## Appendix 9: Statement of Policy on Minimum Revenue Provision

### Executive Summary

The Authority creates a capital debt liability whenever it incurs capital expenditure that is not financed from available resources, such as capital receipts or capital grants. This debt liability is charged to revenue over a period that is considered to be broadly commensurate with the life of assets to which the debt liability is chosen to relate.

The charge for each financial year is termed the Minimum Revenue Provision ("MRP"), the amount of which is to be the level determined by the Council to be prudent, after it has had regard to Guidance issued by the Secretary of State.

The manner in which the Full Council is to determine the MRP for each year must be contained within a Policy Statement, which should be approved before the start of each year. The Policy Statement may also be varied during the currency of each year.

Since the Guidance was introduced in 2007, the Council has adopted two of the four potential assessment options suggested in the Guidance for the non-housing element of its outstanding debt liability, together with a discretionary annual charge of 2% in respect of the outstanding housing element of debt liability.

Following an external review of the Council's MRP Policy, an opportunity has arisen to achieve a significant reduction in each year's charge by re-assessing the difference that arose between the method of calculating outstanding debt liability under the previous system of capital controls, and the revised method that was introduced with effect from 1st April 2004. This difference is termed "Adjustment A", for which the manner of assessment is specified within statute.

Essentially, the Council is able to assess the amount of MRP charges in an earlier financial year that were greater than they need have been, according to the statutory calculation procedure or other criteria, and adjust a current year's charge to take account of this.

The opportunity for a significant increase in the Council's Adjustment A has primarily been identified following the issue of revised Regulations, the express purpose of which is to override a previous requirement for local authorities to identify and adjust for factors found to have caused the different levels of assessed debt liability to arise.

The effect of the revised Adjustment A calculation is significant, in that, after taking account of MRP overcharges in earlier years, it enables the Council to determine an amount of prudent MRP at a lower level than currently budgeted.

This matter has been discussed with the Council's external auditor, notwithstanding that it is for the Council alone to determine what they consider to be a prudent amount of MRP for each year. There is no Guidance as to what might be considered to be "prudent", but it is suggested that an adjustment made as a result of complying with a statutory calculation procedure, together with the associated Guidance, could not reasonably be considered to represent an imprudent decision.

The Council may implement the revised MRP calculation procedure in the current financial year by varying the Policy Statement that was previously approved.

**Recommended Minimum Revenue Provision – Effective from 2015/16 and 2016/17**

- That the annual MRP statement previously endorsed and implemented from 1 April 2015 be varied to take account of the higher Adjustment A that has now been assessed, together with those other variations to the previous Policy referred to above, and detailed below.

- That the Policy for the financial year commencing 1st April 2016 be also approved in accordance with the following:-

- Option 1 ( Regulatory Method ) be used to calculate MRP on that element of the Council's capital debt liability that was incurred prior to 1st April 2008, or subsequently in reliance upon supported borrowing allocations. This method allows for taking account of a revised Adjustment A of £107.921m, which in turn enables it to be considered reasonable to adjust a current year's charge to take account of perceived errors in any earlier application of Adjustment A.

  The adoption of this option will include the provision that the full effect of applying Adjustment A should continue to apply to any amount of outstanding capital debt liability should that element which relates to earlier capital expenditures become fully charged to revenue, after allowing for the effect of Adjustment A.

- Option 3 (Asset Life Method) be used to calculate the MRP in relation to increased capital debt liability arising after 1st April 2008 in respect of assets for which a life period has been ascribed, together with any assets financed by way of Finance Lease arrangements or on balance sheet PFI contracts. In the case of these latter financing arrangements, should annual charges made to revenue be greater than the amount of MRP assessed under Option 3 for any year, such excess will be taken to represent the MRP in respect of any other element of post 1st April 2008 capital debt liability still outstanding.

  As part of the Council's Capital Investment Programme, the Council will be making use of a Special Purpose Vehicle (SPV) to progress certain large scale Housing projects. This will involve borrowing to provide funding for the SPV. The annuity repayments from the SPV to the Council over the useful life of the asset will be treated as the MRP for the project in question.

- A discretionary MRP equivalent to 2% of the HRA Capital Financing Requirement may be charged annually as appropriate in order to offset the outstanding housing capital debt liability signified by the HRA CFR.

**Context**

For many years local authorities have been required by statute and associated statutory instruments to charge to the revenue account an annual provision for the repayment of capital debt liability arising from unfinanced capital expenditure. This charge to the revenue account is referred to as the minimum revenue provision (MRP).

The statutory requirement to make an MRP was first introduced by the Local Government and Housing Act 1989, under which the non-housing element of MRP was 4% of that element of the outstanding capital debt liability, which amount was assessed in relation to a Credit Ceiling.

The Credit Ceiling assessment process was governed by statute, but its amount did not derive from the Balance Sheet which formed part of the Statement of Accounts. Consequently, when the Local Government Act 2003 required that the outstanding capital debt liability should, with effect from 1st April 2004, be determined from the Balance Sheet, it was found by most authorities that there was a difference between their closing Credit Ceiling and their commencing amount of CFR. This difference was termed Adjustment A, the amount of which represents an amount of debt liability that need not be subject to a future MRP charge.

A further revision to the method of calculating MRP was introduced by the Council with effect from 1st April 2008. The amount of capital debt liability outstanding at that time remains subject to statutory calculation criteria set out in the Local Government Act 2003, and associated Regulations. This earlier assessment procedure was radically revised by The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008, which require a local authority to determine each financial year an amount of MRP which it considers to be prudent by reference to a different method of calculating the outstanding capital debt liability – termed the Capital Financing Requirement (CFR). To support this, the Department for Communities and Local Government (DCLG) produced statutory Guidance which local authorities must have regard to for the purpose of determining a prudent amount of MRP.

The Guidance is partly prescriptive, whilst also leaving considerable scope for local discretion. There is a requirement that before the start of the financial year, a statement of MRP Policy for the forthcoming financial year be approved by the full council. The broad aim of introducing a prudent provision is that to ensure that outstanding debt liability is repaid over a period that is reasonably commensurate with either the period that associated assets are considered to provide benefits, or with associated grant periods.

MRP usually commences in the financial year following that in which the expenditure is incurred, or in the year following that in which a relevant asset becomes operational. This can result in a proportion of each year's capital debt liability not qualifying for an MRP charge.

The move to International Financial Reporting Standards (IFRS) means that private finance initiative (PFI) schemes and qualifying finance leases should now be included in the balance sheet as part of the outstanding capital debt liability. The Guidance suggests that the consequent need for an MRP may be treated as having been met by the principal repayments made under these transactions. However, in many cases the associated assets may have far longer lives than the period for which these arrangements are in place. In such cases, it may be appropriate for any excess of such annual charges over an assessed amount of MRP to be allocated to other elements of the outstanding capital debt liability.

**MRP options**

Four options for prudent MRP provision are set out in the DCLG guidance. Details of each are set out below;

**Option 1: Regulatory Method**

MRP under this option is equal to the amount determined in accordance with the former ss27-29 of the 2003 Regulations as if they had not been revoked. In effect, this is 4% of the debt principal outstanding, not including HRA debt. MRP is calculated as 4% of the CFR for all borrowings excluding HRA borrowing and less Adjustment A.

**Option 2: CFR Method**
This method simplifies the calculation of MRP by basing the charge solely on the authority's CFR but excludes the technical adjustments included in option 1. The annual MRP charge is set at 4% of the non-housing CFR at the end of the preceding financial year.

**Option 3: Asset Life Method (Equal instalment or Annuity method)**
Where capital expenditure on an asset is financed wholly or partly by borrowing or credit arrangements, MRP is to be determined by reference to the life of the asset.

- With the *Equal Instalment* approach, MRP is determined by reference to the life of the asset and an equal amount charged in each year.

- With the *Annuity method,* MRP is the principal element for the year of the annuity required to repay over the asset's life the amount of capital expenditure financed by borrowing.

**Option 4: Depreciation Method**
Under this option, MRP is equal to the provision required in accordance with depreciation accounting in respect of the asset, including any amount of impairment chargeable to the Comprehensive Income and Expenditure Statement. It also takes account of any residual value at end of the asset's life. As standard depreciation rules are used where an asset is part-financed by loan (e.g. 50% loan, 50% capital receipts), then a depreciation charge proportionately equal to the loan on the asset (i.e. 50%) is required to be charged as MRP. MRP is required to be charged annually until the cumulative amount of the provision is equal to the original expenditure financed by borrowing. Should the asset be disposed of, then the charge needs to continue as if the asset had not been disposed of unless the debt is repaid.

**Finance Lease and PFI**
Changes in accounting regulations from 2009/10 meant that assets held under a PFI contract now form part of the Balance Sheet. On its own, this change would have resulted in a one-off increase to the Capital Financing Requirement and (on a 4% basis), a potential increase in the charge to revenue. This is not seen as a prudent course of action, and with a view to mitigating against such increases, the guidance permits the inclusion in the annual MRP charge of an amount equal to the sum charged to revenue under the contract to repay the liability. In terms of PFI schemes, this charge forms part of the payment due to the PFI contractor.

**HRA Reform**
The Council continues to review on an on-going basis its Treasury Management Strategy in light of the HRA self financing reforms. As noted above, the Council is required to make proper arrangements for the repayment of loans. This is done in the General Fund (GF) by way of the aforementioned MRP charge. Until the recent changes to the subsidy regime, this had been deemed sufficiently prudent, based on the guarantees that the government will meet whatever

interest costs are incurred through housing subsidy and that finance will always be available through the PWLB.

The end of subsidy under HRA self financing removed the first guarantee and the government policy change with regard to certainty around the availability of PWLB financing calls into question the second. There is no statutory requirement for an MRP charge in the HRA. However, the Director of Finance will consider making a discretionary 2% provision where it is prudent to do so..

**Financial implications**

Sufficient resources have been set aside to meet the revenue commitment from MRP providing that borrowing levels remain broadly line with current projections. Based on current data the estimates of MRP for the GF and HRA are set out below:

| Minimum Revenue Provision (£m) | 2016/17 | 2017/18 | 2018/19 |
|---|---|---|---|
| General Fund (includes lease arrangements) | 4.69 | 4.77 | 4.68 |
| Housing Revenue Account | 0.00 | 0.00 | 0.00 |
| **Total** | **4.69** | **4.77** | **4.68** |

**Annex 1: Demonstration of MRP calculation under each of the four methods**

| Option | Calculation | |
|---|---|---|
| (a) For future supported borrowing and previous borrowings | | |
| **Option 1:** **Regulatory Method** | Calculated as 4% of the total CFR for all borrowing, excluding HRA and Less Adjustment A.<br><br>MRP = 4%(CFR – HRA –AA) | Where:<br>CFR = Capital Finance Requirement<br><br>HRA = HRA Borrowing<br><br>AA = Adjustment A |
| **Option 2:** Capital Financing Requirement (CFR) Method | This uses the same formula as option 1 but does not take account of Adjustment A.<br><br>MRP = 4%(CFR – HRA) | Where:<br>CFR = Capital Finance Requirement<br><br>HRA = HRA Borrowing |
| NB: Adjustment A is an accounting adjustment to ensure consistency with previous capital regulations. Once calculated the figure remains a fixed variable within the calculations. In Lambeth, Adjustment A is fixed at £7,672,165) | | |
| (b) For future supported borrowing and previous borrowings | | |
| **Option** | **Calculation** | |
| **Option 3:** **Asset Life Method** | The MRP for each asset acquired through unsupported borrowing is calculated using the formula**:**<br>**<u>A-B</u>**<br>**C** | Where:<br>**A** = Capital Expenditure (unsupported borrowing) on asset.<br>**B** = Total MRP already made against the asset, i.e., the local provision made before the current financial year in respect of that expenditure.<br>**C** = Remaining Useful Life of the asset |
| **Option 4:** **Depreciation Method** | The MRP for each asset acquired through unsupported borrowing is calculated using the formula**:**<br>**<u>A-B - D</u>**<br>**C**<br><br>In essence, MRP under this method is equal to the provision required in accordance with depreciation | As Above, with **D** = Residual value of the Asset<br><br>NB: The only difference between the two methods of calculating the MRP (i.e., |

| | | |
|---|---|---|
| | accounting in respect of the asset on which expenditure has been financed by borrowing or credit arrangements. This should include any amounts for impairments chargeable to the Income & Expenditure Account. | Options 3 & 4) is that there is recognition in Option 4 that the asset will still have some quantifiable value after its useful life has expired. |