

## Review of Minimum Revenue Provision Calculations (Debt Rescheduling).

### Background.

The Local Authorities (Capital Finance and accounting) (England) (Amendment) Regulations 08 (SI 08/414) places a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision (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 main MRP options available to councils are:

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

However, this does not preclude other prudent methods being used. Options 1 and 2 may be used only for supported expenditure. Methods of making prudent provision for self financed expenditure include Options 3 and 4 (which may also be used for supported expenditure if the Council chooses).

### Previous review of the Council’s approach to calculating MRP.

The Council reviewed its approach to the calculation of asset life related MRP in 2013/14 and for unsupported capital expenditure moved from calculating MRP on a straight line basis (i.e. Equal Instalments of Principal were repaid throughout the life of the asset) to an annuity basis (i.e. the repayments are equal in cash terms throughout the life of the asset with the first repayment being largely composed of interest and the final repayment largely made up of principal – similar to a domestic “repayment mortgage”). The annuity method takes account of the time value of money, whereby paying £100 in 10 years time is less of a burden than paying £100 now. The implication of making this change was to reduce payments in earlier years but to increase them in later years.

The reduction in costs arising from this change were calculated as:-

	£m
2014/15	1.489
2015/16	1.232
2016/17	1.084
2017/18	0.921

Local authorities are allowed to make voluntary extra provision (VRP) in any year, that is to say MRP above the minimum prudent amount can be made. In the case of the straight line method the formula used to calculate MRP ensures that where VRP is made, future years provision is reduced. Having reviewed our MRP policy in 2013/14, we concluded that a one off adjustment in 2013/14 should be made in order to recover this voluntary over-provision made in previous years. The over provision

for 2012/13 and previous years was £3.843m and the saving in MRP for 2013/14 was £1.041m giving a total one-off benefit of £4.884m in 2013/14.

A further change to the calculation of MRP was made in 2014/15 in relation to borrowing in respect of Government allocations. This was also changed to an annuity basis and produced one off savings in 2014/15 of £1.419m and the following annual savings.

	£m
2015/16	0.290
2016/17	0.255
2017/18	0.248
2018/19	0.257

### **Current proposal**

After considerable research and subsequent dialogue with KPMG, the Council's external auditors, a further opportunity to reschedule debt repayments has been identified. This relates to "historic debt" incurred before the prudential borrowing regime was introduced. At present MRP on this debt is currently calculated on a 4% of reducing balance basis. It is now proposed to change the calculation to a flat 2% backdated to 2006/07. This effectively pays off the debt over 50 years, rather than using a reducing balance basis that never actually pays off the balance. If this change is made, at the start of the current financial year, the Council will have over-provided for MRP by around £8.6m. We could therefore reduce MRP to £0 for 3 years to recover this and to contribute to the Council's very challenging current medium term financial outlook in the face of protracted and unprecedented cuts to our grants from Government.

Given the scale of the accounting entries, this approach has been discussed with the Council's External Auditors who have looked at the information that we have provided and have also reviewed the relevant guidance. KPMG have now concluded that the approach "seems to be perfectly acceptable". Clearly however, the details of the final calculations and overall approach will be reviewed as part of the year-end audit, so certainty on the acceptability of the calculations and approach will only be received once the accounts for the current financial year have been audited i.e. by September 2016.

If the Council sets MRP to nil for relevant parts of the MRP calculation, the following one-off savings would arise in the short term.

2015/16	£3.235m
2016/17	£3.664m
2017/18	£3.412m
2018/19	£0.531m
2019/20	£0.400m
2020/21	£0.339m

The in year saving reduces until the charge would start to increase compared to charges calculated under the current basis from 2027/28 onwards. This change in approach is a rephasing of debt repayment costs. If the Council makes this change, debt levels will be higher for longer and additional interest costs will be incurred. However, with the effect of inflation, increased cash payments in later years will cost less in real terms than now. The Council is currently under extreme financial pressure given the scale of cuts to Government grant and making the proposed change to MRP would enable funds to be freed up to phase in the delivery of ongoing savings and potentially to fund one-off costs associated with delivering ongoing revenue benefits. The recent announcement by the Chancellor at the Conservative Party Conference that business rates will be fully retained by Councils as core grant is phased out should, dependent on the detail of how the scheme works and what additional unfunded responsibilities are transferred to councils, enable funding to be built in to future budget models to cover the increased costs that will arise in later years. It is essential that making this accounting adjustment does not result in not taking the very challenging decisions that we must make in order to deliver a sustainable financial position in the medium term.

#### **PFI MRP**

MRP on the Council's PFI contract is currently charged in line with the life of the agreement (28 years). The nature of the agreement is that the assets are maintained in "as new" condition throughout the life of the agreement. For other borrowing MRP is charged over the life of the asset on an annuity basis. The Council has been researching whether the MRP charge to revenue could be amended to the same basis as the method of financing an asset does not generally determine the period over which taxpayers receive a benefit from an asset. The Council generally assumes that a school has a life of 60 years and if this life was assumed for the PFI related assets, at the start of the current financial year, MRP would have been over charged to revenue by £12.3m. This could potentially be recovered by making no further MRP relating to the PFI contract for the next 17 years to recover this. However, the relevant regulations and accounting entries are extremely complex and agreement on this change has only recently been reached with the external auditors. This change would also have an impact on debt levels, which will be higher for longer due to not setting aside as much revenue money in respect of debt repayments in the early years. This will increase borrowing and debt levels over the 60 years. This additional borrowing will peak at £91m in 2034/35 before falling to £0 at the end of 2066/67. The savings on this basis are as follows

2015/16	£2.127m
2016/17	£2.212m
2017/18	£2.326m
2018/19	£2.548m
2019/20	£2.791m
2020/21	£2.994m

Because of the rephasing of MRP and the resultant additional borrowing there is an interest cost associated with this proposal and this is listed below.

2015/16 £0.035m  
2016/17 £0.180m  
2017/18 £0.400m  
2018/19 £0.543m  
2019/20 £0.668m  
2020/21 £0.798m

Overall, due to the different phasing of principal repayments of both the proposed adjustments for the repayment of historic debt and PFI related debt means that the changes have a net present value saving although over the life of the assets the Council will be funding the same amount and payments will better reflect the benefit to taxpayers which will extend beyond the life of the PFI contract.