BRIDGEND COUNTY BOROUGH COUNCIL

INFORMATION REPORT TO CABINET

18 SEPTEMBER 2018

REPORT OF THE INTERIM HEAD OF FINANCE AND SECTION 151 OFFICER

REVIEW OF THE MINIMUM REVENUE PROVISION (MRP) POLICY 2018-19

1. Purpose of the Report

1.1 The purpose of the report is to present to Cabinet alternative methods of calculating a prudent annual charge to revenue to repay capital financing costs. This is known as the Minimum Revenue Provision (MRP). It asks Cabinet to note:-

- The revision of the MRP Policy 2018-19 for calculating MRP on capital expenditure funded from supported borrowing from a 4% reducing balance method to a straight-line over 45 years method;
- The resultant surplus on the capital financing budget for 2018-19 is used to increase the Capital programme earmarked reserve; and
- Further consideration is given to the treatment of the base budget for MRP 2019-20 within the Medium Term Financial Strategy.

2. Connection to Corporate Improvement Objectives/Other Corporate Priorities

2.1 This report supports the Corporate Priority:

> **Smarter use of resources** – ensuring that all its resources (financial, physical, human and technological) are used as effectively and efficiently as possible and support the development of resources throughout the community that can help deliver the Council's priorities.

3. Background

3.1 Under regulation 21 of the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003, local authorities are required to charge Minimum Revenue Provision (MRP) to their revenue account for each financial year to account for the principal cost of their debt in that financial year.

3.2 Since 2007-08, local authorities calculate an amount of MRP which they consider to be **prudent**. The legislation does not define what constitutes a "prudent provision". However previous guidance issued by the Welsh Government (April 2010) provides an interpretation of prudent provision and examples of options of acceptable methods for calculating a prudent level of MRP.

3.3 The guidance states that there are four options :-

- Options 1 & 2 are based on the principle that for supported borrowing through the RSG, the level of provision is reasonably commensurate with the period implicit in the determination of the grant.
- Option 3 & 4 are recommended for borrowing where there is no support being given and therefore is self-financed. Option 3 is the Asset Life Method and makes the provision over the estimated life of the asset for which the borrowing is undertaken. Option 4 is the depreciation method and makes the MRP in accordance with standard rules for depreciation.

Local authorities are legally obliged to "have regard" to such guidance, but having done so may consider a more individually designed MRP approach is justified. The aim of the guidance is to ensure that the debt is repaid over a period that is reasonably commensurate with that over which the capital expenditure provides benefits.

3.4 The responsibility for determining what is prudent is entirely a matter for the authority. It is not the role of the Welsh Government or the external auditor to determine in cases whether any proposed arrangement is prudent. The external auditor does have a responsibility however to consider whether or not an authority has complied with its statutory duty in their approach to setting MRP. Authorities are required to prepare an annual statement of their policy on making MRP. Within Bridgend CBC, this Policy is included within the Treasury Management Strategy and is formally approved by Full Council.

4. Current Situation / Proposal

4.1 Council approved the Annual MRP Policy 18-19 as part of the Treasury Management Strategy in February 2018 and is contained as **Appendix A**. This report examines changing the charging mechanism for capital expenditure identified as paragraph 1 in the Policy that is:-

i. Capital expenditure incurred before 1 April 2008 and any capital expenditure after 1 April 2008 that is government supported expenditure and does not result in a significant asset will be based on the Capital Financing Requirement after accounting adjustments at 4% of the opening balance. This charge was supplemented by voluntary MRP (based on the useful asset life) in respect of those assets which were financed by unsupported borrowing before 1 April 2008.

4.2 The MRP charge for supported borrowing for 2018-19 on the current methodology (4% reducing balance) is £4.884 million. This charge is met from the capital financing budget that sits within the non-Directorate service area of the revenue account.

4.3 As the mechanism for charging is discretionary and as Councils explore ways to generate revenue budget savings, there has been a growing number of authorities that have reviewed their existing MRP Policy and amended the method of charging. There are now only a small number that still base their MRP charge for Supported Borrowing on a 4% reducing balance basis.

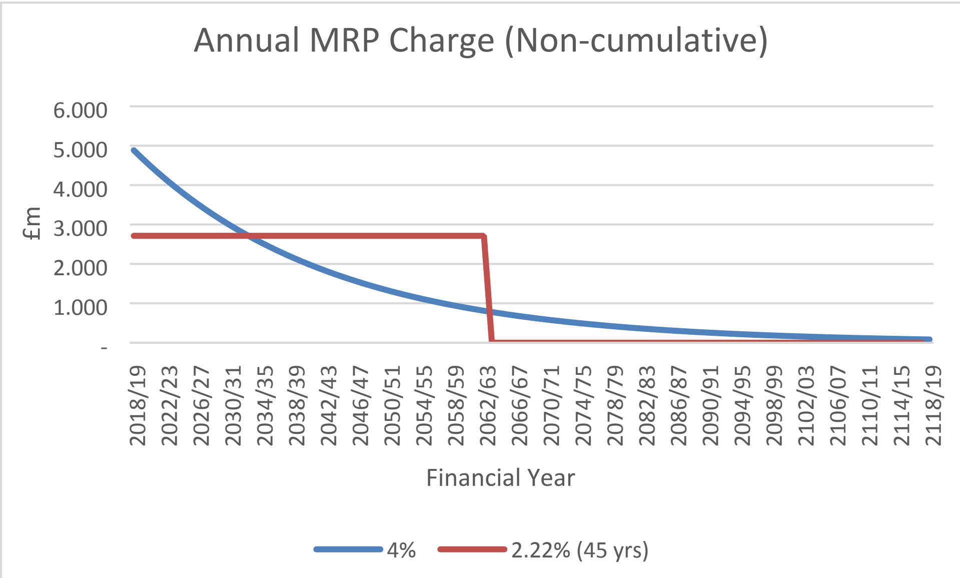
4.4 The current reducing balance approach allocates a higher charge to earlier years and a lower charge to latter years. The rationale being in the years when expenditure is first incurred is when most of the benefits are used and when maintenance costs are minimal. Only in latter years maintenance costs would be higher, coinciding with a lower revenue provision for debt. The method implies that borrowing will be repaid over a 25 year period (in that 100% / 4% = 25), however as the calculation applies the 4% to the reducing balance it takes much more than 25 years to fully repay the borrowing. Therefore, there is an argument that it does not support the Well-being of Future Generations (Wales) Act 2015 as there would still be a revenue charge in two hundred years' time. In forty-five years' time, which is akin to the average residual life of the Council's assets, the current methodology would still leave £18.673 million of remaining debt to be paid off and an annual revenue charge still at £0.778 million.

4.5 **Appendix B** provides examples of the actual revenue provision that would be calculated on different approaches based on a Capital Financing Requirement (CFR) for supported borrowing of £122 million at 1 April 2018. For the purpose of modelling, it ignores the impact of subsequent annual approvals of supported borrowing from Welsh Government.

4.6 One alternative method could still be to make MRP based on a reducing balance but at 3%. This would generate savings for twenty-seven years when it would then become more expensive than at 4%. There would still remain the issue that the debt is never really extinguished and therefore it is felt that a reducing balance approach does not meet the requirements of the Well-being of Future Generations (Wales) Act.

4.7 A straight line approach assumes all users benefit equally from use of the assets over the period. It provides certainty of the annual revenue charge for supported borrowing and ensures that the debt is fully paid off over the life of the asset. The graph below shows a comparison of the MRP annual charge based on the existing 4% reducing balance and straight line using an average asset life of forty-five years equivalent to 2.22% :-

Graph 1: Comparison of MRP Charge on Existing Basis & Straight-line over 45 Years



4.8 As can be seen from the above, changing the methodology from reducing balance to straight-line does produce savings in the first fifteen years. However, in 2033-34, the charge using the existing methodology would become cheaper until the time when the debt is fully extinguished on the straight-line method.

4.9 Appendix B includes an analysis based on the time value of money. It uses a discount factor of 3.5% which is assumed to indicate the discounted cash flow of the monetary differences after a number of years. This demonstrates the significant revenue savings which can be made in the early years for each approach but after a period of time MRP will be greater than that charged at 4% reducing balance currently charged.

4.10 The table below summarises the Appendix and indicates the impact of each approach compared to 4% reducing balance method together with the discounted cash flow of the savings:-

Table 1: Comparison of MRP Charges on Various Bases over 200 years

Years	Current MRP 4% Reducing Balance £'m	Straight Line 40 Years £'m	£'m	£'m	Straight Line 45 Years £'m	£'m	£'m	Straight Line 50 Years £'m	£'m	£'m
	Charges	Charges	(Savings) /Cost	DCF	Charges	(Savings) /Cost	DCF	Charges	(Savings) /Cost	DCF
0-5	26.527	18.316	(8.211)	(7.647)	16.281	(10.246)	(9.518)	14.653	(11.874)	(11.014)
6-27	56.646	67.159	10.513	4.266	59.697	3.051	(0.066)	53.727	(2.919)	(3.531)
28-50	23.709	36.632	12.923	4.904	46.129	22.420	6.812	53.727	30.018	7.883
51-100	13.248	0.000	(13.248)	(1.420)	0.000	(13.248)	(1.420)	0.000	(13.248)	(1.420)
101-200	1.944	0.000	(1.944)	(0.034)	0.000	(1.944)	(0.034)	0.000	(1.944)	(0.034)
TOTAL	**122.074**	**122.107**	**0.033**	**0.069**	**122.107**	**0.033**	**(4.225)**	**122.107**	**0.033**	**(8.116)**

4.11 By amending the MRP Policy and re-phasing the repayment of debt, then there are potential savings to be achieved. The table demonstrates the greatest savings can be realised in years 0-5 under the 50 years straight line method £11.874 million (£11.014 million discounted), but for years 28-50, the Council will incur £30.018 million (£7.883 million discounted) more than that charged at 4% reducing balance, before further savings are realised. In all three straight-line scenarios, the overall cost of the charges is £33,000 more than the existing methodology but this is because the full amount of the debt outstanding, that is the £122.074 million, is extinguished. The discounted cash flow shows for straight-line charges for both 45 and 50 years that there are still positive savings over fifty years even where the charges increase in later years. The below table shows the net present value of savings for the charges based on straight-line 45 years of £2.772 million and £6.662 million on straight-line 50 years in:-

Table 2: Comparison of Current MRP Charge on Various Bases over 50 years

Years	Current MRP 4% Reducing Balance £'m	Straight Line 40 Years £'m	£'m	£'m	Straight Line 45 Years £'m	£'m	£'m	Straight Line 50 Years £'m	£'m	£'m
	Charges	**Charges**	**(Savings) /Cost**	**DCF**	**Charges**	**(Savings) /Cost**	**DCF**	**Charges**	**(Savings) /Cost**	**DCF**
0-5	26.527	18.316	(8.211)	(7.647)	16.281	(10.246)	(9.518)	14.653	(11.874)	(11.014)
6-27	56.646	67.159	10.513	4.266	59.697	3.051	(0.066)	53.727	(2.919)	(3.531)
28-50	23.709	36.632	12.923	4.904	46.129	22.420	6.812	53.727	30.018	7.883
TOTAL	**106.881**	**122.107**	**15.226**	**1.523**	**122.107**	**15.226**	**(2.772)**	**122.107**	**15.226**	**(6.662)**

4.12 As at the 31 March 2018, the net book value (NBV) of the Council's fixed assets was £491.898 million. A number of these assets would have been funded from supported borrowing but actual borrowing is not assigned to individual assets. As stated previously, the supporting borrowing Capital Financing Requirement (CFR) at the 1 April 2018 was £122.107 million which represents 24.8% of the net book value. The assets have a range of estimated asset lives and it is difficult to establish which would be included within the supported borrowing CFR. However, examining the range of asset lives within the Asset Register (vary from 1 to 99 years for land) and the fact that the majority of the CFR relates to historic debt, it would seem that a prudent MRP charge could be based on asset lives of 45 years and a move to a straight-line basis which would result in a total saving of £2.171 million in the current year. The under-spend that would result in 2018-19 would be used to increase the earmarked reserve that supports the Capital Programme. It would also provide an opportunity to permanently reduce the budget for the 2019-20 financial year.

4.13 Welsh Government has just released a consultation document on proposed changes to the existing MRP Guidance. The three proposed changes which would be applicable from 1 April 2019 are:-

1. Definition of Prudent Provision – Welsh Government proposes to change the definition of prudent provision to one that requires local authorities to set MRP in a way that covers the gap between the Capital Financing Requirement and the amount of that requirement that is funded by income,

grants and receipts. The revised methodology is based on an assessment of asset lives and therefore the MRP charge will be commensurate with the period of benefit.

2. Meaning of a Charge to the Revenue Account – Welsh Government proposes that there should not be any credit back to revenue for previously overpaid MRP. This revised policy is not looking to backdate the change in methodology so there would not be any credit back to the revenue account in 2018-19 as a result.
3. Impact of changing Methods of Calculating MRP – Welsh Government continues to recognise that local authorities should have flexibility to change the methods for charging MRP but again clarifies that an overpayment cannot be calculated retrospectively. Again the proposed policy does not suggest any retrospective adjustment.

The proposal is therefore in line with any proposed changes that might come into effect for the next financial year.

5. Effect upon Policy Framework & Procedure Rules

5.1 None

6. Equalities Impact Assessment

6.1 None

7. Well-being of Future Generations (Wales) Act 2015 Implications

7.1 This report links to the Council's long-term well-being objectives. It ensures that the purchase of assets to support front line service delivery is prudent, affordable and sustainable and there is sufficient investment in infrastructure to enable the Council to provide services well in to the future.

7.2 The recommendation to change the MRP policy for supported capital expenditure from reducing balance to straight line ensures that the costs are spread more evenly amongst the taxpayers benefiting from the capital expenditure. It also means that there is certainty with a consistent revenue charge for the provision of debt and that the debt is full extinguished within forty-five years instead of leaving a residual debt balance for citizens for up to two hundred years.

7.3 The change therefore is not considered as compromising the ability of future generations to meet their own needs merely that future generations pay for assets from which they benefit. It seeks to charge MRP to the revenue account over a period which is commensurate with the estimated residual lives of the Council's assets.

8. Financial Implications

8.1 The budget for MRP for supported borrowing for 2018-19 is £5.113 million. This includes a small budget of £132,000 to finance an on-going charge based on asset life leaving a balance of £4.981 million for the charges based on 4%

reducing balance. If the methodology is changed to straight-line over 45 years as in the graph above, there would be a surplus in the current year as below:

Financial Year	Annual Budget £m	Proposed Charge (2.22%) £m	Surplus £m
2018-19	4.981	2.713	2.268

8.2 It is recommended that this surplus is used to increase the earmarked reserve that supports the Capital programme given the pressures on capital funding for Band B schools and other essential capital expenditure.

8.3 Members will need to be aware that the proposed charge above is based on the CFR at 1 April 2018. Every subsequent year the charge will be increased on the basis of the allocation of supported borrowing from Welsh Government. For example, if the allocation is £3.935 million as per the assumptions within the MTFS Capital Programme, an additional annual charge of £87,000 would be generated. Therefore any adjustment to the base budget in 2019-20 would need to be mindful of this. For this reason, the MRP Policy will continue to be kept under review annually.

9. Recommendation

9.1 It is recommended that Cabinet note the proposed changing to the methodology for charging MRP for supported borrowing and ask Council to approve:-

- The revision of the MRP Policy 2018-19 for calculating MRP on capital expenditure funded from supported borrowing from a 4% reducing balance method to a straight-line over 45 years method and a revised Minimum Revenue Provision Statement is approved (**Appendix C**);
- The resultant surplus on the capital financing budget for 2018-19 is used to increase the Capital programme earmarked reserve; and
- Further consideration is given to the treatment of the base budget for MRP 2019-20 within the Medium Term Financial Strategy.

Gill Lewis
Interim Head of Finance & Section 151 Officer

15 August 2018

Contact Officer: Mary Williams, Group Manager – Chief Accountant

Telephone: 01656 643605

E-mail: Mary.Williams2@bridgend.gov.uk

Postal Address: Raven’s Court, Brewery Lane, Bridgend, CF31 4AP

- **Background documents:**
- Treasury Management Strategy 2018-19