

TRAFFORD BOROUGH COUNCIL

Report to: Executive 16 November 2015
Accounts & Audit Committee 25 November 2015
Council Meeting 20 January 2016

Report for: Decision

Report of: The Executive Member for Finance and the Director of Finance

Treasury Management Strategy - Review of the Minimum Revenue Provision

Summary

This report outlines the recent review undertaken of the Council's annual Minimum Revenue Provision (MRP) charge to the revenue budget in respect of capital expenditure financed by borrowing. The MRP is an annual charge to reduce the indebtedness of the Council.

The outcome of this review has identified both short to medium term revenue savings as well as introducing a fairer and simpler approach to be adopted for current and future council tax payers. Currently MRP for capital expenditure incurred prior to 2008 (known as Supported Borrowing) is charged at a rate of 4% of the Capital Financing Requirement (CFR) and therefore is never completely extinguished. It is proposed that this policy be amended so that the charge is linked to the average life of an asset.

The amendments proposed to the current policy approved by Council on 18 February 2015 will remain fully compliant with Department for Communities & Local Government (DCLG) regulations on this issue and generate some immediate capacity in the revenue budget.

Recommendations

That the Executive and Accounts & Audit Committee recommend to Council that with effect from 1 April 2015:

- a) the Council's MRP policy, paragraph (a) only, be amended to, "For capital expenditure incurred before 1 April 2008: MRP will be calculated on an straight line basis over the expected average useful life of the assets"
- b) the annual PFI lease charge be financed from the provision currently set-up to cover the final bullet payment and that capital receipts be used to replenish this provision to ensure this can still be made in 2028/29.

Contact person for background papers:

Graham Perkins – Technical Accountant - Extension: 4017

Background papers: None

Relationship to Policy Framework/Corporate Priorities	Value for Money
Financial	The amendment to the Council's current MRP policy will generate revenue savings as well as providing a fairer and simpler approach to the calculation of MRP.
Legal Implications:	Approval is required for the amendment to the existing MRP policy contained within the current treasury management strategy.
Equality/Diversity Implications	Not applicable
Sustainability Implications	Not applicable
Resources Implications e.g. Staffing/ICT/Assets	Not applicable
Risk Management Implications	This approach to re-profile the MRP on debt incurred prior to 1 st April 2008 held within the Council's CFR complies with current DCLG regulations and provides for the debt to be repaid over a period equivalent to the average life of the Council's assets.
Health & Wellbeing Implications	Not applicable
Health and Safety Implications	Not applicable

1. BACKGROUND

- 1.1 Each financial year the Council is required, in accordance with Regulation 27 to 29 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [SI 3146, as amended], to set aside an amount known as the Minimum Revenue Provision (MRP) for the repayment of its debt (borrowing taken out to finance capital expenditure as assessed by the Capital Financing Requirement (CFR)).
- 1.2 The Capital Financing Requirement is that amount of capital expenditure incurred which is not financed from capital grants and contributions, revenue or capital receipts. This is usually the amount to be borrowed but can also include other financing arrangements such Public Finance Initiative (PFI).
- 1.3 Prior to the commencement of each financial year, the Council approves an MRP Policy it intends to adopt and this was included as part of the 2015/16 Treasury Management Strategy report which was approved by Council at its meeting on 18 February 2015.
- 1.4 The components of the current MRP policy are:
 - a) Capital expenditure incurred before 1 April 2008 financed by **Supported Borrowing** (further information on this is detailed at paragraphs 2.2 & 2.3 below): MRP will follow the existing practice outlined in former DCLG regulations, i.e. 4% of the CFR each year (Regulatory Method);
 - b) Capital expenditure incurred after 1 April 2008 financed by **Prudential Borrowing**: MRP will be based on the estimated life of the assets once operational charged on a straight line basis or annuity basis in accordance with the Guidance, (as highlighted at paragraph 2.1);
 - c) PFI schemes and leases shown on the balance sheet: MRP will be based on the amount of the principal element within the annual unitary service payment;
 - d) For expenditure that does not create an asset, or following the use of a Capitalisation Direction: provision will be made over a period not exceeding 20 years, in accordance with Guidance.
 - e) In instances where the Council incurs borrowing and a third party is obliged to repay the principal (serviced debt arrangements): the Council will not charge MRP to the revenue account.

2. CURRENT POSITION

- 2.1 In 2008 the Secretary of State issued statutory guidance to Councils on what a 'prudent' level of MRP should be and this was subsequently revised in 2010 & 2012 primarily responding to the way Government revised its method for calculating Revenue Support Grant (RSG). These revisions introduced a wide, but not exhaustive, variety of methods which Councils can adopt when calculating MRP.

- 2.2 Prior to 2008 the RSG paid by the Government included an element for debt service costs on in respect of capital expenditure financed by loan and Councils would in turn set aside MRP at the same rate i.e. 4%.
- 2.3 Over recent years changes in the way Government calculates RSG and the impact of the national deficit reduction programme has resulted in the erosion of its contribution to MRP in respect of Supported Borrowing.
- 2.4 Under this reducing balance approach debt is never completely paid off and whilst the level of debt falls, the level needed to be set aside also falls. Additionally, in the early years higher repayments are encountered which has a disproportionate impact for current council tax payers
- 2.5 It is expected that RSG will continue to be cut substantially in the coming years and to maintain the level of debt repayment at 4% on this element of the Council's CFR, would place a burden on the revenue budget not matched by government support, increasing the pressure for further budget reductions in operational services.
- 2.6 The indicative budget provision for MRP is shown in the table below split between Prudential & Supported debt:

	2015/16 £000	2016/17 £000
Prudential borrowing	1,925	1,935
PFI Lease	193	203
Supported borrowing	2,513	2,292
Total	4,631	4,430

3. PROPOSAL

- 3.1 For the reasons set out in section 2 it is appropriate that the Council should review its MRP policy to be more appropriately linked to the average useful life of the assets related to this debt.
- 3.2 To enable this change of policy to occur, ensuring a fairer policy be implemented for the council tax payers of the Council, the following 3 options, as outlined below, have been considered;
- **Option 1** – Calculate annual MRP on a Straight line basis.

The Supported Borrowing element held within the CFR be written down over a period of 50yrs (this being the average life of the Council's assets over which they are depreciated);

This approach is the favoured option as it permits costs to be calculated evenly over the useful life of an asset and maintains a stable and consistent charge to the revenue budget. If adopted this process would have the following consequences on the amount of MRP for Supported Borrowing to be provided for:

	2015/16 £000	2016/17 £000
Current budget provision	2,513	2,292
Proposed budget provision	1,362	1,362
Saving	(1,151)	(930)

- **Option 2** – Calculate annual MRP on an Annuity basis

Costs using this approach are generated by applying an annuity factor and this method is particularly applicable to assets which have a long fixed life e.g. land, building and roads. In considering an appropriate interest rate to apply in order to establish the amount of MRP required to be provided each year, the current Public Works Loan Board interest rate for a 50 year annuity loan could be used and this is currently around 3.5%. Adopting this approach would initially offer the greatest level of immediate revenue savings due the structure of calculating annuity payments i.e. levels of principal repaid start low and gradually increase during the term of the loan. If adopted this process would have the following consequences on the amount of MRP for Supported Borrowing to be provided for:

	2015/16 £000	2016/17 £000
Current budget provision	2,513	2,292
Proposed budget provision	502	521
Saving	(2,011)	(1,771)

This option is not recommended because it is considered to be less prudent than the Straight line basis as it passes an increasing financial burden onto future council taxpayers.

- **Option 3** – Calculate annual MRP on a 2% reducing balance basis.

A further option to consider would be to reduce the annual provision of 4% down to 2% which would be more in line with the current Government funding received via the Revenue Support Grant. The budgetary impact of this would be:

	2015/16 £000	2016/17 £000
Current budget provision	2,513	2,292
Proposed budget provision	1,362	1,335
Saving	(1,151)	(957)

This option is not recommended as it does not offer a definitive end date for the debt to be extinguished.

- 3.3 Linking MRP to the average useful life of an asset is in keeping with the general principle of achieving a prudent approach, as out in the 2008 DCLG guidance, which stipulates that the profile of MRP charges should reflect the economic benefit the Council gets from using the asset to deliver services over its useful life.
- 3.4 The table below shows the level of Supported Borrowing will still be outstanding after 50 years for each option outlined within this report:

	Current method £000	Option 1 £000	Option 2 £000	Option 3 £000
Outstanding balance - 1 April 2015	68,108	68,108	68,108	68,108
Outstanding balance - 31 March 2065	8,846	0	0	24,803

- 3.5 The views of the Council's Treasury Management Advisers, Capita Asset Services, who are advising a number of other local authorities on this issue, have been sought and they are supportive of the proposals set out in this report.
- 3.6 The annual Prudential debt element of the MRP will remain unchanged as it is already linked to the asset life basis.

4. PRIVATE FINANCE INITIATIVE

- 4.1 The construction of Sale Waterside was financed by a Private Finance Initiative and this liability is included within the Council's CFR balance. The annual repayment required to be made for this is currently included within the MRP provision.
- 4.2 In order to reduce the impact this places on the revenue budget, the Council is requested to approve that this charge is to be financed from a provision which exists to cover the final bullet payment in respect of the principal element of the Unitary Service Payment which is to occur in 2028/29.
- 4.3 Capital receipts will then be used to replenish the provision by this date and by adopting this procedure, revenue savings of £0.193m and £0.203m will be generated in 2015/16 & 2016/17 respectively.

5. RECOMMENDATIONS

- 5.1 That the Executive and Accounts & Audit Committee recommend to Council that with effect from 1 April 2015:
- a) the Council's MRP policy paragraph (a) be amended as follows:

“For capital expenditure incurred before 1 April 2008, MRP will be calculated on a straight line basis over the expected average useful life of the assets”

- b) The annual PFI lease charge be financed from the provision currently established to cover the final bullet payment and that capital receipts be used to replenish this provision to ensure this can still be made in 2028/29.

Other Options

These are discussed in the report.

Consultation

The Council’s external auditor has been consulted on this recommended change in practice and has raised no objection but advises that the Council must be satisfied that it is prudent to make any change in policy.

Reasons for Recommendation

The report has been produced in order to ensure that the Council’s tax payers make a fair contribution to the cost of providing its assets as well as generating both short & medium term revenue savings.

Finance Officer Clearance ... ID.....

Legal Officer Clearance HK.....

Director of Finance Signature *Signature appended in hard copy*