Report to the Audit & Governance Committee

Date of meeting: 28th November 2022

Epping Forest District Council

Portfolio: **Finance, Qualis Client & Economic Development**

Subject: **Proposed Change in Minimum Revenue Provision (MRP) Policy**

Responsible Officer: **Andrew Small** **(01992 564278)**

Democratic Services: **Laura Kirman** **(01992 564243)**

Recommendations/Decisions Required:

(1) To consider and pass comment for full Council on the proposed change to the Minimum Revenue Account (MRP) Policy with effect from 2023/24.

Executive Summary:

Minimum Revenue Provision (MRP) is a statutory requirement for councils to make a charge to its General Fund to provide for the repayment of past capital debt and other credit liabilities. A council is also allowed to undertake additional voluntary payments if choosing to do so (Voluntary Revenue Provision - VRP). MRP does not need to be set aside for the Housing Revenue Account (HRA).

In determining a prudent level of MRP the Council is under a statutory duty to have regard to guidance on MRP issued by the Secretary of State. The guidance provides four options which can be used by a council when determining its MRP policy and a prudent amount of MRP. Two of the four options are available to Epping Forest District Council (as all capital expenditure financed from borrowing has been incurred since 1st April 2008).

The options do not change the total MRP that the Council must pay over the remaining life of the capital expenditure; however, they do vary the timing of the MRP payment.

The Council's 2022/23 MRP Policy follows the 'Asset Life Straight-Line' method of calculating MRP. It is a relatively simple approach, providing equal instalments spread over the life of the asset purchased from borrowing. This approach works well during periods of low interest rates. However, following the recent sharp rise in interest rates, the strength of the approach is weakened. This report ***(Appendix A)*** presents the case for switching methods to the 'Asset Life Annuity' method, whereby MRP is the principal element for the year of the annuity required to repay over the asset's useful life the amount of capital expenditure financed by borrowing.

The Annuity method, as well as being fully compliant with statutory guidance, recognises the time value of money and matches the repayment profile to how the benefits of the asset are consumed over its useful life. It also conforms with Government guidance on what is "prudent" and results in a lower revenue charge to the General Fund in the medium term.

A change in MRP Policy from the Straight Line to the Annuity method is therefore recommended for 2023/24.

Reasons for Proposed Decision:

To enable the robust scrutiny of the Council's approach to the repayment of debt, ensuring specifically that the adopted approach is both prudent and compliant with relevant legislation. The report proposes a change to its current policy, which requires consideration by the Audit & Governance Committee and the subsequent approval of full Council.

Legal and Governance Implications:

Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (regulations 27, 28 and 29).

Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (Regulation 28 revised).

Safer, Cleaner and Greener (SCG) Implications:

None.

Background Papers:

Council Budget 2022/23 (Capital Strategy – Attachment 6, Annex 1). Full Council 24th February 2022.

Risk Management:

A robust MRP policy is an important risk management feature, which ensures that the Council has sufficient funds set-aside to repay its debts when they become due.

Appendix A

Proposed Change in Minimum Revenue Provision (MRP) Policy

Introduction

Minimum Revenue Provision (MRP) is a statutory requirement for a council to make a charge to its General Fund to provide for the repayment of past capital debt and other credit liabilities. A council is also allowed to undertake additional voluntary payments if choosing to do so (Voluntary Revenue Provision - VRP). MRP does not need to be set aside for the Housing Revenue Account (HRA).

The MRP scheme was set out in former Regulations 27, 28 and 29 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003. This system was revised by the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008. The revised Regulation 28 replaced a requirement that local authorities calculate the MRP pursuant to detailed calculations with a duty to make prudent MRP.

The Council is under a statutory duty "to determine for the current financial year an amount of MRP which it considers to be prudent." Local authorities are asked by the Secretary of State "to prepare an annual statement of their policy on making MRP for submission to their full Council."

MRP Calculation Method: the case for a policy change

In determining a prudent level of MRP the Council is under a statutory duty to have regard to guidance on MRP issued by the Secretary of State. The guidance provides four options which can be used by a council when determining its MRP policy and a prudent amount of MRP.

The options do not change the total MRP that the Council must pay over the remaining life of the capital expenditure; however, they do vary the timing of the MRP payment.

Two of the four options are available to Epping Forest District Council (as all capital expenditure financed from borrowing has been incurred since 1st April 2008) as follows:

1) Asset Life Method – where capital expenditure on an asset is financed wholly or partly by borrowing or credit arrangements, MRP is to be determined by reference to the useful life of the asset. Two variations on this are allowable:

   a) *Straight-Line Method* – simply equal instalments spread over the life of the asset; and

   b) *Annuity Method* – MRP is the principal element for the year of the annuity required to repay over the asset's useful life the amount of capital expenditure financed by borrowing or credit arrangements (using an appropriate interest rate).

2) Depreciation Method – MRP is deemed to be equal to the provision required in accordance with deprecation accounting in respect of the asset on which expenditure has been financed by borrowing or credit arrangements.

The Council's current (2022/23) MRP Policy (adopted by full Council on 24th February 2022) is Option 1a presented above. Calculating and applying the annual MRP provision using the Asset Life Straight-Line method is a relatively straightforward way of establishing a prudent provision. When interest rates are low, the resulting sum is closely comparable to sums calculated using an Annuity method.

Members will be aware that until very recently, interest rates have been at historically low levels for a long time. However, that is a position that has changed dramatically since the 2022/23 MRP Policy was adopted. The two Asset Life methods are now beginning to diverge significantly in terms of results (reflecting rising interest rates on annuities). By way of illustration, using the estimated MRP for 2023/24 of £1.723 million embedded in the updated Medium-Term Financial Plan (Cabinet 10th October 2022), an MRP derived using the Annuity method would be £1.586 million (£137,000 lower than the Straight-Line method; using PWLB published annuity rates 16/11/22). This is because the Straight-Line method does not recognise the time value of money (whereby paying £100 in 10 years' time is less of a burden than paying £100 now).

The Annuity method also matches the repayment profile to how the benefits of the asset financed by borrowing are consumed over its useful life (the method reflects the fact that asset deterioration is slower in the early years of an asset and accelerates towards the latter years). The MRP calculated using the Annuity method therefore conforms to the DCLG "Meaning of Prudent Provision" which provides that "*debt [should be] repaid over a period that is reasonably commensurate with that which the capital expenditure provides benefits*."

The Depreciation method (Option 2 above) is a method rarely adopted as it tends to be overly prudent and unaffordable. The method front loads MRP in the early years as it matches Depreciation charges in the Accounts. For example, a typical depreciation policy could be '20% reducing balance' on a £1.0 million asset, resulting in an annual MRP provision of £200,000 per annum; this could realistically compare to a 50-year asset life, whereby the equivalent Straight-Line provision using the Asset Life method would be just £20,000 (and even less in the early years, using the Annuity method).

Conclusion and Recommendation

A medium-term revenue benefit to the General Fund budget would also be realised if a change is made from the Straight-Line to Annuity methods, which would contribute towards addressing the projected General Fund budget deficit of £4.126 million for 2023/24 reported to Cabinet in October 2022. On balance, for the reasons presented, a change in policy from the Straight-Line to Annuity (Asset Life) MRP method is recommended (a draft updated MRP Policy is presented at ***Appendix B***).

Appendix B

Minimum Revenue Provision Statement 2023/24

DRAFT PROPOSAL

Where the Council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as "Minimum Revenue Provision" (MRP), although there has been no statutory minimum since 2008.

The Local Government Act 2003 requires the Council to have regard to the Ministry of Housing, Communities and Local Government's (MHCLG) Guidance on MRP (the MHCLG Guidance) updated in 2018.

The MHCLG Guidance requires the Council to approve an Annual MRP Statement and recommends a range of options for calculating a prudent amount of MRP.

MRP Policy

No MRP is required to be charged for Housing Revenue Account (HRA) assets.

No MRP is required to be charged on any General Fund Capital Financing Requirement, which was in existence prior to the HRA Subsidy Reform exercise of 2012.

For General Fund capital expenditure incurred after the HRA Subsidy Reform exercise of 2012:

- MRP will be determined by charging the expenditure over the expected useful life of the asset, to a maximum of 50 years, on an annuity basis; and
- MRP on purchases of freehold land will be charged over 50 years.

The MRP payment is financed from revenue with an option that part, or all, of the payment could be financed from capital receipts to repay debt.

MRP will commence in the financial year following the asset coming into operational use or after purchase.

External Loans

For capital expenditure loans to third parties that are repaid in instalments of principal, the Council will make nil MRP, but will instead apply the capital receipts arising from principal repayments to reduce the capital financing requirement.

Capitalisation Directions

For capitalisation directions on expenditure incurred after 1st April 2008 MRP will be made using the annuity method over 20 years.