Subject: **Minimum Revenue Provision Policy - Review**

Report to: **Policy and Resources – 28 November 2017**

Report by: **Capital Projects and Senior Accountant**

SUBJECT MATTER/RECOMMENDATIONS
To consider and recommend a change to the Council's Minimum Revenue Policy. Recommendation: To approve the revised MRP policy thus amending the calculation of the MRP for the post 2008 expenditure to the annuity asset life method (as set out at 4.3 within the report) to be applied to 2017/18 onwards.

1. INTRODUCTION AND BACKGROUND

1.1 Local Authorities are required to set an annual Minimum Revenue Provision (MRP) statement, this is approved each year as part of the treasury management strategy which is agreed annually by Full Council alongside the budget setting processes.

1.2 MRP represents the minimum charge to an Authorities revenue account that must be made each year in relation to capital expenditure that was originally funded from debt. In summary for all capital expenditure that is not financed from 'cash' resources for example reserves, external grants and contributions or capital receipts and is financed by borrowing will incur a MRP charge annually.

1.3 Regulations and statute in respect of MRP are covered within The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 which became effective from March 2008. These regulations replaced the formula-based method for calculating MRP which existed under previous regulations. Regulations 27 and 28 (as amended in 2008) require that a local authority "shall determine for the current financial year an amount of Minimum Revenue Provision which it considers to be prudent".

1.4 The Department for Communities and Local Government (DCLG) have produced statutory guidance alongside the regulations which local authorities must have regard to when setting out what they deem to be a prudent MRP charge. These are discussed in more detail in section 2 of the report.

1.5 MRP is essentially linked to the concept of the capital financing requirement (CFR) in the CIPFA Prudential Code. The CFR represents the total of all the Council's past capital expenditure, less the total capital financing applied other than debt. Debt is only a temporary form of finance, as loans must be repaid. The CFR therefore represents the Council's underlying need to borrow for capital purposes, and the amount that has yet to be permanently financed. MRP is the main method of permanently financing that expenditure.

1.6 The council's current MRP policy was introduced in 2007/08. Before 2007/08, the method of calculating MRP was set out in legislation. But from 2007/08 onwards, local authorities have had the ability to set their own policy on calculating MRP, with the principal legislative condition being that the amount calculated must be one that the Council deems to be "prudent".

1.7 As the policy has not been reviewed since it was implemented it is timely to review the method used for calculating the MRP.

2. MRP OPTIONS

2.1 In accordance with the Local Authorities (Capital Finance and Accounting) (England) Regulations 2008 the guidance sets out the following four methods for calculation of the MRP:

a) **Regulatory Method -** This method reflects the previous regulations; MRP is charged at 4% of the authority's underlying need to borrow for capital purposes, i.e. the capital financing requirement (CFR). The formula includes an item known as 'Adjustment A' which was intended to manage the difference between the CFR and the former method of calculation prior to the introduction of the Prudential System from April 2004.

b) **Capital Financing Requirement (CFR) Method -** This method calculates the MRP by basing the charge on the authority's CFR excluding the technical adjustments included in option 1 and aims to simplify the method. The annual MRP charge is set at 4% of the non-housing CFR at the end of the preceding financial year.

c) **Asset Life Method -** This method calculates MRP based on the life of the asset for which the borrowing is undertaken and can be calculated by either of the following methods:

(i) equal instalments - where the principal repayment made is the same in each year, or
(ii) annuity - where the principal repayments increase over the life of the asset.

d) **Depreciation Method –** This method is similar to that under option 3 but the MRP is equal to the depreciation provision required in accordance with proper accounting practices in respect of the asset on which the capital expenditure has been financed by borrowing.

2.2 Local authorities have the discretion to set their own MRP policy although the guidance recommends a number of factors to consider:

a) A statement of MRP policy for the forthcoming financial year is approved by the full council or equivalent before the start of each financial year, – this is approved annually within the Treasury Management Strategy alongside the budget report;

b) The broad aim of the policy is to ensure that MRP is charged (to the revenue account) over a period that is reasonably commensurate with the period over which the capital expenditure which gave rise to the borrowing/debt provides a benefit to the Authority;

c) MRP is not required to be charged to the Housing Revenue Account (HRA);

d) Where a local authority's overall Capital Financing Requirement[1] is zero or a negative amount there is no requirement to charge MRP.

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[1] *The capital financing requirement (CFR) measures an authority's underlying need to borrow or finance by other long-term liabilities for a capital purpose (i.e. it means capital expenditure incurred but not yet paid for).*

2.3 MRP charges commence in the financial year following the year in which the expenditure is incurred, or in the year following that in which the relevant asset becomes operational. This enables an MRP "holiday" to be taken where there is no charge to the revenue account in relation to assets which take more than one year to be completed before they become operational. This condition applies to each of the calculation methods that can be adopted.

3. CURRENT MRP POLICY

3.1 The budgeted annual MRP charge equates to in the region of £1.8 million for 2017/18 and is forecast to increase as the capital programme's increasing reliance on borrowing as a capital financing source increases as opposed to internal resources, for example revenue reserves and capital receipts.

3.2 MRP for the Council is currently calculated in accordance with the following:

a) MRP on all General Fund capital expenditure incurred before 1st April 2008 is equal to 4% of the opening CFR less a fixed sum known as "Adjustment A" (2.1 (a) above);

b) MRP on General Fund expenditure incurred from April 2008 onwards is made over the asset's estimated useful life on a straight line basis, starting in the year after the asset becomes operational (2.1 (c) (i) above) ;

c) No MRP is made on HRA expenditure.

3.3 The annuity method is not currently used and current guidance suggests that this is an alternative to the straight line basis for post-2008 expenditure. In respect of finance leases (which are eligible for MRP) the current method used is not the suggested method for finance leases of making MRP equal to the principal repayment, which is a variation of the annuity method.

3.4 The council's MRP policy was created in 2007 at the start of the new MRP system. It has now been in place for eight years, and the council now faces a significantly different financial climate with substantial challenges remaining in terms of producing medium to long term sustainable financial position. The Council therefore needs to review the method and application of its policies to ensure these remain appropriate and reasonable.

4. PROPOSED MRP POLICY

4.1 The review of the MRP policy has been informed by work carried out by the Council's treasury management advisors, Arlingclose. Discussions have also been had with the Council's external auditors EY, and their comments have informed the recommended approach moving forward.

4.2 The following outlines the proposal for the MRP policy moving forward:

4.3 **Proposal for Post-2008 Expenditure** - For capital expenditure financed by borrowing since April 2007, the current method adopted by the Council is the straight line asset life. It is recommended that an alternative of annuity asset life method, be adopted instead. The annuity MRP method would be a lower annual charge in the earlier years compared to the straight line method and higher in later years. The approach is both prudent and a recommended method as per the CLG guidance (2.1 c,ii). This method allows for a reduction in the interest costs chargeable (as the CFR is repaid) over time and will be offset by a rise in MRP over the same period, thereby resulting in a consistent revenue charge of the cost of capital.

4.4 **Proposal for Pre 2008 Expenditure** – It is recommended that the current method for the pre 2008 expenditure is continued as there has been no change in the guidance for this element of the MRP from DCLG and the advice from the Council's auditors could be subject to challenge.

5. FINANCIAL AND RISK IMPLICATIONS

5.1 The financial implications of the proposed changes to the policy will be reflected in the detailed work of the 2018/19 budget to be presented for approval by Members in February 2018.

6. CONCLUSIONS

6.1 The current MRP policy has not been reviewed since it was established in 2008. The proposed new policy provides a prudent annual MRP charge to the revenue account that will more accurately align the MRP with the period over which the capital expenditure provides benefits to the Authority.

7. RECOMMENDATIONS

7.1 To approve the revised MRP policy thus amending the calculation of the MRP for the post 2008 expenditure to the annuity asset life method (as set out at 4.3 within the report) to be applied to 2017/18 onwards.

8. BACKGROUND PAPERS

8.1 Arlingclose MRP review document.

8.2 Current GYBC MRP policy.

8.3 DCLG Guidance on MRP calculation and setting.

Areas of consideration: e.g. does this report raise any of the following issues and if so how have these been considered/mitigated against?

Area for consideration	**Comment**
Monitoring Officer Consultation:	
Section 151 Officer Consultation:	
Existing Council Policies:	
Financial Implications:	
Legal Implications (including human rights):	
Risk Implications:	
Equality Issues/EQIA	

assessment:	
Crime & Disorder:	
Every Child Matters:	