEES:

Head of Finance
Chief Executive
Executive Member for Resources
Audit committee

8.1 The Audit committee considered this report on 3rd December 2015 where the balance of opinion was to recommend the proposal to Council. A summary of the issues raised at Audit Committee are included below:

8.2 *It would be useful to have WAOs response before advocating the approach to Council*. WAO were in attendance at the meeting and reported they are aware that increasing number of Councils are considering similar refinements to their Treasury Strategy, and that there is a letter on its way to Council's from the Auditor General on the subject. WAO confirmed that irrespective of this letter, it was a decision for individual Councils to take rather than them, and that their advice would involve reminding Councils of the considerations to take into account as follows,

1. Have regard for legislative regulations and guidance
2. Remain prudent
3. Considers Future generations implications.

8.3 In response to this it can be noted that the proposal does accord with the legislative framework and guidance as evidenced in section 3 above. The proposal is prudent and appropriate in that it introduces no additional net cost for the Council, being a refinement to cashflow profile. In terms of the Future generations implications these are covered in Section 6 of the report and Appendix 3 where it is explained that as the new method takes account of the time value of money, future generations are not being expected to pay disproportionately more than current Council Tax contributors.

8.4 *This is a budget saving exercise and more time should be taken to consider the change in policy.* In response, the proposal should not be viewed as providing a saving per se, the annuity basis reflects a fairer methodology for Council Tax payers and an examination of the MRP charges made from 2007/08 reveals that the Council has overprovided during the period 2007/08 to 2015/16. This over-provision could be released back to revenue to ensure the total provision to the end of 2016/17 is in line with the reprofiled MRP schedule, which has a benefit in mitigating further cost savings and service decline necessary to achieve a balanced budget which would be beneficial to both current and future taxpayers.

9 BACKGROUND PAPERS:

Appendix 1 Annual Forecast of Existing and Modelled MRP changes
Appendix 2 proposed MRP Statement for 2016/17
Appendix 3 Future Generations Evaluation form

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APPENDIX 1

INDICATIVE CASHFLOW MOVEMENTS UNSUPPORTED BORROWING MRP CALCULATION

		Historic Capital Financing Requirement				**Historic Capital Financing Requirement**			**Changes**	
		Equal Instalment Method				**Annuity Method**				
Year	Year ending 31st March	**CFR b/fwd**	**Equal instalment Method MRP**	**Set aside adjustment**	**CFR c/fwd**	**CFR b/fwd**	**Annuity Method MRP**	**CFR c/fwd**	**Gross Difference in MRP**	**Net MRP Difference**
Prior		44,641,453	(4,137,712)		40,503,742	44,641,453	(3,041,975)	41,599,478		
0	2015	40,503,742	(2,236,744)		38,266,998	41,599,478	(1,877,432)	39,722,046	(1,455,049)	
1	2016	38,266,998	(2,522,530)	262,902	35,744,468	39,722,046	(1,882,810)	37,839,236	(376,818)	(1,831,866)
2	2017	35,744,468	(2,505,014)	262,902	33,221,938	37,839,236	(1,937,978)	35,901,258	(304,134)	(304,134)
3	2018	33,221,938	(2,504,071)	263,358	30,717,867	35,901,258	(1,945,429)	33,955,829	(295,285)	(295,285)
4	2019	30,717,867	(2,188,806)	263,358	28,529,060	33,955,829	(1,687,476)	32,268,353	(237,972)	(237,972)
5	2020	28,529,060	(1,730,464)	263,358	26,798,596	32,268,353	(1,380,658)	30,887,695	(86,448)	(86,448)
6	2021	26,798,596	(1,669,099)		25,129,497	30,887,695	(1,429,324)	29,458,371	(239,775)	(239,775)
7	2022	25,129,497	(1,669,099)		23,460,398	29,458,371	(1,479,891)	27,978,480	(189,208)	(189,208)
8	2023	23,460,398	(1,596,197)		21,864,201	27,978,480	(1,453,658)	26,524,822	(142,539)	(142,539)
9	2024	21,864,201	(1,596,197)		20,268,003	26,524,822	(1,506,702)	25,018,120	(89,495)	(89,495)
10	2025	20,268,003	(1,596,197)		18,671,806	25,018,120	(1,561,852)	23,456,268	(34,345)	(34,345)
11	2026	18,671,806	(1,596,197)		17,075,609	23,456,268	(1,619,195)	21,837,073	22,998	22,998
12	2027	17,075,609	(1,596,197)		15,479,412	21,837,073	(1,678,818)	20,158,255	82,621	82,621
13	2028	15,479,412	(1,596,197)		13,883,215	20,158,255	(1,740,814)	18,417,441	144,617	144,617
14	2029	13,883,215	(1,596,197)		12,287,018	18,417,441	(1,805,278)	16,612,163	209,081	209,081
15	2030	12,287,018	(1,596,197)		10,690,820	16,612,163	(1,872,311)	14,739,852	276,114	276,114
16	2031	10,690,820	(1,596,197)		9,094,623	14,739,852	(1,942,015)	12,797,837	345,818	345,818
17	2032	9,094,623	(1,596,197)		7,498,426	12,797,837	(2,014,500)	10,783,337	418,302	418,302
18	2033	7,498,426	(1,596,197)		5,902,229	10,783,337	(2,089,876)	8,693,461	493,679	493,679
19	2034	5,902,229	(1,408,485)		4,493,744	8,693,461	(1,949,719)	6,743,742	541,234	541,234
20	2035	4,493,744	(1,256,911)		3,236,832	6,743,742	(1,798,792)	4,944,950	541,880	541,880
21	2036	3,236,832	(1,084,104)		2,152,728	4,944,950	(1,585,334)	3,359,616	501,230	501,230
22	2037	2,152,728	(979,104)		1,173,623	3,359,616	(1,470,166)	1,889,450	491,062	491,062
23	2038	1,173,623	(639,335)		534,288	1,889,450	(977,722)	911,728	338,386	338,386
24	2039	534,288	(435,932)		98,356	911,728	(705,088)	206,640	269,156	269,156
25	2040	98,356	(98,356)		(0)	206,640	(206,640)	0	108,284	108,284
26	2041	(0)			(0)	0	0	0	0	0
27	2042	(0)			(0)	0	0	0	0	0
28	2043	(0)			(0)	0	0	0	0	0
29	2044	(0)			(0)	0	0	0	0	0
30	2045	(0)			(0)	0	0	0	0	0

		Historic Capital Financing Requirement plus Anticipated Unsupported Borrowing (next 4 year MTFP) Equal Instalment Method					Historic Capital Financing Requirement plus Anticipated Unsupported Borrowing (next 4 year MTFP) Annuity Method				Changes	
Year	Year ending 31st March	CFR b/fwd	Additional Unsupported Borrowing	Equal instalment Method MRP	Set aside	CFR c/fwd	CFR b/fwd	Additional Unsupported Borrowing	Annuity Method MRP	CFR c/fwd	Gross Difference in MRP	Net MRP Difference
Prior												
0	2015	40,503,742		(2,236,744)		38,266,998	41,599,478		(1,877,432)	39,722,046	(1,455,049)	
1	2016	38,266,998		(2,522,530)	262,902	35,744,468	39,722,046		(1,882,810)	37,839,236	(376,818)	(1,831,866)
2	2017	35,744,468	19,596,415	(2,505,014)	262,902	52,835,869	37,839,236	19,596,415	(1,937,978)	55,497,673	(304,134)	(304,134)
3	2018	52,835,869	1,000,000	(2,545,637)	263,358	51,290,232	55,497,673	1,000,000	(1,972,432)	54,525,241	(309,847)	(309,847)
4	2019	51,290,232	0	(2,430,605)	263,358	48,859,627	54,525,241	0	(1,833,556)	52,691,684	(333,691)	(333,691)
6	2020	48,859,627	1,000,000	(2,430,605)	263,358	47,429,022	52,691,684	1,000,000	(1,795,504)	51,896,180	(371,743)	(371,743)

Option	2015/16			2016/17			2017/18			2018/19			2019/20		
	Supported Borrowing	Unsupported Borrowing	Total MRP	Supported Borrowing	Unsupported Borrowing	Total MRP	Supported Borrowing	Unsupported Borrowing	Total MRP	Supported Borrowing	Unsupported Borrowing	Total MRP	Supported Borrowing	Unsupported Borrowing	Total MRP
2015/16 MTFP	£3,128,189	£2,403,095	**£5,531,284**	£3,101,833	£2,385,578	**£5,487,411**	£3,159,694	£2,426,201	**£5,585,895**	£3,225,640	£2,360,255	**£5,585,895**	£3,225,640	£2,360,255	**£5,585,895**
Budget Virements 2015/16 (Vehicles)		£119,435	**£119,435**		£119,435	**£119,435**		£119,435	**£119,435**		£70,350	**£70,350**		£70,350	**£70,350**
Budget Virements (Vehicles)					£53,072	**£53,072**		£93,966	**£93,966**		£293,941	**£293,941**		£190,208	**£190,208**
Set aside against ACM expenditure 2015/16		-£262,902	**-£262,902**	-£0	-£262,902	**-£262,902**	£39,774	-£263,358	**-£223,584**	£71,487	-£263,358	**-£191,871**	£169,169	-£263,358	**-£94,189**
New options:															
Option C: Move to Annuity based on asset life on Unsupported - Retrospective			**£0**		-£1,831,866	**-£1,831,866**			**£0**			**£0**			**£0**
Option D: Move to Annuity based on asset life on Unsupported new capex			**£0**		-£304,134	**-£304,134**		-£309,847	**-£309,847**		-£333,691	**-£333,691**		-£371,743	**-£371,743**
Adjusted MRP budget	£3,128,189	£2,259,628	**£5,387,817**	£3,101,833	£159,183.21	**£3,261,016**	£3,199,468	£2,066,398.37	**£5,265,867**	£3,297,127	£2,127,496.89	**£5,424,624**	£3,394,809	£1,985,711.92	**£5,380,521**
Increase/(Decrease) from existing MTFP			**-£262,902**			**-£2,226,395**			**-£320,029**			**-£161,271**			**-£205,374**