BARNSLEY METROPOLITAN BOROUGH COUNCIL

This matter is not a Key Decision within the Council's definition and has not been included in the relevant Forward Plan

Report of the Director of Finance, Assets and Information Services

REVIEW OF POLICY FOR THE COUNCIL'S 2015/16 MINIMUM REVENUE PROVISION

1. Purpose of Report

1.1 The Council must determine its Minimum Revenue Provision (MRP) policy on an annual basis. The purpose of the report is to propose a revised Minimum Revenue Provision Policy Statement for 2015/16.

2. Recommendation

2.1 **It is recommended that the Council revise the 2015/16 MRP policy in accordance with the recommendations at section 4 of this report and detailed at Appendix A;**

2.2 **It is also recommended that the Council review MRP on an annual basis to take account of the Council's changing requirements, particularly in relation to its financial position. The revised MRP policy has already been agreed by Cabinet for 2016/17 as part of approving the overall 2016/17 Treasury Management Strategy.**

3. Background/ Introduction

3.1 Minimum Revenue Provision (MRP) is a charge to the Council's revenue account to make a provision for the repayment of the Council's outstanding capital debt liabilities.

3.2 The Council is required by law to annually "determine for the current financial year an amount of minimum revenue provision which it considers to be prudent". The Secretary of State has issued statutory guidance ("the guidance") to guide local authorities in determining the "prudent" level of MRP. The guidance is not prescriptive: local authorities must have regard to the guidance, but must make their own judgement about what is prudent provision.

3.3 The MRP Statement must, by law, be approved by the Council. The statutory basis for MRP is provided in more detail at Appendix B.

4. Proposals

4.1 The Council's MRP policy was created in 2007 at the start of the new MRP system. There are four options for calculating MRP:-

Option 1: Regulatory Method
Option 2: Capital Financing Requirement (CFR) Method
Option 3: Asset Life Method
Option 4: Depreciation Method

However, these are by no means prescriptive, providing that the Authority has regard to the guidance and complies with the statutory duty to make prudent provision. Barnsley MBC's existing MRP policy follows Option 1, the Regulatory Method for Government supported expenditure and Option 3, Asset Life Method, for non-government supported expenditure.

4.2 The Council is facing significant budgetary reductions over the next few years and needs to ensure a stable and deliverable financial transition over this period. As such, Finance Officers have carried out a more fundamental review of its MRP policy to ensure it is appropriate in the context of its financial backdrop. Since 2007, there have only been relatively minor changes to the policy so this represents the first major review.

4.3 The review covers the 4 proposals outlined as follows:-

Proposal 1: Use of Regulatory Method

4.4 The "Regulatory Method" is one of the four MRP options exemplified in the Guidance (paragraph 7) and further described in DCLG's commentary (paragraphs 15 to 19). The guidance proposes that this method is relevant to providing for repayment of debt outstanding from before 1 April 2007 and that the borrowing supported by Government Revenue Support Grant be repaid over a period "reasonably commensurate with the period implicit in the determination of that grant". The Regulatory Method continues the arrangements set out in former Regulations, under which non-housing debt was repaid at 4% of the balance outstanding at each year and, after deducting an amount referred to as "Adjustment A" which was introduced by the Government at the start of the prudential system in 2004.

4.5 As the local government finance system has evolved, it has become increasingly difficult to relate the Revenue Support Grant received to any particular level of annual debt repayment. Since the business rates reform in 2013/14, there is no component of grant determining an implicit level of support for debt repayment. In addition, total grant is controlled to national totals which have been reduced substantially in recent years, irrespective of the level of "supported" borrowing outstanding. A review undertaken by SIGOMA calculates that, on the assumption that interest costs are fully funded within revenue grant, by 2015/16 the Government is only funding around 45% of the 4% MRP – i.e. implied grant support for MRP at 1.8% rather than 4%.

4.6 It is therefore proposed that it would be appropriate, affordable and reasonable that the Council's MRP policy will adapt the Regulatory Method by paying this debt over a term of 50 years, on an annuity basis. This 50 year repayment period is considered a reasonable average assumption for the lives of the assets funded by this expenditure.

4.7 In the initial years, this element of the MRP charge is lower than the 4% reducing balance calculation, but it does, however, fully repay the remaining balance of pre-2007/08 debt, including Adjustment A, by the end of 50 years. A repayment term of 50 years is arguably significantly more prudent than a method which never pays off the whole debt.

4.8 Although the Council's proposed 50 year annuity method initially has a lower debt repayment than the 4% reducing balance method, it is better aligned to Government Grant arrangements, is reasonable in regard to the average lives of the assets involved, recognises the Council's financial transition pressures in the coming few years, and in the longer term is more consistent with the aims of the guidance. It is therefore considered that it would be appropriate, affordable and reasonable for the Council to move to such a provision for 2015/16 onwards.

Recommendation: To adopt a modified approach to the Regulatory Method to apply a 50 year term to all Government funded borrowing and to adopt the annuity method for calculating debt repayments.

Proposal 2: Assessment of Asset Life

4.9 At present, the Authority has two options with regards the calculation of MRP in respect of capital expenditure that is funded through prudential borrowing i.e. not supported from the Government within the Capital Finance and Accounting Regulations.

4.10 The first of the two options prescribed is the 'Asset Life' option which is based on repayment akin to the useful life of the assets that the charge relates. This itself has two methods of calculation which are the 'Annuity Method' which applies an implicit interest rate to the debt outstanding over time resulting in a repayment 'curve' increasing over time and the 'Equal Instalment Method' which sets equal MRP charges across the life of the asset.

4.11 The second option prescribed is the 'Depreciation' option which matches the MRP charge to the economic consumption of the assets involved. The guidance explicitly states that this includes depreciation and impairment of the assets.

4.12 Currently, the Authority only uses the Asset Life option and predominately uses the equal instalment method to do so but does also utilise the annuity method for major schemes, for example, BSF and the purchase of Gateway.

4.13 It is proposed to revisit the asset lives that the MRP is calculated on to bring them in line with the repayment periods discussed in proposal 1. The asset lives proposed to be used on all non-school assets is a 50 year period, calculated on an annuity basis (see PFI below for school assets).

4.14 The Authority considers this prudent and recognises that the Authority's maintenance programme enhances the useful lives of such assets by maintaining them in a condition that ensures that the economic benefit derived from those assets lasts for longer. Moreover, the useful life for buildings and equipment is widespread and difficult to determine for each asset so a 50 year average for assets is a justifiable compromise and one which the Council's valuers support.

4.15 It is also proposed to exclusively calculate MRP on an annuity basis rather than an EIP basis. This will ensure a consistent approach as the Council currently uses both methods but in addition, the annuity method recognises the time value of money and therefore spreads the real cost over all generations of taxpayer. By contrast, EIP is a flat cost and as such penalises today's tax payer who in real terms, pays more for an asset than future generations.

Recommendation: Apply a 50 year term to all non-school assets, unless a more appropriate period is identified and adopt the annuity method for calculating debt repayments.

Proposal 3: PFI Schemes

4.16 At present, MRP in relation to PFI schemes is charged in line with CIPFA's Accounting Code of Practice which adopts an implicit interest rate that is applied to the PFI debt to give a notional debt repayment charge each year, which is part of the unitary charge. However, there is no requirement for MRP to match the contract term or the financing arrangements of such deals. That would be equivalent to saying that MRP in relation to conventional borrowing should be over the life of the PWLB loans taken rather than over the life of the assets. It is proposed to treat it consistently with the Council's general MRP policy. Currently all non PFI school assets are based on a 60 year repayment term and it is intended to apply a 60 years repayment period on an annuity basis, in line with Proposal 2 above. Moving to a 60 year repayment period results in significant changes in the MRP charge, predominantly due to the PFI contracts being on a significantly shorter period, at 25 years, than the proposed 60 year repayment period.

4.17 At present, there's a degree of inconsistency around the MRP applied to PFI funded and the Authority's Design and Build schools, which both sit under the same BSF project umbrella. The MRP charged on both the design and build contributions and the capital contributions made in respect of the PFI schools to reduce the unitary charge are currently based on 50 years. To ensure consistency as outlined at 4.16 above, it is intended to apply a 60 year repayment term to all PFI and non PFI school assets.

4.18 The MRP charged in respect of the liability embedded within the unitary charge payments are over the duration of 25 years i.e. the life of the PFI contract. This review will seek to bring the two methods together, based on the useful asset lives of the assets involved.

4.19 It should be noted that since the PFI arrangements were entered into, 8 of the 21 schools covered under the schools PFIs will have become academies as at 31 March 2015. Other authorities who have used this new proposed approach to MRP will have faced a similar situation in respect of academies. Furthermore, the assets (schools) concerned are of continuing economic benefit to the Borough even though they are no longer on the Council's balance sheet.

Recommendation: Apply a 60 year term to all BSF/PFI and other school assets and adopt the annuity method for calculating debt repayments.

Proposal 4: Treatment of Pre 2015/16 Debt

4.20 The guidance also allows a review of previous MRP charged against the General Fund and allows restatement prospectively from that date, on the basis that it has been under or over provided in the past.

4.21 This backdated element (pre-2015/16) represents a significant sum as the early years' MRP provision is substantially more than the 2% proposed charge as result of this review. The view of the Authority is that the debt has already been written down under the current MRP provision and at this stage there are no plans to backdate its MRP policy for pre 2015/16 debt.

4.22 This is unlike some other authorities that have had audit agreement to create a retrospective useable reserve from the backdated change of MRP policy (pre-2015/16). The Authority's proposal in terms of the backdated element again reflects the prudent nature of Barnsley's proposal. No adjustment of this retrospective element is planned for 2015/16 but it is recommended that this proposal is kept under review for any future changes to the MRP policy.

Recommendation: To only apply the revised MRP policy from 2015/16 onwards and not backdate it to apply to any pre-2015/16 debt. This recommendation is to be reviewed on an annual basis.

5. Justification

5.1 The Council's current MRP policy uses both annuity and equal instalment methods to repay debt. The Council is seeking to revise its MRP policy to solely adopt the annuity method, only repaying debt over a standard 50 year repayment period, unless a more appropriate timescale is suitable. The proposed changes can also be justified on a prudent basis taking into account the following:-

- Adopting a single method (i.e. annuity) ensures that the Council adopts a consistent approach to the way it treats its debt going forward;
- Adoption of the annuity method recognises the time value of money i.e. a £1 being worth more today than in 22 years' time, whereas the equal instalment basis unduly penalises the current tax payer in comparison to the future tax payer. This is fundamental to the change in policy as it equitably spreads the true cost of capital across all generations of Council Tax payer;

- Adopting a 50 years average repayment period for non-school assets is a reasonable and prudent average. This is in line with the methodology adopted by other authorities and which is supported by our professional valuers;
- Using a 60 year average life for school assets (as now) is equally prudent. Many of the Authority's schools are part of PFI/BSF programmes with the purpose of maintaining them in day 1 condition at the end of the 25 year programme; and
- The policy is affordable in 'cash' terms because the Council will free up a General Fund budget that currently supports the BSF programme. It is estimated that this will increase to £10M by the end of the 25 year programme (on a prudent estimate of future indexation which is required regardless to pay the contractor) and this will be used to offset the 'cash' increase in capital financing costs.

5.2 The proposals above demonstrate that the policy is consistent, affordable over the longer term and ensures a more equitable spread of debt repayment costs across all generations of taxpayer. They take into account the Council's strict and cautious approach to MRP to date as well as the Council's future financial circumstances.

5.3 The Council will continue to periodically review its MRP policy to ensure that it consistently follows the above principles in the future. Following the approval of these proposals, more detailed work will be undertaken to review the proposed changes and their financial implications.

6. Consideration of Options

6.1 The Council has the following options:-

- Do not change the existing policy;
- Do all four proposals including back dating;
- Do a selection (proposals 1-4) of the options outlined above;
- Adopt the recommended policy changes (proposals 1-3) as outlined at Appendix A.

6.2 It is recommended that the Council adopts the revised MRP policy as outlined at Appendix A (Proposals 1-3) for the reasons outlined at para 5.1 above.

7 Implications for Local People and Service Users

7.1 None.

8. Financial Implications

8.1 There are likely to be significant savings resulting from the implementation of the change to the Council's MRP policy. However this is a complex, technical area of work that will be reviewed over the next 6-8 weeks in order to produce a final figure for the 2015/16 statement of accounts. It is intended to outline the final position within the final 2015/16 outturn report due to Cabinet in July.

8.2 It should be noted that the Council's external auditor has been consulted on the initial draft of these proposals and will continue to be consulted as the policy is firmed up. Auditor comments on other authorities undertaking similar review exercises have confirmed that it is a matter for the individual Council to determine what is prudent with consideration given to the statutory guidance provided.

9. Employee Implications

9.1 None

10. Communications Implications

10.1 None

11. Consultations

11.1 Consultation has been carried out with the Council's Treasury Management advisers, the Council's appointed external auditor and other local authorities.

12. Tackling Health Inequalities

12.1 None

13. Climate Change and Sustainable Energy Act (2006)

13.1 None

14. Consideration of Risks

14.1 None.

15. Health and Safety Implications

15.1 None

16. Compatibility with the European Convention on Human Rights (ECHR)

16.1 The contents of this report have no implications for compatibility with ECHR.

17. Promoting Equality, Diversity and Inclusion

17.1 None.

18. Reduction of Crime and Disorder

18.1 No impact.

19. Conservation of Biodiversity

19.1 No impact on biodiversity

20. List of Appendices

Appendix A – Revised MRP policy
Appendix B – Statutory Requirement for MRP

21. Details of Background Papers

21.1 Officer Contact: Neil Copley

APPENDIX A

REVISED 2015/16 MRP STATEMENT

The Council is required to make a prudent provision for debt redemption known as the Minimum Revenue Provision (MRP). Guidance on MRP has been issued by the Secretary of State and local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.

The four MRP options available are:

Option 1: Regulatory Method
Option 2: CFR Method
Option 3: Asset Life Method
Option 4: Depreciation Method

NB This does not preclude other prudent methods.

MRP in 2015/16: Options 1 and 2 may be used only for General Fund supported expenditure. Methods of making prudent provision for General Fund self-financed expenditure include Options 3 and 4 (which may also be used for supported expenditure if the Council chooses). **There is no requirement to charge MRP in respect of HRA capital expenditure funded from borrowing.**

The MRP Statement is required to be submitted to Council before the start of the 2015/16 financial year for approval. Any revision of which must be submitted to Council for approval.

The Council is recommended to approve the following statement:

- **For capital expenditure incurred before 1st April 2008, and for supported capital expenditure incurred on or after that date, MRP will be determined in accordance with Option 3;**

- **For non-supported (prudentially borrowed) capital expenditure incurred after 1st April 2008, MRP will be determined in accordance with Option 3;**

- **MRP in respect of Private Finance Initiatives (PFI) brought on balance sheet under the International Financial Reporting Standard Code of Practice will be determined in accordance with Option 3;**

- **Within Option 3, MRP is permitted to be calculated in one of two ways – equal instalments or on an annuity basis. The Council has chosen to calculate MRP on an annuity basis;**

- **MRP will normally commence in the financial year following the one in which expenditure is incurred. However, MRP Guidance permits authorities to defer MRP until the financial year following the one in which the asset becomes operational. The Council has chosen to employ this "MRP holiday" on the significant qualifying projects such as the Building Schools for the Future programme.**

MRP in respect of leases brought on balance sheet under the International Financial Reporting Standard Code of Practice will match the annual principal repayment for the associated deferred liability. This approach will produce an MRP charge comparable to that under Option 3 in that it will run over the life of the lease term.

APPENDIX B

STATUTORY BASIS OF MRP

Regulations 27 and 28 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 require that a local authority "shall determine for the current financial year an amount of minimum revenue provision which it considers to be prudent". MRP is a charge to the revenue account in relation to capital expenditure financed from borrowing (or credit arrangements), and is sometimes referred to as a provision for "debt repayment".

The Secretary of State has issued statutory guidance on determining the "prudent" level of MRP, to which authorities are required to have regard. The guidance states that:

> *"the broad aim of prudent provision is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant"*

This general aim does not stipulate a minimum amount of provision to be made in any particular year, providing that the debt is wholly repaid within the period in which the capital investment provides benefits, or which relates to the associated grant. Indeed, the guidance exemplifies four different annual repayment profiles and encourages authorities to consider their own repayment profiles.

A full explanation is provided in the DCLG Commentary which accompanies the guidance notes that there are four options for calculating MRP but these are by no means prescriptive, providing that the Authority has regard to the guidance and complies with the statutory duty to make prudent provision.