

**CABINET**

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| <b>Date of Meeting</b> | Tuesday 14 <sup>th</sup> February 2017               |
| <b>Report Subject</b>  | Minimum Revenue Provision – 2017/18 Policy           |
| <b>Cabinet Member</b>  | Leader of the Council and Cabinet Member for Finance |
| <b>Report Author</b>   | Chief Executive and Corporate Finance Manager        |
| <b>Type of Report</b>  | Operational  |

**EXECUTIVE SUMMARY**

Local Authorities are required each year to set aside some of their revenue resources as provision for the repayment of debt.

Regulations require an authority to each year make an amount of Minimum Revenue Provision (MRP) which it considers to be 'prudent'. The Regulations themselves do not define 'prudent' provision. Welsh Government (WG) has provided guidance which makes recommendations to local authorities on the interpretation of the term and authorities are required to prepare an annual statement of their policy on making minimum provision.

As part of the budget strategy for 2017/18 officers critically reviewed the Council's 2016/17 MRP policy along with our treasury management advisors and recommended that changes be made to parts of the policy. Detailed reports and presentations were made to Cabinet, Corporate Resources Overview and Scrutiny Committee and Council through November and December 2016 outlining the review and the recommended changes. Changes to the 2016/17 and the 2017/18 policy were approved at the December 2016 Council meeting.

This report restates the revised 2017/18 MRP policy as part of the suite of 2017/18 budget setting reports being considered by Cabinet and Council during February 2017.

## RECOMMENDATIONS

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| 1 | <p>Members approve and recommend to County Council for Council Fund (CF) outstanding debt that:-</p> <ul style="list-style-type: none"><li>• Option 3 (Asset Life Method) be used for the calculation of the MRP in financial year 2017/18 for the balance of outstanding capital expenditure funded from supported borrowing fixed as at 31<sup>st</sup> March 2016. The calculation will be the 'straight line' method over 50 years.</li><li>• Option 3 (Asset Life Method) be used for the calculation of the MRP in 2017/18 for all capital expenditure funded from supported borrowing from 1<sup>st</sup> April 2016 onwards. The calculation will be the 'straight line' or 'annuity' (where appropriate) method over an appropriate number of years, dependent on the period of time that the capital expenditure is likely to generate benefits.</li><li>• Option 3 (Asset Life Method) be used for the calculation of the MRP in 2017/18 for all capital expenditure funded from unsupported (prudential) borrowing or credit arrangements.</li></ul> |
| 2 | <p>That members approve and recommend to the County Council for Housing Revenue Account (HRA) outstanding debt:-</p> <ul style="list-style-type: none"><li>• Option 2 (Capital Financing Requirement Method) be used for the calculation of the HRA's MRP in 2017/18 for all capital expenditure funded by debt.</li></ul>   |
| 3 | <p>Members approve and recommend to County Council that MRP on loans from the Council to NEW Homes to build affordable homes through the Strategic Housing and Regeneration Programme (SHARP) (which qualify as capital expenditure in accounting terms) be as follows:-</p> <ul style="list-style-type: none"><li>• No MRP is made during the construction period (of short duration) as the asset has not been brought into use and no benefit is being derived from its use.</li><li>• Once the assets are brought into use, capital repayments will be made by NEW Homes. The Council's MRP will be equal to the repayments made by NEW Homes. The repayments made by NEW Homes will be classed, in accounting terms, as capital receipts, which can only be used to fund capital expenditure or repay debt which is a form of MRP. The capital repayment / capital receipt will be set aside to repay debt, and is the Council's MRP policy for repaying the loan.</li></ul>  |

## REPORT DETAILS

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| <b>1.00</b> | <b>EXPLAINING THE MINIMUM REVENUE PROVISION</b>  |
|             | <b>Background to Capital Expenditure and Financing</b>   |
| 1.01        | <p>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.</p> <p>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.</p> <p>Borrowing can be either:</p> <ul style="list-style-type: none"><li>• Supported borrowing - funding is provided by Welsh Government through the Revenue Support Grant to cover the revenue debt financing costs of interest and repayment costs; or.</li><li>• 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 support from Welsh Government.</li></ul> |
| 1.02        | <p>The annual charge to the revenue account for repaying debt is known as the Minimum Revenue Provision (MRP).</p> <p>Local Authorities are required each year, under the Capital Finance and Accounting Wales Amendment Regulations 2008, to set aside some of their revenue resources as provision for the repayment of debt.</p> <p>Regulation 22 of the 2008 Regulations requires an authority to, make an amount of MRP each year which it considers to be 'prudent', though the Regulations themselves do not define 'prudent' provision.</p> <p>Regulation 21(B) of the 2008 Regulations requires local authorities to have regard to guidance issued by Government.</p>  |
| 1.03        | <p>The Welsh Government has issued guidance for the setting of MRP policy. It states that the broad aim of prudent provision is to ensure that the debt is repaid over a period that is reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by the Welsh Government, reasonably commensurate with the period implicit in the determination of that grant.</p> <p>The WG guidance provides 4 options for making 'prudent provision' outlined below but states in its informal commentary that:-</p>  |

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|      | <p><i>'The options are those likely to be most relevant for the majority of authorities but other approaches are not meant to be ruled out, provided they are fully consistent with the statutory duty to make prudent revenue provision. Authorities must always have regard to the guidance, but having done so, may in some cases consider that a more individually designed MRP approach is justified.</i></p> <p><i>The decision on what is prudent is for the Authority and it is not for the Welsh Government to say in particular cases whether any proposed arrangement is consistent with the statutory duty.'</i></p>   |
| 1.04 | In a recent letter to all local authorities the Auditor General for Wales concurred that it is for each authority to determine what is a 'prudent' policy.   |
|      | <b>Options for Prudent Provision within WG Guidance</b>  |
| 1.05 | <p>Option 1 - Regulatory Method</p> <p>For capital expenditure funded from supported borrowing which is supported through funding in the Revenue Support Grant (RSG), authorities may continue to use the formula specified in the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 (the regulations which preceded the 2008 Regulations).</p> <p>Under this method the outstanding capital expenditure (known as the Capital Financing Requirement CFR) funded from supported borrowing less Adjustment A is written down annually by 4% on a reducing balance basis. Adjustment A is a commutation adjustment, a fixed value determined by changes to statutory regulations referred to above (which all Welsh Council's will have).</p> <p>The method implies that borrowing will be repaid over a 25 year period (in that <math>100\% / 4\% = 25</math>), however as the calculation applies the 4% to the reducing balance it takes much more than 25 years to fully repay the borrowing.</p> <p>The method is commensurate with the methodology used in the Revenue Support Grant to allocate revenue funding from WG to finance debt, as it also uses the 4% reducing balance method on notional outstanding debt.</p> |
| 1.06 | <p>Option 2 - Capital Financing Requirement Method</p> <p>The same as Option 1 without adjusting for Adjustment A, which results in a higher charge.</p>   |
| 1.07 | <p>Option 3 - Asset Life Method</p> <p>Provision is made over the estimated life of the asset for which debt is undertaken.</p>  |

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|      | <p>This can be calculated using the 'straight line' method or the 'annuity' method. To illustrate the difference, as an example an asset which is purchased at a cost of £4m which has an estimated useful life of 50 years;-</p> <ul style="list-style-type: none"> <li>• Straight line method - equal annual MRP charge<br/>£4m / 50 years = £0.080m</li> <li>• Annuity or inflation method – annual MRP charge that takes the time value of money in the form of inflation into consideration<br/>Year 1 = £0.047m<br/>Year 2 = £0.048m<br/>Year 3 = £0.049m<br/>Year 4 = £0.050m<br/>Year 5 = £0.051m</li> </ul>        |
| 1.08 | <p>Option 4 - Depreciation Method</p> <p>Alternatively, provision is made in accordance with the standard rules for depreciation accounting. The method is similar to option 3 above</p>  |
| 1.09 | <p>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.</p>  |
|      | <p><b>Housing Revenue Account (HRA)</b></p>   |
| 1.10 | <p>Following the introduction of self-financing for the HRA and the voluntary exit from the negative subsidy system on 31<sup>st</sup> March, 2015, from 1<sup>st</sup> April 2015 the calculation of the HRA MRP is now similar to the Council Fund as set out above, with the following modifications:</p> <ul style="list-style-type: none"> <li>• Options 1 and 2 - the percentage is 4% for the Council Fund and 2% for the HRA; and</li> <li>• Options 1 and 2 can be used in relation to capital expenditure incurred before 1<sup>st</sup> April 2021. After that date only Options 3 and 4 may be used.</li> </ul> |
| 1.11 | <p>The Council approved loans to its wholly owned subsidiary NEW Homes for the purpose of building affordable homes. The loans qualify as capital expenditure and therefore need to be part of the MRP policy. At its meeting on 14th June 2016 the Council approved the MRP calculation for loans to NEW Homes as outlined in recommendation 3 above.</p>  |
|      | <p><b>Practical Considerations</b></p>  |
| 1.12 | <p>The useful life of an asset will vary depending on the class of asset concerned; a vehicle or ICT equipment may be financed over 5 years whereas a new school over 50 years. Judgements about the useful life will need to be made on an individual basis as expenditure is incurred.</p>  |

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| 1.13 | Large capital projects may take a number of years to complete, for example the 21 <sup>st</sup> Century Schools building programme. In this instance the MRP is incurred in the year after the asset has become operational, rather than during the construction phase.   |
| 1.14 | <p>The MRP on most assets will be calculated on a 'straight line' basis, with consideration being given to an 'annuity' method when appropriate including:</p> <ul style="list-style-type: none"> <li>• Where the flow of benefits from an asset are expected to increase in later years, for example capital schemes promoting administrative efficiencies or revenues that increase over time</li> <li>• Capital schemes whose purpose is to generate income that will increase with inflation over time for example rents from house building</li> </ul>   |
| 1.15 | <p>It is important to note that the capital financing position on outstanding capital expenditure (the Capital Financing Requirement) and the Council's level of external borrowing are not the same.</p> <p>Regulations stipulate that the Council can only borrow for capital purposes. However in day to day cash management, no distinction can be made between revenue cash and capital cash. External debt arises as a consequence of all the financial transactions of the Council and not simply those arising from capital spending. (Though checks are in place to ensure the Council does not borrow in the medium to long term for revenue purposes, as referred to in the Prudential Indicator report included elsewhere on the agenda).</p> <p>In practice the Council is under borrowed, this arises when the level of external borrowing is below the capital financing position on outstanding capital expenditure. The Council through its treasury management processes makes use of available cash arising from reserves etc. to fund capital expenditure and has 'internally' borrowed to an extent. This cash would otherwise have been invested at very low rates of return. External borrowing would also be that much more, at higher borrowing interest rates than any returns on cash invested. Such activities are considered best practice and are done so in accordance with the Council's Treasury Management Policy Statement, Strategy, Schedules and Practices.</p> |
| 1.16 | <p>The MRP annual charge to the revenue account is based on the Capital Financing Requirement (the outstanding capital expenditure). It is not the same as the cash repayment of external borrowing.</p> <p>The simplified example below illustrates the difference:<br/>Assume a 10 year maturity loan of £15m is taken out to fund capital expenditure of £15m on an asset with a life of 20 years.</p> <p>The annual MRP charge to the revenue account on straight line asset life basis is <math>\text{£15m} / 20 \text{ years} = \text{£0.750m}</math>.</p>  |

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|  | At year 10, the loan is repaid from cash on the balance sheet at £15m, but only £0.750m x 10 = £7.5m has been charged through the Council's revenue account. A decision would need to be made, either to take out another 10 year loan, or fund from internal cash resources for that 10 year period, dependent on the Council's position at that time. |
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| <b>2.00</b> | <b>RESOURCE IMPLICATIONS</b>  |
| 2.01        | The 2017/18 Council Fund and HRA budgets provide for the MRP charges in accordance with the calculations set out in the report. |
| 2.02        | There are no other resource implications as a direct result of this report.   |

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| <b>3.00</b> | <b>CONSULTATIONS REQUIRED / CARRIED OUT</b>   |
| 3.01        | In changing the Council's MRP policy during the year detailed discussions took place with the Council's treasury management advisors, senior internal officers and key Cabinet members.<br><br>Wales Audit Office were also consulted as external auditors. |
| 3.02        | The revised MRP policy was reviewed by Cabinet and Corporate Resources Overview and Scrutiny Committee before being approved at County Council as part of Stage 2 of the 2017/18 budget in December 2016.   |

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| <b>4.00</b> | <b>RISK MANAGEMENT</b>  |
| 4.01        | <p>The impacts of an MRP policy has long term effects that cannot be readily undone and therefore carries a significant amount of associated risk for future generations.</p> <p>The Well-being of Future Generations (Wales) Act 2015, when fully enacted, will put in place a requirement to;</p> <p><i>“act in a manner which seeks to ensure that the needs of the present are met without compromising the ability of future generations to meet their own needs”.</i></p> <p>It also requires that authorities take account of, amongst other things;</p> <p><i>“the importance of balancing short term needs with the need to safeguard the ability to meet long term needs”.</i></p> <p>The MRP policy ensures that costs are spread evenly amongst the tax and</p> |

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|  | rent payers benefiting from the capital expenditure. This 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 from using. |
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| <b>5.00</b> | <b>APPENDICES</b> |
| 5.01        | None              |

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| <b>6.00</b> | <b>LIST OF ACCESSIBLE BACKGROUND DOCUMENTS</b>  |
| 6.01        | <p>Hyperlink to Council Fund Stage 2 Budget 2017/18 report to Council 6<sup>th</sup> December 2016<br/> <a href="http://committeemeetings.flintshire.gov.uk/documents/s40871/201718%20Council%20Fund%20Budget%20Stage%202.pdf?LLL=0">http://committeemeetings.flintshire.gov.uk/documents/s40871/201718%20Council%20Fund%20Budget%20Stage%202.pdf?LLL=0</a></p> <p><b>Contact Officer:</b> Liz Thomas – Finance Manager, Technical Accountancy<br/> <b>Telephone:</b> (01352) 702289<br/> <b>E-mail:</b> <a href="mailto:liz.thomas@flintshire.gov.uk">liz.thomas@flintshire.gov.uk</a></p> |

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| <b>7.00</b> | <b>GLOSSARY OF TERMS</b>   |
| 7.01        | <p><b>Capital Expenditure:</b> Expenditure on the acquisition of non-current assets or expenditure that extends the life or value of an existing asset</p> <p><b>Capital Financing Requirement (CFR):</b> A measure of the capital expenditure incurred historically by an authority that has yet to be financed from capital receipts, capital grants or revenue financing.</p> <p><b>Council Fund (CF):</b> The fund to which all the Council’s revenue and capital expenditure is charged.</p> <p><b>Housing Revenue Account (HRA):</b> The fund to which all the Council’s revenue and capital expenditure relating to its housing stock is charged.</p> <p><b>Minimum Revenue Provision (MRP):</b> A charge made to the Council Fund to repay borrowing taken out for capital expenditure. Authorities must determine their own prudent MRP charge each year, taking into consideration statutory guidance issued by the Government.</p> <p><b>Prudential Code:</b> The code of practice drawn up by the Chartered Institute of Public Finance and Accountancy (CIPFA) to underpin the requirements of the Local Government Act 2003 in respect of an authority’s duty to determine the affordability, prudence and sustainability of its capital investment needs.</p> <p><b>Revenue Expenditure:</b> All expenditure incurred by an authority that cannot be classified as capital expenditure</p> <p><b>Revenue Support Grant (RSG):</b> Is paid to each authority to cover the cost</p> |



of providing standard services less the Council Tax income at the standard level.

**Unhypothecated Supported Borrowing (USB), commonly referred to as Supported Borrowing:** Each year Welsh Government provide Council's with a Supported Borrowing allocation. Council's borrow to fund capital expenditure equivalent to that annual allocation, Welsh Government then include funding to cover the revenue costs associated with the borrowing for future years within the Revenue Support Grant. The Council decides how this funding is spent.

**Unsupported Prudential Borrowing:** Borrowing administered under the **Prudential Code**, whereby authorities can set their own policies on acceptable levels and types of borrowing. The Prudential Framework allows authorities to take out loans in response to overall cash flow forecasts and other factors provided they can show that the borrowing is to meet planned capital expenditure in the current year or the next three years.