Meeting of:	**CABINET**
Date of Meeting:	**22 OCTOBER 2024**
Report Title:	**MINIMUM REVENUE PROVISION POLICY**
Report Owner / Corporate Director:	**CHIEF OFFICER – FINANCE, HOUSING & CHANGE**
Responsible Officer:	**NIGEL SMITH** **GROUP MANAGER – CHIEF ACCOUNTANT**
Policy Framework and Procedure Rules:	**Paragraph 3.5.1 of the Financial Procedure Rules requires the preparation of a Capital Strategy for submission to Council to approve prior to the start of each financial year. The Capital Strategy includes the Minimum Revenue Provision Policy Statement, which is required to be approved by Council before the start of the financial year.**
Executive Summary:	• **The debt financing of any capital expenditure requires a charge to revenue to set aside resources to repay that debt in the future. This is known as Minimum Revenue Provision (MRP). The level of debt that has to be provided for is known as the Capital Financing Requirement (CFR).** • **Debt is either supported, where Welsh Government provide funding within the local government settlement towards the cost of borrowing and repayment, or unsupported, where the Council has to meet the full cost of that borrowing from existing resources.** • **The current MRP Policy requires the setting aside of MRP over a straight line basis, over a 45-year period for supported borrowings or the life of the asset for unsupported borrowing.** • **A straight-line basis of MRP results in a higher cost in early years (when including interest costs), reducing over time.** • **Using an annuity method of calculating MRP spreads the total cost – MRP plus interest – over the life of the asset and is considered to match the benefit gained from the use of the asset over its full lifetime.**

1. Purpose of Report

1.1 The purpose of the report is to seek Cabinet approval to recommend to Council a revision to the Minimum Revenue Provision (MRP) Policy for 2024-25.

2. Background

2.1 Capital expenditure is defined as expenditure to acquire, enhance or prolong the useful life of non-current assets, those which have a useful life of more than one year e.g. buildings or infrastructure improvements. Capital expenditure is funded from a combination of capital receipts, revenue contributions, specific grants and debt in the form of borrowing or other long term financing arrangements, such as leasing. Borrowing can be either:

- Supported borrowing – funding is provided by the Welsh Government through the Revenue Support Grant to cover the revenue debt financing costs of interest and repayment costs; or
- Unsupported borrowing (commonly referred to as prudential borrowing) – councils have the freedom to determine the level of borrowing considered affordable in revenue debt financing costs, with no financial support from Welsh Government.

2.2 Regulation 22 of the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 require that local authorities set aside some of their revenue resources as provision for the repayment of debt. The annual charge to the revenue account for repaying debt is known as the Minimum Revenue Provision. The regulation states that an authority must make an amount of MRP which it considers to be "prudent". The regulation does not itself define "prudent provision". However, Welsh Government has issued 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 Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant." It does not stipulate a minimum amount of provision to be made in any particular year, providing that the broad aims above are met. The Welsh Government guidance provides four different options for making "prudent provision" outlined below.

2.3 The four options are set out below:

- **Option 1 – Regulatory Method** - Under this option, the former regulations are followed exactly as if they had not been revoked, effectively on an annual basis repaying 4% of the outstanding debt (on a reducing balance).
- **Option 2 – Capital Financing Requirement (CFR) Method** - This option is similar to Option 1 but a simpler alternative, so on an annual basis repaying 4% of the outstanding debt (on a reducing balance).

Note: Options 1 and 2 are primarily for debt supported by Welsh Government through the Revenue Support Grant system.

- **Option 3: Asset Life Method** - This option is intended for new borrowing under the Prudential system for which no Government support is being given and is therefore self-financed, to make a provision over the estimated life of the asset for which the borrowing relates. This can be calculated using the straight line method (equal annual MRP charge) or the annuity method (annual MRP charge that takes the time value of money into consideration).

- **Option 4: Depreciation Method.** -This is intended for new borrowing under the Prudential system for which no Government support is being given and is therefore self-financed, to make a provision in accordance with the standard rules for depreciation accounting of the asset for which the borrowing relates.

Welsh Government guidance requires that either option 3 or 4 be used for all capital expenditure which is to be financed by unsupported borrowing or other long term liabilities. Options 1 and 2 are not permitted for this use.

2.4 Council approved a change to the MRP Policy from Option 1 – the Regulatory Method to Option 3 – Asset Life Method on 19 September 2018and to revise the calculation of MRP from a 4% reducing balance method to a straight-line over 45 years method.

3. Current situation / proposal

3.1 Council approved the Annual MRP Policy 2024-25 as part of the Capital Strategy in February 2024. This report proposes changing the calculation of MRP identified in paragraph i. and ii. of the Policy:

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.

ii. Supported capital expenditure that results in a significant asset (based on internal assessment) incurred on or after 1 April 2008 and all unsupported capital expenditure, exercised under the Prudential Code, the MRP charge will be based on the Asset Life Method. The minimum revenue provision will be at equal annual instalments over the life of the asset. The first charge can be delayed until the year after the asset is operational but this will be at the discretion of the Section 151 Officer.

3.2 The estimated MRP charge for supported and unsupported borrowing for 2024-25 on the current methodology is £5.77 million. This charge is met from the capital financing revenue budget that sits within the council wide revenue budgets for supported borrowing and from directorate revenue budgets for unsupported borrowing.

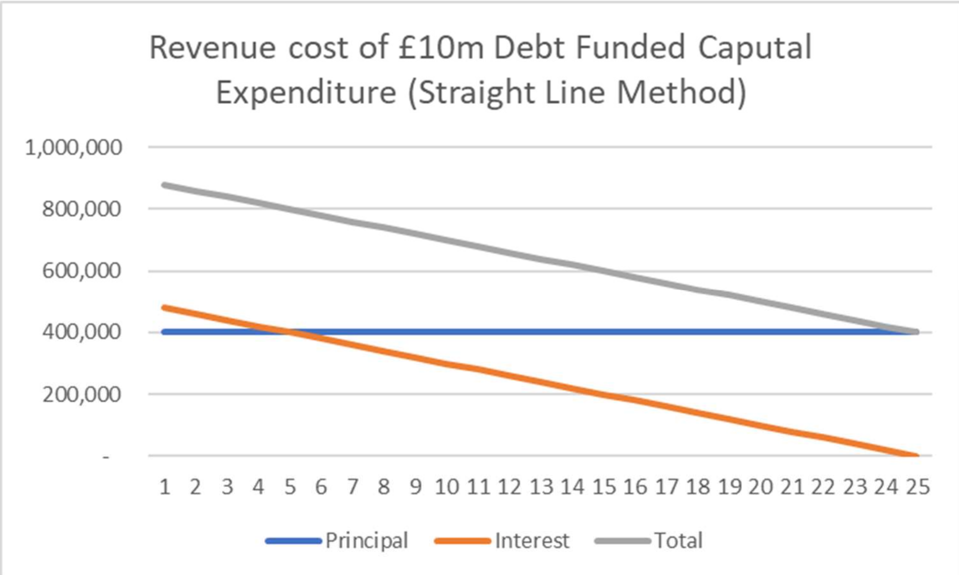
3.3 The table below shows the amount of outstanding capital expenditure that needs to be repaid as at 31 March 2024:

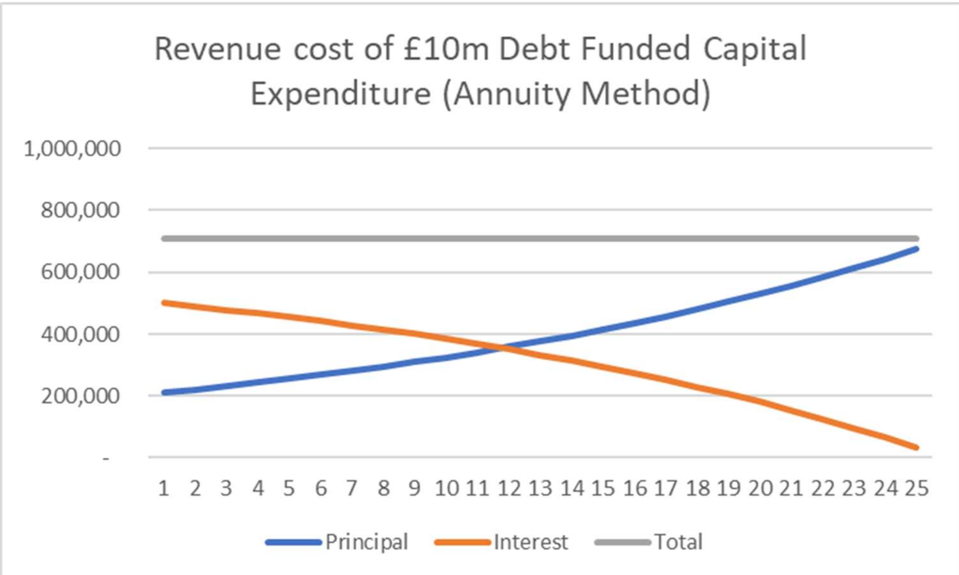
	£'000
Supported Borrowing	**131,462**
Unsupported Borrowing	**31,283**
Borrowing Capital Financing Requirement (CFR)	**162,745**

Proposed changes

3.4 In comparison to the straight line method the annuity method means less MRP is made in earlier years and more is made in later years. Although this may sound less prudent, the annuity structure for MRP when combined with interest costs leads to a smoother profile of costs. It also takes account of the time value of money, whereby paying £1,000 in a years' time is less of a burden than paying £1,000 now.

3.5 The following charts shows the comparison of the total cost of a notional CFR of £10 million over a 25 year period based on the current straight line method and the annuity method. As can be seen from the charts the straight line method will show a higher total cost in the earlier years, reducing over time, whilst the annuity method smooths out the total cost over the duration of the loan. The straight line method, whilst keeping MRP even, front loads the interest cost as the interest is based on the outstanding balance each year. As the annuity method evens out the total cost over the life of the debt, it matches the cost equally to the benefit from the lifetime of the asset. Both methods repay the same £10 million CFR and over the same time period.





3.6 The annuity method requires the use of an interest rate in the calculation. This will be the rate at which the Council would be able to borrow, should it need to.

3.7 If the Council moves from the straight line to annuity method the savings over the next 10 years based on capital expenditure to 31 March 2024 is shown in the table below.

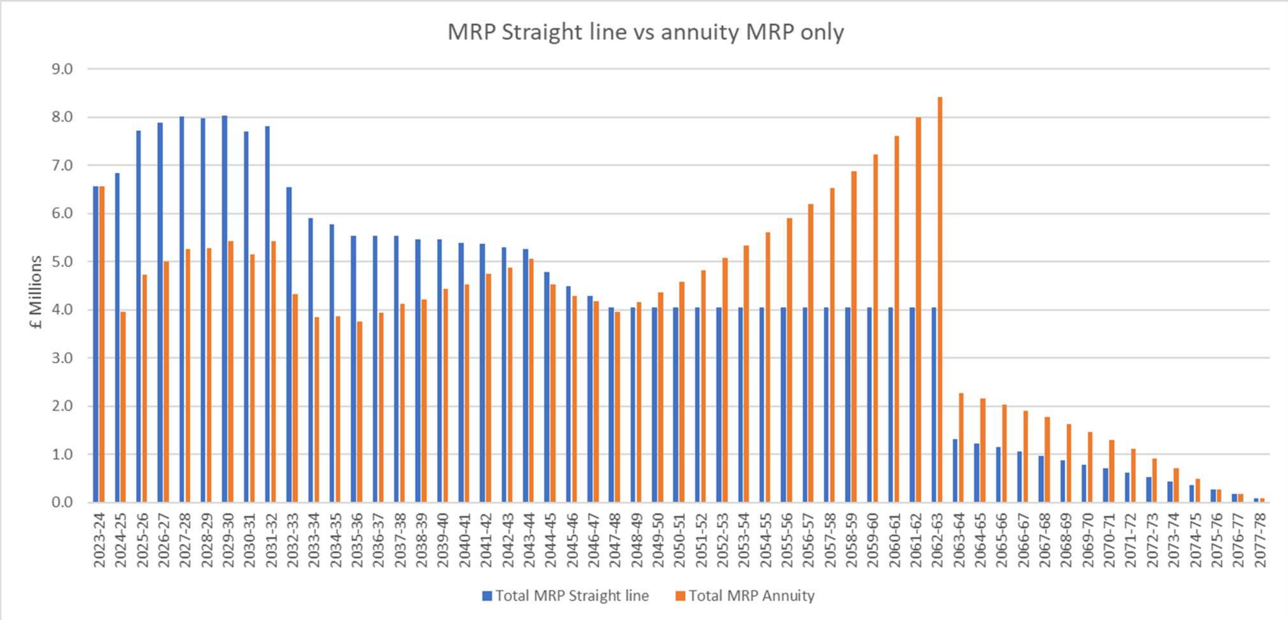
Year ended 31 March	MRP saving	Extra interest (cost)	Total saving
2025	2,882,351	-	**2,882,351**
2026	2,998,790	- 124,389	**2,874,401**
2027	2,884,187	- 217,682	**2,666,505**
2028	2,752,155	- 302,468	**2,449,687**
2029	2,691,391	- 388,357	**2,303,034**
2030	2,597,876	- 478,617	**2,119,259**
2031	2,545,134	- 578,262	**1,966,872**
2032	2,373,837	- 684,299	**1,689,538**
2033	2,216,287	- 794,891	**1,421,396**
2034	2,059,777	- 908,748	**1,151,029**

3.8 Total savings are estimated to be £21.524 million over the next 10 years, or £19.0 million if discounted using the HM Treasury green book rate of 3.5%. If the discount rate were to take account of forecast interest rates, the saving with a nominal rate of 5.6% would be £17.737 million.

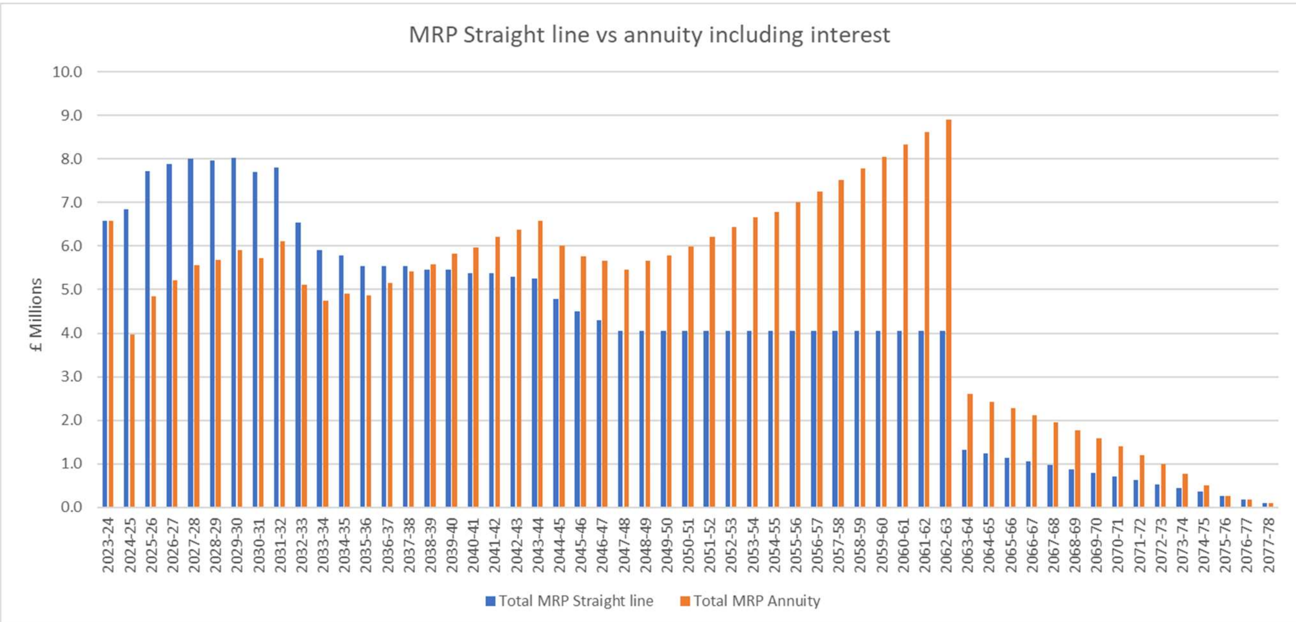
3.9 Over the life of making MRP there is no overall saving on MRP on an undiscounted basis as the same Capital Financing Requirement (CFR) will need to be provided for however there would be an increased interest cost. Based on interest rate expectations the increased interest cost is estimated at £41.9 million over the period 2024-25 to 2077-78 and based on known and forecast capital commitments as at 31 March 2024. Any new capital commitments will increase both the MRP and interest cost.

3.10 As future capital expenditure is likely to be different from those as at 31 March 2024, these figures are estimated but provide a guide to anticipated future savings.

3.11 The graph below shows a comparison of the MRP annual charge based on the existing 45 year straight line method and an annuity method (based on the remainder of the 45 years for existing supported borrowing) and the asset lives for unsupported borrowing.



3.12 As can be seen from the above, changing the methodology will produce savings in the MRP charge in the first 24 years, however, in 2048-49 the charge using the existing methodology would become cheaper until the time the debt is fully extinguished. However, this does not include the anticipated additional interest charge as a result of having less cash available (as less MRP is being set aside). The following chart shows the estimated impact when additional interest costs are included:



3.13 As can be seen from the above chart, changing the methodology will produce savings until 2038-39, when the annuity method will then be more costly than the current straight line basis.

3.14 All MRP expected to be made in future should equal the current CFR unless there are specific amounts within the CFR for which no MRP is permitted to be made. This is because MRP is designed to write down the CFR to nil over time. In the Council's case the only amount for which MRP is permitted to be made is an 'adjustment A' factor of £82,000. This is an adjustment made when the MRP regulations changed from 1 April 2008. It is a historical figure and is a difference between pre- and post- 1 April 2008 methodology calculation. It is recommended that this adjustment be removed, which will ensure that the CFR is fully written down to nil over time.

3.15 The Council's treasury advisors – Arlingclose – have reviewed the Council's MRP Policy and support the move from a straight line method to an annuity method for supported and unsupported borrowing. Arlingclose believes this approach is more prudent, as it matches the benefit from the assets with the cost over time.

3.16 The policy has also been updated to include the Council's MRP policy in relation to Salex loan funding.

3.17 The proposed Minimum Revenue Provision Policy is attached at **Appendix A**.

4. Equality implications (including Socio-economic Duty and Welsh Language)

4.1 The protected characteristics identified within the Equality Act, Socio-economic Duty and the impact on the use of the Welsh Language have been considered in the preparation of this report. As a public body in Wales the Council must consider the impact of strategic decisions, such as the development or the review of policies, strategies, services and functions. This is an information report therefore it is considered that there will be no significant or unacceptable equality impacts as a result of this report.

5. Well-being of Future Generations implications and connection to Corporate Well-being Objectives

5.1 The Act provides the basis for driving a different kind of public service in Wales, with 5 ways of working to guide how public services should work to deliver for people. The well-being objectives are designed to complement each other and are part of an integrated way of working to improve well-being for the people of Bridgend.

Long term	Local authorities have a duty to charge their general fund (revenue budget) with a prudent amount of MRP each year. Government MRP guidance defines prudence as aligning the period over which MRP is charged to one that is commensurate with the period over which the capital expenditure provides benefits.
Prevention	The Council has to ensure that it provides the asset base from which to deliver its services to the community and ensure it has the resources to be able to invest in capital for the future.
Integration	The MRP Policy is a key element of the Council's Capital Strategy, which is an integral part of the Council's medium term financial strategy, ensuring coherence between revenue and capital budgets to enable delivery of the Council's services.
Collaboration	The Capital Strategy brings together the capital plans of the Council to ensure the delivery of the well-being objectives and sets out the funding of those plans. The setting of the MRP Policy is an essential part of the Capital Strategy which requires approval by full Council.

Involvement	The MRP Policy is required to be approved by full Council, providing all members of the Council to review and approve the Policy.

6. Climate Change Implications

6.1 There are no climate change implications as a result of this report.

7. Safeguarding and Corporate Parent Implications

7.1 There are no Safeguarding or Corporate Parent implications as a result of this report.

8. Financial Implications

8.1 The change in MRP policy to an annuity-based calculation will have a lower debt repayment than the current method and therefore a lower charge to revenue budgets. For 2024-25 the MRP based on the current policy is estimated to be £5.77 million. For the proposed policy it is estimated at £2.89 million. The charge under the proposed policy will increase to £3.84 million in 10 years' time (the duration of the capital programme). Added to this will be increased interest costs of £0.91 million due to the need to delay repaying debt, reducing investments, increasing borrowing or a mixture of all as a result of less cash resource having been set aside, giving a total forecast cost to revenue in 2033-34 of £4.75 million in comparison to the current year's estimate of £5.77 million.

8.2 The reduction in the MRP in the initial years will help to alleviate current pressure on the revenue budget, both in-year and in terms of the Medium Term Financial Strategy (MTFS) 2025-26 onwards, and, looking forward, may enable us to consider paying off MRP on existing schemes to offer up revenue budget savings in the future.

8.3 The proposed cost above is based on the CFR as at 1 April 2024 and takes into consideration the expectation that the allocation of supported borrowing from Welsh Government is fully utilised within the capital programme, thereby increasing the Council's debt and requiring the Council to set aside MRP to repay that debt. It also includes current forecast unsupported borrowing within the capital programme as agreed by Council in February 2024 as part of the MTFS. Any additional unsupported borrowing that is added to the capital programme and approved by Council will increase the MRP charge to revenue and will incur additional interest costs that will impact on revenue budgets.

8.4 The MRP Policy will be regularly reviewed and is required to be approved by Council on an annual basis, in advance of the financial year to which it relates.

9. Recommendation

9.1 It is recommended that Cabinet recommends that Council:

- approves the revision of the MRP Policy 2024-25 for calculating MRP on capital expenditure funded from supported and unsupported borrowing from a straight line basis to an annuity method and a revised Minimum Revenue Provision Statement is approved (**Appendix A)**.

Background documents

None