BRIEFING PAPER

REPORT to : Council Forum

LEAD OFFICER: Director of Finance and IT

DATE: 26th January 2017

WARD/S AFFECTED: All

REVIEW OF MINIMUM REVENUE PROVISION POLICY

1. PURPOSE

A review of the Council's MRP (Minimum Revenue Provision) Policy has been undertaken and the paper presents proposals to amend the current Policy.

2. RECOMMENDATIONS

2.1 It is proposed that the Council amends its MRP (Minimum Revenue Provision) Policy, with effect from 2016/17 as follows:-

(a) *For capital expenditure that is self-financed from debt arising in 2007/08 and thereafter* - to continue to use the Asset Life Method, but to use the annuity variant based on the average Public Works Loan Board (PWLB) annuity rates prevailing in the year of the expenditure, rather than the current method of charging MRP on a straight line basis over the estimated life of the asset.

(b) *For finance leases and 'on-balance sheet' Private Finance Initiative (PFI) contracts* - to again use the annuity variant of the Asset Life Method but using the annuity rates built into the financing arrangements, rather than the current method of matching the MRP to the value of the rent/charge that is charged each year to write down the balance sheet liability of the respective finance lease or PFI contract.

(c) *For historic debt that was entered into prior to unitary authority status and is managed by Lancashire County Council (LCC)* - to spread the cost on a straight line basis over 49 years, in alignment with the profile for historic supported borrowing

(d) *In those cases where asset lives cannot be readily determined* - to use a default period of 20 or 25 years in line with government guidance.

3. BACKGROUND

3.1 Local authorities are required each year to set aside a provision for debt repayment. Previously there were detailed rules setting out how to calculate such a Minimum Revenue Provision (MRP) but now, under Statutory Instrument 2008 no.414, it stipulates that:

"A local authority shall determine for the current financial year an amount of minimum revenue provision that it considers to be prudent."

There is not a specific definition of "prudent" provision however the Government issued MRP Guidance, most recently in 2012, making recommendations to authorities on the interpretation of that term. Authorities are legally obliged to have regard to this guidance.

MRP is made each year against the Council's total outstanding Capital Financing Requirement (CFR). This comprises;

Total capital spend financed from the Council's own resources
LESS the use of any capital receipts or revenue provision
LESS any MRP already made.

The CFR increases each year as new capital spend financed from borrowing is incurred, and reduces as the annual MRP is made or if capital receipts are applied to the debt thereby reducing the amount of borrowing required.

The MRP Policy determines not ***what the cost is*** but ***how it is to be spread over time***.

3.2 At Council Forum in January 2016, the Council changed its approach to making MRP on supported borrowing *mainly in respect of assets financed from borrowing up to 31st March 2008*. The change involved a switch from making MRP at 4% of the relevant carrying CFR (which had reflected the notional level of historic government grant funding support) to making MRP on this element of the CFR at a straight 2% over 50 years.

3.3. During 2016/17, the Council has undertaken a further review of its MRP calculation methodology and accounting assumptions. To assist in this complex work the Council engaged the services of its Treasury Management advisors, Arlingclose, to review the policy and advise on best practice. From the review it was concluded that the current policy is very conservative compared to many other Councils and therefore we have developed recommendations for changes in our calculation methodology which will still ensure that prudent provision is made, but which will change the profile or spread of the costs over time for charges made in 2016/17 and beyond.

4. KEY ISSUES

4.1 The basis of the proposed policy change

The proposed policy change will ensure that the revenue costs of capital expenditure are more closely matched with the economic benefits received over the life of those capital assets. The net effect of the proposed changes will be to reduce MRP charges in the current and near future years, and increase them beyond that. The amended MRP charges will continue to be prudent but will be matched more appropriately to the cost of the assets over time.

There are four keys areas where recommendations for change to the current policy are made. It is proposed for these to take effect from 2016/17.

4.2 MRP in respect of assets financed from prudential borrowing

This addresses the MRP in respect of those assets financed from borrowing *since 1st April 2008*. The Council's current method of calculating MRP in respect of prudential borrowing has been to spread the cost of borrowing in a straight line over the estimated lives of the assets. On this basis, current council tax payers pay a relatively higher charge than council tax payers will do in the future, for example, using the current straight line basis an asset costing £20m to build with a life of

20 years would result in a consistent £1m charge each year however using the annuity method, the impact of inflation is taken into account thereby smoothing the charge to address the fact that £1m today has a higher value than £1m will have in 20 years' time.

The annuity method also reflects the fact that the interest costs related to an asset will reduce over time as the debt is repaid. The annuity method is therefore similar to a repayment mortgage whereby repayments of the principal or capital sum increase over time and correspondingly the related interest payments reduce, however the repayments made remains constant.

It is therefore proposed to move to an annuity based MRP calculation; whilst this will still reflect the same estimated asset lives, it will use the average PWLB annuity rates prevailing in the year of the expenditure to make the provision, based on loans with the same length to maturity as the estimated asset life.

4.3 MRP in respect of PFI (Private Finance Initiative) assets

The Council currently makes MRP equal to the element of the rent or charge that goes to write down the balance sheet liability each year. This is a form of annuity MRP, using the interest rate implicit in the financing arrangement made over the life of the PFI contract rather than the life of the asset created. It is therefore proposed to change the calculation so that the MRP reflects the assets lives rather than reflecting the financing arrangements made in respect of those assets as it does at present. We would continue to use annuity rates based on those built into the PFI financing arrangements.

Though the Council currently has no finance leases, it would be consistent to adopt a similar "asset life" MRP method should they arise. This would again mean that MRP charges would no longer equal the rent or service charge payable for the year.

4.4 MRP in respect of Debt Managed by LCC (Lancashire County Council)

Following Local Government Reorganisation in 1998, part of the historic debt relating to the Council continued to be managed by LCC and charges for the principal and interest elements of this debt are made to them each year. The Council currently makes MRP equal to the principal element of LCC's charge i.e. the amount by which the balance sheet liability is reduced or written-down each year. It is proposed to change this so that MRP more closely reflects the lives of the asset to which the finance relates, rather than the financing arrangements made in respect of those assets. As such we propose to use the same basis as for our other historic supported borrowing – i.e. straight line over 49 years. It is proposed to use 49 years rather than 50 years to reflect the fact that this change is being made one year later than the change made in 2015/16 in respect of the Council's other historic debt i.e. to bring them into line.

4.5 MRP where there are no Asset Lives to be determined

Where there are no asset lives to be determined – for example where the Council has capitalised redundancy costs - the Council has to date chosen relatively short fixed periods of time over which to spread the cost. It is proposed to standardise the approach so that MRP on expenditure that is not specifically related to fixed assets, but which has been capitalised by regulation or direction, will be charged over a 20 or 25 year period in line with the government guidance.

5. POLICY IMPLICATIONS

5.1 The policy implications are for a change in the Council's MRP Policy, as outlined above.

6. FINANCIAL IMPLICATIONS

6.1 MRP Savings

The impact of the proposed MRP policy changes on the Council's MRP annual charge, based on current assumptions for capital expenditure and receipts, are as follows:

	16/17 £'m	17/18 £'m	18/19 £'m	19/20 £'m	29/30 £'m	39/40 £'m	49/50 £'m
Prudential Borrowing	1.8	1.8	1.7	1.6	0.3	-0.4	-0.9
PFI Assets	1.4	1.6	1.6	1.5	3.2	-0.8	-2.0
LCC Debt	0.3	0.3	0.3	0.2	0.0	-0.1	-0.2
No assets	0.4	0.2	-0.1	0.1	0.0	0.0	0.0
Use of Capital receipts	0.5	0.7	0.7	0.6	0.0	0.0	0.0
TOTAL MRP Saving	**4.4**	**4.6**	**4.2**	**4.0**	**3.5**	**-1.3**	**-3.1**

6.2 Additional Interest Costs

As a result of the proposed changes to MRP policy, the Council's CFR will be higher than previously projected (as the reduction in this from the reduced MRP charge each year will be less in the near future). This will therefore reduce the Council's cash balances and will require additional borrowing.

MRP savings will therefore be offset in part by extra interest costs, but it is projected that there will still be a significant net reduction in the early years.

6.3 Net Financial Implications

The net impact of the proposed changes to MRP calculations will ultimately depend on the levels of expenditure to be financed from borrowing. Based on current assumptions, impact is forecast as follows:

	16/17 £'m	17/18 £'m	18/19 £'m	19/20 £'m	29/30 £'m	39/40 £'m	49/50 £'m
Gross MRP Saving	4.4	4.6	4.2	4.0	3.5	-1.3	-3.1
Additional interest cost	0.0	-0.1	-0.2	-0.4	-2.1	-3.2	-1.8
Net Saving (after Interest)	**4.4**	**4.5**	**4.0**	**3.6**	**1.4**	**-4.5**	**-4.9**

As can be seen, there are significant savings in earlier years, offset by increased costs in later years. This represents a more even spread of the costs of the Council's assets over their useful lives.

7. LEGAL IMPLICATIONS

7.1 Under the Local Government Act 2003, local authorities determine locally their policies Minimum Revenue Provision. Government guidance has been developed to support local authorities in taking these decisions, and the Council is required by the Act to have regard to the guidance when determining its MRP.

8. RESOURCE IMPLICATIONS	None

9. CONSULTATIONS	None

10. STATEMENT OF COMPLIANCE

The recommendations are made further to advice from the Monitoring Officer and the Section 151 Officer has confirmed that they do not incur unlawful expenditure. They are also compliant with equality legislation and an equality analysis and impact assessment has been considered. The recommendations reflect the core principles of good governance set out in the Council's Code of Corporate Governance.

VERSION:	**0.05**

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BACKGROUND PAPERS:	CIPFA Guidance - CLG Investment Guidance - Council Treasury Management Strategy approved Finance Council 29th Feb 2016 / Mid-Year Strategy Report approved Policy Council 1st December 2016