TREASURY MANAGEMENT STRATEGY 2016/17

ANNEX D – Policy on Minimum Revenue Provision

==

1. Introduction

1.1 Local authorities are required to set aside 'prudent' revenue provision for debt repayment (MRP) where they have used borrowing or credit arrangements to finance capital expenditure. Statutory Guidance covering Minimum Revenue Provision (MRP), published in February 2012 by the Department for Communities and Local Government (DCLG) sets out various options and boundaries for calculating prudent provision.

1.2 Whilst 'prudent provision' is not specifically defined, the guidance suggests that debt ought to be repaid over a period that is either commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Revenue Support Grant, it is reasonably commensurate with the period implicit in the determination of the grant.

1.3 The guidance sets out various options for calculating prudent MRP but does not rule out alternative approaches that are not specifically mentioned. One of the options presented in the guidance is the 'regulatory method' which equates to setting aside 4% of the opening balance outstanding on a reducing balance basis after deducting £24.1m, which reduces the MRP charge. This adjustment is commonly known as "adjustment A" and was allowed under the regulations on the introduction of the new prudential regime for capital finance on 1st April 2004. The Council currently uses this method for calculating MRP on General Fund debt previously financed from credit approvals or supported borrowing, namely capital financing costs that were financed as part of the annual local government finance settlement.

1.4 The Treasury Management Panel is recommending that the Council changes the method of provision for previously supported borrowing to one which is arguably more prudent than the current approach.

2. Current Approach

2.1 General Fund debt which was previously supported through the local government finance regime (previously supported borrowing) is calculated to be £123.4m (as at 31st March 2008) and is gross of "adjustment A" referred to in paragraph 1.3 above. This 'debt' figure is notional and forms part of the Council's Capital Financing Requirement (CFR).

2.2 As stated in paragraph 1.3 above the Council currently applies the 'regulatory method' to this element of the CFR which equates to setting aside 4% of the opening balance outstanding on a reducing balance basis. Before applying the 4% the debt figure is reduced by £24.1m which is the difference between debt calculated under the prudential code (as at 1st April 2004) and debt calculated under the previous 'statutory' capital controls regime which commenced on 1st April 1990 (this reduction is often referred to as "adjustment A"). This adjustment reduces the MRP charge and as a result means that £24.1m of the CFR will never be repaid.

2.3 The 'regulatory method' of calculating MRP is widely applied by many local authorities and is explicitly permitted by DCLG's statutory guidance. However, if this option had not been specifically included in the guidance, it is likely it would fail any objective test of 'prudence' for the following reasons:

- The 4% calculation is applied on a reducing balance basis. This means that the 'debt' that the 4% is applied to reduces each year by a smaller and smaller amount, however it is never fully repaid.

- Because £24.1m is deducted from the debt prior to applying the 4% charge, this element of debt will also not be repaid.
- For the majority of the last parliament, the ‘needs’ based formula for allocating resources through the annual local government finance settlement has been frozen. Subsequent reductions in local government funding have also seen significant reductions in central government support through revenue support grant. This has severed the link between the regulatory method of calculating MRP and the associated funding provided through the local government finance settlement.

3. Revised Approach

3.1 It therefore makes sense to change the method of calculating MRP on the old previously supported borrowing, calculated to be £123.4m at 31st March 2008, and adopt a more prudent approach. The Treasury Management Panel is recommending that the provision for MRP on this element of debt is based on a 2% straight line method before reducing the opening balance by “adjustment A” (referred to in paragraph 2.2 above).

3.2 This approach will ensure that over 50 years prudent provision is made in relation to the balance of General Fund debt at 31st March 2008. The change in policy set out below in paragraph 4.10, in respect of supported capital expenditure, will apply for the first time in 2016/17 and will be carried back to previous years, starting on 1st April 2008.

3.3 Following the review of the method of Charging MRP on previously supported borrowing, the calculated overpayment of £12.5m, will be used to reduce the MRP charge made in the statement of accounts during the current year 2015/16 and the following 4 years. (section 5 below).

3.4 A comparison of the budgeted annual savings achieved by implementing the new MRP policy from 2015/16 and the calculated overprovision arising in earlier years starting in 2008/09, will enable the Council to reduce its MRP charge in 2015/16 and the following 4 years, details of which are set out in section 5 below.

3.5 Prior to changing its MRP Policy the council took independent advice as to the legality of making the change.

4. Minimum Revenue Provision (MRP) Policy Statement 2015/16 and 2016/17

4.1 The Council is required by statute to charge a Minimum Revenue Provision (MRP) to the General Fund Revenue Account each year for the repayment of debt (capital expenditure financed by borrowing and credit arrangements). The MRP charge is the means by which capital expenditure which has been funded by borrowing is paid for by council taxpayers.

4.2 The 2008 Regulations replaced the detailed rules with a simple duty for an authority each year to make an amount of MRP which it considers prudent. The term “prudent provision” is not defined within the regulation; however, the statutory guidance includes specific examples of options for making “prudent provision”.

4.3 The broad aim of prudent provision is to ensure debt is repaid over a period that is either reasonably equal with that over which the capital expenditure provides benefit, or in the case of borrowing supported by Government Revenue Support Grant reasonably equal with the period implicit in the determination of that grant.

4.4 The guidance sets out various options for calculating prudent MRP but does not rule out using alternative approaches that are not specifically mentioned but are considered to be more prudent. The four options set out in the guidance for determining the MRP are as follows

4.5 Option 1 - Regulatory Method
4.6 Option 2 - The Capital Financing Requirement (CFR) Method
4.7 Option 3 - Asset Life Method (the MRP is determined by reference to the life of the asset)
4.8 Option 4 - Depreciation Method (MRP is equal to the provision required under depreciation accounting).

4.9 Following a review of the calculation of MRP by the Treasury Management Panel, referred to in paragraph 3.1 above, the MRP Policy has been revised as follows:

4.10 For all supported capital expenditure incurred prior to 1st April 2008 and for future supported capital expenditure, the MRP will be based on the 2% straight line method, before making an adjustment for £24.1m, which is the difference between debt calculated under the prudential code (as at 1st April 2004) and debt calculated under the previous 'statutory' capital controls regime which commenced on 1st April 1990.

4.11 For capital expenditure incurred after 1st April 2008 and financed by unsupported borrowing, the MRP will be based on option 3, the Asset Life Method. This method was already being used by the Council for capital expenditure financed by unsupported borrowing prior to the introduction of the 2008 Regulations and it is considered both appropriate and prudent to continue with it.

4.12 In exceptional circumstances MRP for capital expenditure incurred after 1st April 2008 and which is funded by unsupported borrowing can be calculated using the Annuity Method (a variation allowed under option 3 of the 2008 Regulations). However, this method is only suitable for particular types of capital expenditure projects where the benefits are expected to increase in later years or where the income stream generated by the new project mirrors the Annuity profile. It may be particularly attractive in connection with projects promoting regeneration or administrative efficiencies where revenues will increase over time. This method may only be used if it receives approval by the Treasury Management Panel.

4.13 The above policy will ensure that the Council satisfies the requirement to set aside a prudent level of MRP.

5. Change to Minimum Revenue Provision - Actual Annual Savings and Budgeted Savings

Financial Year Prior Years	Actual Charge £'000	Revised Charge £'000	Overprovision in Earlier Years £'000
2008/09	3,969	2,468	
2009/10	4,000	2,523	
2010/11	4,142	2,574	
2011/12	4,502	2,631	
2012/13	4,477	2,631	
2013/14	4,147	2,631	
2014/15	3,979	2,631	
2015/16	3,979	2,631	
Total	33,195	20,720	(12,475)

Notes:

1. Based on the revision of the Council's MRP policy on supported borrowing from 4% reducing balance after deducting adjustment "A" to 2% straight line, this means that there is an overprovision of MRP of £12.5m in the years 2008/9 to 2015/16.
2. As a result we can reduce the MRP charge on supported borrowing in the current year (2015/16) and the next four years (2016/17, 2017/18, 2018/19 and 2019/20), which means that there are funds available to contribute to earmarked reserves over the same period.