



**TO: COUNCIL**  
**FROM: DIRECTOR OF FINANCIAL SERVICES**  
**DATE: 3 MARCH 2008**

**PORTFOLIOS AFFECTED: ALL**

**WARDS AFFECTED: ALL**

---

<b>TITLE OF BRIEFING PAPER</b>	<b>THE PRUDENTIAL CODE, MINIMUM REVENUE PAYMENT POLICY AND TREASURY MANAGEMENT STRATEGY 2008/09</b>
--------------------------------	---

---

## **1. PURPOSE**

- 1.1 The Council is required to determine various Prudential Indicators around the affordability, sustainability and prudence of the Council's borrowing and investment proposals. These should be consistent with the Council's Budget Strategy.
- 1.2 The Council should also set a Treasury Management Strategy for the forthcoming year.
- 1.3 In anticipation of forthcoming legislative changes, it is proposed that a policy be established for Minimum Revenue Payment of debt.

## **2. RECOMMENDATIONS**

- 2.1 The Council is recommended to approve
  - a) the Prudential Indicators proposed by the Director of Financial Services, as outlined in Appendix 1,
  - b) the proposed Treasury Management Strategy, as outlined in Appendix 2, and
  - c) the policy proposals for determination of Minimum Revenue Provision for repayment of debt, as outlined in Appendix 3, subject to the relevant legislation being enacted

## **3. KEY ISSUES**

- 3.1 The Council has a legal requirement to set Prudential Indicators, to inform borrowing and capital investment decisions. These have to be affordable, sustainable and prudent.

- 3.2 The Council should, at the same time, agree a Treasury Management Strategy for the forthcoming year.
- 3.3 It is anticipated that Government legislation will require councils to develop their own policy for the prudent management of debt repayment, moving away from previous prescriptive approaches. A proposal is made for the policy to be adopted in the event that the legislative changes are made.

#### **4. RATIONALE**

- 4.1 Under the Local Government Act 2003, local authorities determine locally their levels of capital investment and associated borrowing. Operating under the 'Prudential Code', introduced from 2004/05, the Council is required to approve a number of key indicators prior to setting its' Council Tax each year. The aim of the Prudential Code is to allow members to be informed of the impact of capital investment decisions on the overall Council Budget. Capital investment plans must be assessed to establish that the proposals are
- affordable
  - prudent
  - sustainable
- 4.2 The Code also requires councils to consider and agree indicators for the next three years, as part of medium term financial planning. These can be reviewed annually.
- 4.3 The Council must legally set ten Indicators. These are detailed in Appendix 1 and are consistent with the proposed Budget Strategy to be considered later in the agenda.
- 4.4 In addition the Prudential Code requires the Council to set borrowing limits which specifies Approved Borrowing Limits and the 'debt mix' of any borrowings to be made. The Council is also required to approve the annual Treasury Management Strategy (set out in Appendix 2).
- 4.5 The Prudential Indicators and Treasury Management Strategy are consistent with the Budget Strategy and recommended Council Tax. The budgetary impact of setting these Indicators is reflected in the proposed Revenue and Capital Budget for 2008/09.

#### **Minimum Revenue Payment – legislative change and proposed policy**

- 4.6 The Government has consulted with local authorities on proposals to change the statutory requirements in respect of charges made to the revenue account in each year for Minimum Revenue Payment (MRP) - effectively the principal repayment made against the debt carried by the authority. It is anticipated that this legislative change will be promulgated very shortly.



- 4.7 Regulations previously set out a detailed method which authorities were required to follow to calculate their MRP, with authorities free to make additional provision over and above that minimum. It is proposed that, for the financial year 2007/08 and subsequent financial years, the specified detailed calculations be replaced with a requirement that local authorities calculate an amount of MRP which they consider to be prudent. The broad aim of prudent provision is that debt is repaid over a period reasonably commensurate with that over which the capital expenditure provides benefits. Options for what would normally constitute prudent provision have been set out by the Government.
- 4.8 In anticipation of the legislative changes being made, it is proposed that the MRP Policy set out in Appendix 3 be approved. This policy is in line with the Government's proposals. This will allow the Council to take on board the financial consequences of the changes as soon as the legislation is approved.

## **5. POLICY IMPLICATIONS**

- 5.1 Policy implications are contained within the Budget Strategy outlined elsewhere on the agenda.

## **6. FINANCIAL IMPLICATIONS**

- 6.1 The financial implications arising from these determinations are incorporated into the Budget Report and Council Tax recommendations to be considered by the Council in later reports on the agenda.
- 6.2 One consequence of the anticipated MRP changes is to deliver lower revenue costs in early years of capital schemes taking more than a year to build, as there will be no need to start making MRP until the year the asset first becomes operational. The impact of this has been incorporated into the Budget Strategy. In the event that the legislative changes anticipated are not enacted, there will be additional cost pressures on the Council, more significantly from 2009/10 onwards.

## **7. LEGAL IMPLICATIONS**

- 7.1 Local Authorities are required, by way of Regulations issued under the Local Government Act 2003, to operate within the Prudential Code when considering their budgets. The Council must also consider and adopt a Treasury Management Policy which must include an investment strategy and a borrowing strategy.
- 7.2 It is also a statutory requirement for the Council to produce a balanced budget.

## 8. RESOURCE IMPLICATIONS

8.1 None as a direct consequence of this report.

## 9. CONSULTATIONS

9.1 None applicable to this report

CONTACT OFFICERS: Denise Park, Director of Financial Services - Ext. 5482  
Ron Turvey, Capital Accountant - Ext. 5303  
DATE: 12 February 2008  
BACKGROUND PAPER: Draft Capital Programme 2008/11 and associated papers

## TREASURY MANAGEMENT PRUDENTIAL INDICATORS

### ***Indicator One: Local authority has adopted the CIPFA Treasury Management Code of Practice***

The Code was adopted by the Council in March 2003.

### ***Indicator Two: Estimates of capital expenditure***

The Council has to make reasonable estimates of the total of capital expenditure that it plans to incur during the forthcoming financial year and the following two financial years.

2008-09	£50.3 million
2009-10	£41.0 million
2010-11	£21.4 million

In later years, particularly, this does not include all projects for which additional grant finance may be approved during the year. However, grant funded spending will not affect the Council's Capital Financing Requirement.

### ***Indicator Three: Estimates of Capital Financing Requirements***

The Council must make reasonable estimates of the "total Capital Financing Requirement" - i.e. the total borrowing outstanding in respect of capital expenditure, including Lancashire County Council (LCC) debt at the end of the next three financial years

2008-09	£157.0 million	(LCC element £22.2 million)
2009-10	£166.2 million	(LCC element £21.3 million)
2010-11	£165.1 million	(LCC element £20.4 million)

The LCC element relates to debt managed by the County Council in respect of transferred services.

### ***Indicator Four: Estimate of the incremental impact of capital investment decisions on the Council Tax***

The Council has to forecast the impact of the proposed Capital Investment decisions on Council Tax for the next three years. The relevant cost of the 2008-11 capital programme proposals is:-

2008-09	£2.78
2009-10	£11.99
2010-11	£12.40

This is after central government support is taken into account, and reflects the costs of new unsupported borrowing – calculated using the proposed new MRP (Minimum Revenue Payment) policy - and of the associated revenue running costs of the capital programme proposals. These costs are reflected in the proposed three year Budget Strategy.



***Indicator Five: Estimate of ratio of financing costs to net revenue stream***

The Council must estimate the proportion of the revenue budget, which is taken up in financing capital expenditure.

2008-09	10.94%
2009-10	10.58%
2010-11	10.19%

***Indicators Six: External Debt Prudential Indicators***

The Council must set prudential limits for its total external debt, gross of investments, separately identifying borrowing from other long-term liabilities (i.e. Lancashire County Council debt). As well as setting an Authorised Borrowing Limit, the Council previously must also set an Operational Borrowing Limit, inside the maximum Authorised limit, that the Director of Financial Services will operate within (though may *temporarily* exceed)

	<b>Authorised Maximum Limit for borrowing</b>	<b>Operational Limit for borrowing</b>	<b>Long Term Liabilities (LCC Debt)</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
<b>2008-09</b>	175.0	165.0	22.2
<b>2009-10</b>	184.3	174.3	21.3
<b>2010-11</b>	183.1	173.1	20.4

***Indicator Seven: Variable interest rate exposure***

The Council must set the total amount of net borrowing (borrowing less investments) which is at variable rates subject to interest rate movements

The limits proposed are as follows:

2008-09	zero
2009-10	zero
2010-11	zero

because it is anticipated that the Council will operate within a range of negative net borrowing positions.

***Indicator Eight Fixed interest rate exposures***

The Council must set the total amount of net borrowing (borrowing less investments) which is at fixed rates secured against future interest rate movements

The limits are as follows:

2008-09	£140.2 million
2009-10	£149.9 million
2010-11	£149.6 million

***Indicator Nine: Prudential limits for the maturity structure of borrowing***

The Council must set upper and lower limits with respect to the maturity (debt profile) structure of its borrowing calculated as follows:

Period (years)	Lower Limit	Upper Limit
	%	%
Under 12 months	0	30
1 – 2 years	0	30
2 – 5 years	0	30
5 – 10 years	0	30
Over 10 years	25	95

**Indicator Ten: Total investments for periods longer than 364 days**

The Council must set an upper limit on the level of investments that can be invested for more than 364 days

2008-09	£5M
2009-10	£5M
2010-11	£5M

## TREASURY MANAGEMENT STRATEGY

### 1. Introduction

The Council annually considers a Treasury Management Strategy Report. This is a requirement of the CIPFA Code of Practice on Treasury Management, which was adopted by the Council on 13<sup>th</sup> March 2003. The Prudential Code for Capital Finance in local authorities has introduced new requirements for the manner in which capital spending plans are to be considered and approved (the Prudential Code). This requires the development of an integrated treasury management strategy.

This strategy covers:

- the current treasury position;
- prospects for interest rates;
- treasury limits in force which will limit the treasury risk and activities of the Council;
- the borrowing strategy;
- the investment strategy;
- the extent of debt rescheduling opportunities;

Treasury Management is the detailed day-to-day management of the Council's cash flows, banking, investments and borrowings. It is managed by a Treasury Management Group, which meets on a six weekly basis, and which monitors functions and policies, takes decisions in relation to capital financing and borrowing, and ensures that the systems which control the functions are developed and observed.

This function operates under the powers delegated to the Director of Financial Services, and the daily treasury management activity is conducted in the Corporate Finance section of the Resources Directorate. The policy in relation to borrowing and the investment of cash resources not immediately required are reviewed on a six weekly basis, and advice is obtained from Treasury Management Consultants, whom the Council retains on a fee basis.

Under the Prudential Code the Council has a statutory duty to determine and keep under review how much it can afford to borrow. These are shown in the ten Prudential Indicators shown in Appendix 1. The "Affordable Borrowing Limit" sets a maximum for the Council's total external debt, gross of investments, separately identifying borrowing from other long-term liabilities (i.e. Lancashire County Council debt).



## 2. Current Portfolio Position

The Council currently has a spread of borrowing ranging from 1 to 60 years that effectively manages the risk of interest rate movements. In addition the borrowing is spread between long term fixed borrowing and short term variable borrowing. This allows the Council to minimise the net cost of borrowing during the year, along with taking advantage of debt rescheduling opportunities where they arise. The Council's treasury portfolio position at the end of January 2008 comprised:

Type of Borrowing/Investments		Principal		Average Rate
		£m	£m	%
Fixed Rate Funding	PWLB	88.8		
	Market	17.4	106.2	4.70
Variable Rate Funding	PWLB	2.0		
	Market	8.5	10.5	7.13
Other Long Term Liabilities			23.3	5.01
<b>Total Debt</b>			<b>140</b>	<b>4.93</b>
<b>Total Investments</b>			<b>48.25</b>	<b>5.92</b>

## 3. Borrowing Requirement

Based on the above treasury portfolio and proposed capital investment plans it is anticipated that the Council will be required to undertake the following borrowings in the period 2008/09 to 2010/11

	2008-09	2009-10	2010-11
	£m	£m	£m
New Borrowing	17	10	0
Replacement borrowing	0	0	2
<b>Total</b>	<b>17</b>	<b>10</b>	<b>2</b>

## 4. Prospects for Interest Rates

The Council has appointed Sector Treasury Services as our treasury adviser. In consultation with Sector, and based on our assessment of interest rates, we anticipate that bank base rate, and associated rates, will fall further, reaching a projected low level by the second quarter of 2008/09, then holding at that level for some time before rising a little from the middle of 2009/10. PWLB borrowing rates are forecast to remain low across 2008/09, before starting to rise a little during 2009/10. Our forecast of interest rates is shown in the following table :

	Q/E1 2008	Q/E2 2008	Q/E3 2008	Q/E4 2008	Q/E1 2009	Q/E2 2009	Q/E3 2009	Q/E4 2009	Q/E1 2010	Q/E2 2010	Q/E3 2010	Q/E4 2010	Q/E1 2011	Q/E2 2011
Bank Rate	5.25%	5.00%	4.75%	4.75%	4.75%	4.75%	4.75%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
5yr PWLB rate	4.55%	4.55%	4.50%	4.50%	4.55%	4.65%	4.70%	4.75%	4.80%	4.85%	4.85%	4.85%	4.85%	4.85%
10yr PWLB rate	4.60%	4.55%	4.50%	4.50%	4.55%	4.55%	4.65%	4.70%	4.75%	4.80%	4.85%	4.85%	4.85%	4.80%
25yr PWLB rate	4.55%	4.50%	4.50%	4.50%	4.50%	4.55%	4.60%	4.65%	4.70%	4.70%	4.75%	4.75%	4.75%	4.75%
50yr PWLB rate	4.50%	4.45%	4.45%	4.45%	4.45%	4.50%	4.55%	4.60%	4.60%	4.65%	4.65%	4.65%	4.65%	4.60%

This is a central view of potential interest rates. If inflation concerns subside, further cuts in the Bank Rate may be possible.

While interest rates are affected by international as well as domestic events, our assessment of interest rates reflects an initial requirement to support the economy in the face of the international credit squeeze, while still looking to contain potential inflationary pressure. UK growth is expected to fall away during 2008.

## 5. Capital Borrowings and the Borrowing Portfolio Strategy

Based upon the prospects for interest rates outlined above, the intention is therefore to take long dated borrowings during 2008/09, reacting to market fluctuations to get the lowest rates available across the year, with a trigger level of 4.50%.

Variable borrowing will be less attractive, though some variable rate debt may be taken over the next few years, to maintain a balanced mix of funds. While the cheapest borrowing will probably be at the longest end (approaching 50 years), there is expected to be little difference between across the 5 to 50 year PWLB rates, so there may be an opportunity to continue to spread this Council's debt maturity away from a previous concentration on long dated debt. This would also increase the potential for debt restructuring at future dates.

There is expected to be little variation in rates during the year, so it should be possible to take borrowings at various dates across the year.

Consideration will also be given to taking an element of any borrowing in the form of fixed market loans, providing they offer sufficiently better rates than can be obtained via PWLB.

Against this background, caution will continue to be maintained in 2008-11 treasury operations. The Director of Financial Services will monitor the interest rate market and adopt a pragmatic approach to any changing circumstances. If it were felt that there was a significant risk of a sharp rise in long and short term rates – perhaps arising from increased economic activity or inflationary pressures – the likelihood is that fixed rate funding would be drawn more quickly, while rates were still relatively low. If it were felt that there was a significant risk of a sharp fall in long and short term rates – perhaps due to growth rates weakening - then long term borrowings may be postponed, and consideration given to the potential for rescheduling into short term funding.



## 6. Investments Strategy

The Council, having regard to Government and CIPFA guidance on local government investments, will maintain two key investment priorities:

- (a) the security of capital and
- (b) the liquidity of its investments.

Reserves and cash flow surpluses are invested throughout the year, generating investment income to support the Revenue Budget. Whilst prioritising investment security and liquidity (to assist the Council's cash flow), the Council seeks to achieve the optimum return on investments, taking guidance from Sector, our Treasury Management consultants, and maintaining contact with a range of brokers.

The borrowing of monies purely to invest or on-lend and make a return is unlawful and the Council will not engage in such activity.

### Specified and Non-Specified Investments

Since 1<sup>st</sup> April 2004 the Council may make investments for a period of up to 5 years (instead of the previous maximum period of 364 days) and must be categorised as either Specified or Non Specified Investments

a) Specified Investments must meet the following criteria:-

- The investment is denominated in sterling and any payments or repayments are payable only in sterling.
- The investment is not a long-term investment i.e. no longer than a year.
- The investment does not involve the acquisition of share capital or loan capital in any corporate body.
- The investment is made with the UK Government or a local authority, parish council or community council.
- The investment is made with a body or in an investment scheme that has been awarded a high credit rating by a credit rating agency.

b) Non-Specified Investments are ones that do not meet the above criteria.

### Credit Ratings

The Council's Treasury Management Group has reviewed the investment criteria used under the Investment Strategy. Though the credit ratings for financial institutions cannot provide a guarantee against all potential difficulties, they remain the best available practical criteria for judging the safety of the Council's deposits. Furthermore, while the security of funds remains the primary investment concern, there is an inevitable trade off between that and maintaining the scope to invest across a range of dates and institutions, to optimise the return on investments. It is felt that the current criteria give that balance, and that they should therefore remain unchanged.

All credit ratings are monitored, and the Council is alerted to changes in ratings through its use of the Sector creditworthiness service. If a downgrade results in a counterparty no longer meeting the Council's minimum criteria, its further use for new investment will be withdrawn immediately.

### Proposed Criteria



In general, the Council will only use Specified Investments during 2008-09. However there may be the opportunity based on the financial market's forecast of interest rates to agree a forward deal for some of its investments (a forward deal guarantees an interest rate for an investment to be made at a future date). It is also proposed that it be permitted to invest in highly rated institutions for longer than a year, but no more than three years, up to a maximum of £5 million in any one year. No more than 20% of total investments could be placed in Non-Specified Investments.

Therefore the proposed limits for investments in 2008-09 are:-

Specified Investments	maximum 100%
Non-Specified Investments	maximum 20%

The council uses credit ratings for financial institutions from Fitch, supplemented by Moody's if necessary, alongside a grading applied by Sector Treasury Services. Only the higher rated financial institutions meet the proposed investment criteria, which are based on three groupings, as follows:

High Group (Long term rating of at least AA with Fitch and AA2 with Moody's – Sector Red Designation) – Up to £6 million investment for a period up to 1 year

Middle Group (Other institutions with a Red Designation from Sector) – Up to £4 million investment for a period of up to 9 months

Low Group (Sector Green Designation) – Up to £4 million investment for a period of up to 6 months

It is proposed that forward investments exceeding a year, or other one to three year investments, only be made with financial institutions which meet the High Group criteria (see above).

To manage short term cash balances, investments with a limit of £6M can also be made

- (a) into Money Market Funds, provided the fund has a AAA rating,
- (b) into call accounts with institutions in the High and Middle Group

## **7. Debt Rescheduling**

An additional management tool, used from time to time, debt rescheduling is a technique which involves premature debt repayment. It may, at times, be advantageous to repay debt earlier than the agreement provides for. The reasons for any rescheduling to take place will include:

- the generation of cash savings at minimum risk;
- in order to help fulfil the treasury strategy detailed above; and
- in order to enhance the balance of the long-term portfolio (amend the maturity profile and/or the balance of volatility).

Debt rescheduling is only undertaken after extensive evaluation of the potential costs and benefits, including detailed consultation with the Council's Treasury advisers.

Accounting rules and legislative requirements facing councils in this area have been amended, and the Public Works Loans Board has changed the basis on which debt may be restructured, so the potential for *future* debt restructuring remains under review.

## 8. Key Components of the Treasury Management Strategy

- To arrange borrowing so that, where possible, the need to re-borrow in future years does not expose the Council to adverse financial implications caused by higher than average interest rates.
- To borrow, as far as can be perceived, at the most beneficial occasions in 2008-09, taking advantage of any temporary reduction in interest rates.
- To borrow long term monies, from the PWLB or the Money Market, depending on prevailing interest rates, to meet the Council's funding requirements.
- To borrow temporarily when the need arises.
- To lend temporarily in circumstances dictated by market conditions and the investment strategy.
- To regularly review the list of organisations, including local authorities, to whom the Council will lend surplus funds as per the investment strategy.
- To utilise variable rate loans when considered appropriate.
- To continue with the existing overdraft limit of £1 million and to use this facility to support a range of call accounts and investment opportunities to manage the Council's cash flow effectively.
- To re-schedule the Council's loan debt should the opportunity arise to do so advantageously..
- To negotiate leases, where considered best value, at the most economically advantageous rates, as recommended by the Council's specialist leasing advisors.
- To operate within agreed limits for investment, namely:-

Specified Investments	maximum 100%
Non-Specified Investments	maximum 20%





## MINIMUM REVENUE PROVISION GUIDANCE and PROPOSED POLICY

### 1. Proposed Annual MRP (Minimum Revenue Payment) Statement

In anticipation of the Government enacting the legislation, with supporting guidance, as set out in the Technical Background below, it is proposed that the Council agrees the following provisional policy position:

#### *Proposed Annual MRP Policy Statement for 2007/08 and 2008/09*

Subject to anticipated legislative changes being enacted for the future determination of MRP, the Council proposes that :

- (a) for **existing debt** and all future **Government-supported borrowing**, to use the Regulatory Method to determine MRP,
- (b) for future debt arising in 2007/08 AND 2008/09 that is **self-financed** (i.e. not supported by the Government), to use the Asset Life Method to determine MRP,
- (c) when debt arises on major schemes, no MRP is to be made until the asset becomes operational.

In the determination of MRP, the Council will be both:

- (a) prudent, working within the principle that debt be repaid over a period reasonably commensurate with that over which the capital expenditure provides benefits, and
- (b) practical, making detailed determinations where the impact of the calculation will be material, but taking a more general approach to the remaining unsupported debt taken on.

### Technical Background to the Proposed Policy

#### 2. Anticipated Legislative Changes

Local authorities are normally required each year to set aside some of their revenues as provision for debt repayment. This scheme of Minimum Revenue Provision ("MRP") is currently set out in regulations 27, 28 and 29 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003.

The proposal is to revoke most of this legislation and replace it with more flexible *statutory guidance*. This would be issued under section 21 of the *Local Government Act 2003*, as amended by section 238(2) of the *Local Government and Public Involvement in Health Act 2007*, which Government intend to bring into force in time to issue the guidance in the current financial year.

The proposed amendment to the Capital Finance Regulations replaces the present detailed rules in regulation 28 with a simple duty for an authority each year to make an amount of minimum revenue provision which it considers to be “prudent”. The new regulation 28 does not itself define “prudent provision”. However, the MRP Guidance makes recommendations to authorities on the interpretation of that term. Authorities will be legally obliged to “have regard” to any such guidance – which is exactly the same duty as applies to other statutory guidance including, for example, the CIPFA (Chartered Institute of Public Finance and Accountancy) Prudential Code, the CIPFA Treasury Management Code and the Government’s Guidance on Investments.

### **3. Annual MRP Statement**

Authorities will also have to prepare an annual statement of their policy on making MRP for submission to their full Council. This mirrors the existing requirements to report to the Council on the Prudential borrowing limit and investment policy. The aim is to give elected Members the opportunity to scrutinise the proposed use of the additional freedoms conferred under the new arrangements.

### **4. Options for prudent provision**

The Guidance proposes a number of options for making “prudent provision”. It explains that provision for the borrowing which financed the acquisition of an asset should be made over a period bearing some relation to that over which the asset continues to provide a service. The present system of MRP does not necessarily achieve that result.

#### *Option 1: Regulatory Method*

For debt which is supported by the Government (through the Local Government Financial Settlement), authorities will be able to continue to use the formulae in the current regulations, since the support is calculated on that basis. Although the existing regulation will be revoked, authorities will be able to calculate MRP exactly as if it were still in force. Solely as a transitional measure, this option will also be available for all capital expenditure prior to 1 April 2008.

#### *Option 2: CFR Method*

This is a technically simpler alternative to Option 1 and may also be used in relation to supported debt. While still based on the concept of the Capital Financing Requirement [CFR], which is easily derived from the balance sheet, it avoids the complexities of the formulae in existing regulations. However, for most authorities it will probably result in a higher level of provision than Option 1. Solely as a transitional measure, this option will also be available for all capital expenditure prior to 1 April 2008.



### Option 3: Asset Life Method

For new borrowing under the Prudential system for which no Government support is being given and is therefore self-financed, there will be two options. Option 3 is to make provision in **equal annual instalments** over the estimated life of the asset for which the borrowing is undertaken. This is a possibly simpler alternative to the use of depreciation accounting (Option 4), though it has some similarities to that approach.

**Freehold land** cannot properly have a life attributed to it, so for the purposes of the calculation it should be treated as equal to a maximum of 50 years. But if there is a structure on the land which the authority considers to have a life longer than 50 years, that same life estimate may be used for the land.

As with the existing scheme of MRP, provision for debt under Option 3 will normally commence in the financial year following the one in which the expenditure is incurred. But the Guidance highlights an important exception to this rule. In the case of the construction of a new building or infrastructure, MRP would not have to be charged until the new asset came into service. This delay would be perhaps 2 or 3 years in the case of major projects and could make them more affordable. There would be a similar effect in the case of Option 4 under normal depreciation rules.

### Option 4: Depreciation Method

Alternatively, for new borrowing under the Prudential system for which no Government support is being given, Option 4 may be used. This means making MRP in accordance with the standard rules for depreciation accounting.

Authorities will normally need to follow the standard procedures for calculating depreciation provision. But the guidance identifies some necessary exceptions:

- (a) MRP continues until the total provision made is equal to the original amount of the debt and may then cease.
- (b) The capital receipt from the disposal of the asset may not be used for revenue spending, since that would run counter to the Government's "golden rule". Capital receipts may be used only as specified in regulations (to fund capital expenditure or to repay capital borrowing).
- (c) If only part of the expenditure on the asset was financed by debt, the depreciation provision is proportionately reduced.

### Conditions for using the options

The intention is that Options 1 and 2 should normally continue to be available only for **Government-supported borrowing**. Options 3 and 4 are meant to be used in future for all **self-financed borrowing**.



