FLINTSHIRE COUNTY COUNCIL

Date of Meeting	Thursday, 1st March 2018
Report Subject	Minimum Revenue Provision – Review of 2017/18 Policy and Setting 2018/19 Policy
Report Author	Chief Executive and Corporate Finance Manager

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 the Council's 2016/17 MRP policy was amended. Detailed reports and presentations were made to Cabinet, Corporate Resources Overview and Scrutiny Committee and Council through November and December 2016 outlining the review that had taken place and the recommended changes. Changes to the 2016/17 and the 2017/18 policy were approved at the December 2016 Council meeting. The Cabinet report of November 2016 is attached at Appendix 1 to this report.

Cabinet considered the report from the Corporate Finance Manager with regard to setting the policy for MRP for 2018/19, included at Appendix 2, at their meeting on 20th February 2018. Cabinet noted that the MRP Policy was currently under an urgent review, following a recommendation made in the recent independent peer review of the Council's financial position, which would be resolved in the current financial year. The purpose of the peer support was to both challenge and validate our self-assessment of our risk position, and to explore further options. This work was commissioned in January and the peer advice on further options recommends that the Council reviews its policy on the method of calculating Minimum Revenue Provision and consider the merits of moving to a different model similarly to a number of English Local Authorities.

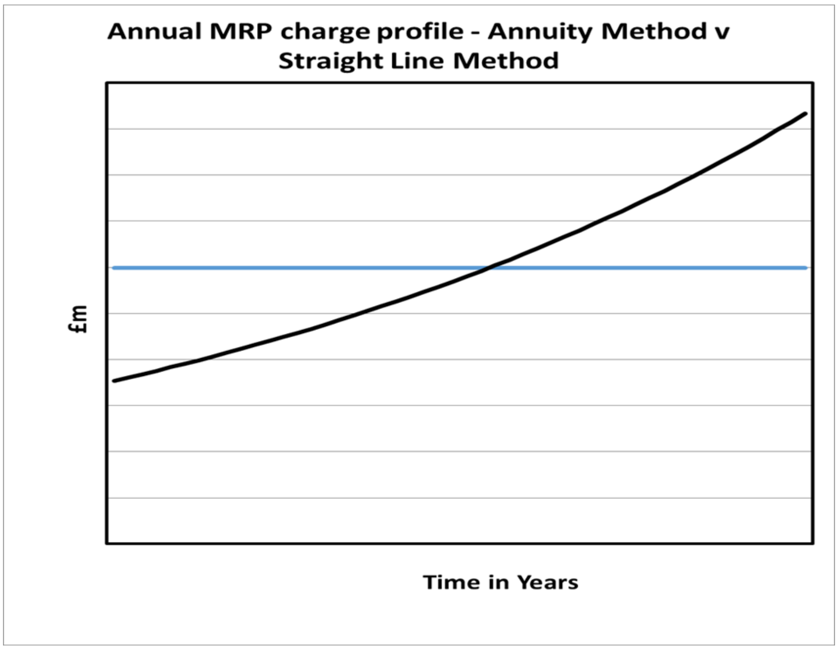
This report summarises the results to date of the review of the MRP policy.

RECOMMENDATIONS	
1	Members consider the review of MRP policy for Council Fund (CF) unfinanced capital expenditure and approve an MRP policy for 2017/18 and 2018/19 that it considers to be prudent
2	Members approve for Housing Revenue Account (HRA):- • Option 2 (Capital Financing Requirement Method) be used for the calculation of the HRA's MRP in 2018/19 for all capital expenditure funded by debt.
3	Members approve 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:- • 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. • 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.

REPORT DETAILS

1.00	**EXPLAINING THE MINIMUM REVENUE PROVISION**
1.01	Local Authorities are required each year, under the Local Authorities (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2008 ('the 2008 Regulations'), to set aside some of their revenue resources as provision for the repayment of debt. Regulation 22 of the 2008 Regulations requires an authority to each year make an amount of Minimum Revenue Provision (MRP) which it considers to be 'prudent', though the regulation itself does not define 'prudent provision'. Welsh Government (WG) has provided guidance which makes recommendations to authorities on the interpretation of the term, this guidance was last updated in April 2010.

	Authorities are required to prepare an annual statement of their policy on making MRP. 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 and a copy of the November 2016 Cabinet report is attached as Appendix 1.
1.02	As an outcome of making the case to Welsh Government for supplementary support and local funding flexibilities for the 2018/19 budget, the Council agreed to engage some expert and independent peer support. The purpose of the peer support was to both challenge and validate our self-assessment of our risk position, and to explore further options. This work was commissioned in January and the peer advice on further options recommends that the Council reviews its policy on the method of calculating Minimum Revenue Provision and consider the merits of moving to a different model similar to a number of English Local Authorities. As reported to Cabinet on 20th February an urgent review has been undertaken and the outcome of this review provides further options for consideration.
1.03	**Option 1 – Continue with the Straight Line Method** The Council has the option to continue with the straight line method and the implications of this were set out in the report to Cabinet on 20th February which is attached as Appendix 2. Cabinet also noted that the policy was subject to review and that a further update report would be provided to Council.
1.04	**Option 2 – Change to Annuity Method from 2017/18** The Council has the legitimate option of changing the MRP policy for supported and unsupported borrowing from 'straight line' to the 'annuity' method. If applied as a change in 2017/18 policy this would mean that: • The historic balance of outstanding capital expenditure funded from supported borrowing as at 31.3.17 will be provided for on an annuity basis over the remaining 49 year period (as it was changed to straight line over 50 years in 2016/17). • 2016/17 capital expenditure funded from supported and unsupported borrowing (and future years) will be provided for based on the asset's life on an annuity basis.
1.05	**Option 3 Change to Annuity Method and Backdate** Similar to Option 2 in that a change is made from straight line to annuity but that the policy is applied from 31.3.2007, that is back dated to 2008/09 financial year onwards.

1.06	Please see Appendix 1 – Cabinet report November 2016 for detailed explanation and definitions of accounting terminology used in paragraph 1.03 to 1.05 above.
1.07	**Difference between straight line and annuity methods** Both methods are based on the asset life method where provision is made to repay capital expenditure over the estimated life of the asset for which the borrowing is undertaken. (Option 3 within the statutory guidance issued by Welsh Government). The amount repaid is the same over the life of the asset, but the repayment profile of charges to revenue is different. The straight line method or equal instalment method generates a series of equal annual amounts over the estimated life of the asset. The annuity method MRP is the principal element for the year of the annuity required to repay over the life of the asset the amount of capital expenditure funded by borrowing using an appropriate interest rate. 2% is the rate suggested by the Council's Treasury Management advisors that rate being the Bank of England's target rate for inflation. The annual amount charged to revenue is lower in earlier years and increases in later years (similar to a mortgage repayment). This means building in an increasing charge for the future over the assets life. The graph below illustrates the difference in the payment profiles. 
1.08	Amendments to MRP policies to follow the asset life - annuity method have been implemented in many English authorities, examples include Birmingham City Council and Leeds City Council. However, it is uncommon in Wales. Changes to MRP policies being made by Welsh Councils to date in the main have all focused on changing from the reducing balance method to the straight line method (as done by the Council in 2016/17). WG issue guidance for Welsh Local Authorities on setting MRP policy, and

	the Ministry of Housing, Communities and Local Government issue guidance for English Local Authorities on setting MRP policy. The English guidance has recently been updated. Prior to that the Welsh guidance was largely based on the English guidance. The Council understand that WG is considering issuing updated guidance later in the year.
1.09	One of the changes made to the English guidance is to state that MRP policies may be amended but that amendments effective from 1st April 2018 cannot be backdated to create an overpayment that permits future MRP charges to revenue to be reduced. Option 3 above in paragraph 1.05 would contravene the English guidance if applied from 2018/19 onwards. Although there is a potential window of opportunity to explore backdating, in the spirit of the impending changes to legislation it is considered inappropriate to consider option 3 any further.
1.10	**Reasons why Straight Line Method was favoured in the 2016/17 review** At the time of the last review the preferred option was the straight line method mainly due to the certainty around an equal fixed charge. Under the straight line policy a recurring pressure must be built into the MTFS each year for new capital expenditure funded from supported borrowing. If the policy were to use the annuity method each year's pressure would also increase over time. Since the last review much more knowledge and intelligence has been received in relation to the alternatives available and practice elsewhere, particularly in England. This knowledge, in addition to the advice from the peer review has resulted in more confidence to explore these options further and in more detail. The informal commentary to the WG guidance explains that the advantage of the annuity method is to link MRP to the flow of benefits from an asset where the benefits are expected to increase in later years. The benefits of capital expenditure funded by borrowing supported by WG doesn't increase over time, and the Council's main sources of income (RSG) does not increase in line with inflation. The same could be said for the majority of capital schemes funded by unsupported borrowing e.g. 21st century schools. Examples quoted where benefits increase of time include: capital schemes promoting administrative efficiencies or revenues that increase over time, capital schemes whose purpose is to generate income that will increase with inflation over time for example rents from house building. Prudence is linked to sustainability. It could be argued that in setting an MRP Policy which causes future pressures if considered unsustainable in the long term is imprudent. Assumptions around the inflation rate have to be made that are then set for the life of the asset, i.e. that inflation will be 2% in the future. Inflation could be higher or lower than 2%.
1.11	Reasons why the Annuity Method could be considered more prudent

	MRP is charged to revenue over an assets useful life in such a way that the decreasing value of money over time due to inflation is factored in. Producing an equal or consistent in 'real' terms charge to the tax payer who benefits from the use of that asset equally over its life. Extract from CIPFA's Practitioner's guide to capital finance in local government: *'It is arguably the case that the annuity method provides a fairer charge than equal instalments as it takes into account the time value of money, where be paying £100 in 10 years' time is less of a burden than paying £100 now. The schedule of charges produced by the annuity method thus results in a consistent charge over an asset's life, taking into account the real value of amounts when they fall due.* *The annuity method would then be a prudent basis for providing far assets that provided a steady flow of benefits over their useful life '.* The Council's capital expenditure provides a steady flow of benefit over the assets useful life. Prudent in this context does not mean the quickest and largest possible repayment period, but has regard to the prudent financial planning of the Council overall, the flow of benefits from the capital expenditure, and other relevant factors. Any revised MRP Policy could therefore take account of the financial forecast in the Council's MTFS in determining what is prudent MRP in the circumstances. In particular, the need for an orderly financial transition as the Council adjusts to further substantial funding reductions.
1.12	**Conclusion** Prudence is a subjective concept and therefore none of the options or methods described can be assessed as being the absolute correct method – this is a matter of judgement. All options must be considered with the Council's particular circumstances in mind and a preferred option selected. The option must be first and foremost prudent but also sustainable and affordable over the long term. Ultimately it is for the Council to decide which method it considers to be prudent.

2.00	**RESOURCE IMPLICATIONS**
2.01	The table below summarises the difference in the MRP charge for outstanding council fund capital expenditure funded from supported borrowing and unsupported borrowing using the current straight line method and the annuity method for the next 50 years.

Year	Cap. Expd funded by Supported Borrowing MRP Charge - SL £000	Cap. Expd funded by Prudential Borrowing MRP Charge - SL £000	Total Cap. Expd. funded by Borrowing MRP Charge - SL £000	Cap. Expd funded by Supported Borrowing MRP Charge - Annuity £000	Cap. Expd funded by Prudential Borrowing MRP Charge - Annuity £000	Total Cap. Expd. funded by Borrowing MRP Charge - Annuity £000	**Variance £000**
2017/18	3,188	597	3,786	1,949	371	2,320	**-1,466**
2018/19	3,403	603	4,006	2,166	382	2,548	**-1,458**
2019/20	3,501	753	4,254	2,336	478	2,815	**-1,439**
2020/21	3,582	852	4,433	2,509	552	3,062	**-1,371**
2021/22	3,744	852	4,595	2,686	563	3,249	**-1,346**
2022/23	3,906	840	4,746	2,866	562	3,428	**-1,318**
2023/24	4,068	815	4,882	3,050	546	3,596	**-1,287**
2024/25	4,230	813	5,043	3,238	554	3,792	**-1,251**
2025/26	4,392	813	5,205	3,429	565	3,994	**-1,211**
2026/27	4,554	813	5,367	3,624	576	4,200	**-1,167**
2027/28 - 2042	92,653	13,007	105,660	85,062	10,908	95,970	**-9,690**
2043/44 - 2067	173,196	19,193	192,389	187,608	23,718	211,326	**18,937**
Total	**304,416**	**39,950**	**344,366**	**300,524**	**39,776**	**340,299**	**-4,067**

The table shows at (today's prices) that overall savings would be made in the first 25 years as a result of changing the MRP method from straight line to annuity. This would be an overall pressure in the later 25 years as the annuity method builds in a charge for inflation over the life of the asset. The maximum savings are made in the first year with a pressure needing to be built in for every subsequent year.

2.02 The savings in the earlier years will results in lower cash balances than currently forecast in the MTFS and therefore there will be an additional interest cost pressure to be considered. Conversely in later years, the higher MRP results in interest savings. The implications of which will be factored into future cash-flow and interest cost computations within the central loans and investment account.

The estimated additional interest costs for the next 5 years are shown in the table below:

Year	Estimated additional interest costs (£000)
2017/18	44
2018/19	44
2019/20	43
2020/21	41
2021/22	40

3.00	**CONSULTATIONS REQUIRED / CARRIED OUT**
3.01	The proposed changes were discussed in detail with the Council's treasury management advisors (Arlingclose Ltd) during the 2016/17 review. The views of the advisors on the 2017/18 review will be shared verbally at the meeting. Officers plan to consult formally with the Wales Audit Office for their views, and will share the outcome verbally at the meeting. Ultimately it is for the Council to decide which method it considers to be prudent.

4.00	**RISK MANAGEMENT**
4.01	The impacts of a change in MRP policy has long term effects that cannot be readily undone and therefore carries a significant amount of associated risk for future generations. The Well-being of Future Generations (Wales) Act 2015, when fully enacted, will put in place a requirement to; *"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".* It also requires that authorities take account of, amongst other things; *"the importance of balancing short term needs with the need to safeguard the ability to meet long term needs".* The change in the MRP policy for supported and unsupported capital expenditure from straight line to annuity being considered ensures that the costs are spread equally in real terms amongst the taxpayers 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 equally to current tax payers.

5.00	**APPENDICES**
5.01	Appendix 1 - Report to Cabinet 15th November, 2016 – Review of Minimum Revenue Provision. Appendix 2 - Report to Cabinet 20th February, 2018 - Minimum Revenue Provision - 2018/19 Policy.

6.00	**LIST OF ACCESSIBLE BACKGROUND DOCUMENTS**
6.01	**Contact Officer:** Gary Ferguson Corporate Finance Manager **Telephone:** (01352) 702271 **E-mail:** gary.ferguson@flintshire.gov.uk

7.00	**GLOSSARY OF TERMS**
7.01	As per the attached report (Appendix 1).