City of BRADFORD METROPOLITAN DISTRICT COUNCIL

Report of the Assistant Director of Finance and Procurement to the meeting of the Executive to be held on 10th July 2018.

Subject: **Document: G**

2017-18 Minimum Revenue Provision Policy Update

Summary statement:

This report provides Members with an overview of the proposed changes to the Council's Minimum Revenue Provision (MRP) policy from 2017-18 onwards. MRP is a statutory requirement to make an annual charge to the Council's budget to provide for the repayment of historic capital debt and other related liabilities.

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Overview & Scrutiny Area:

Corporate

1. SUMMARY

1.1 The Council has undertaken a detailed review of its Minimum Revenue Provision (MRP) Policy within the Capital Strategy.

1.2 The Council has identified budgetary pressure in the Medium Term Financial Strategy 2019-20 to 2021-22 and beyond. A change in the MRP Policy will generate medium term revenue savings through re-profiling the provision.

1.3 This report is submitted to enable the Executive to make recommendations to Council on changes to the MRP Policy 2017-18 onwards. Its sets out the following changes:

- For 2017-18 calculate the MRP on Supported Borrowing from 2008 to 2016 on a 2% straight line method and that the overprovision to be applied as an adjustment to the forecast MRP in the current and future years.
- An amendment to the MRP methodology for PFI assets for 2018-19 and beyond.

2. MINIMUM REVENUE PROVISION (MRP) BACKGROUND

2.1 MRP is a statutory requirement to make an annual charge to the Council's budget to provide for the repayment of historic capital debt and other related liabilities.

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

2.3 MRP was introduced in 2003 with the charge based on 4% of the outstanding balance of debt in any given year. The scheme was updated in 2008 to give councils more latitude around how the charge is calculated. It allows the Council to consider the amount of MRP which it considers to be prudent, rather than the process being explicitly controlled by legislation.

2.4 These current regulations and supplementary Ministry of Housing, Communities and Local Government (MHCLG) MRP guidance (February 2018) therefore offer councils significantly more discretion in deciding upon the amount of MRP. The regulations require councils to "have regard" to the guidance and the recommendations within it. In principle, a council is now only required to make a "prudent provision" in respect of its on going MRP charge, and to arrange for its debt liability to be repaid over a similar period to that which the asset associated with the capital expenditure provides benefits or, in the case of borrowing supported by Revenue Support Grant, in-line with the period implicit in the determination of that grant (i.e.4% p.a.).

2.5 The regulations require councils to prepare an annual statement of their policy on making MRP for submission to their full Council for scrutiny and approval before the start of the financial year. The original statement may be revised during the year by full Council.

2.6 The Guidance recommends four options for the calculation of the provision.

i) Option 1- Regulatory Method – a 4% annual charge, equivalent to paying for an asset with a life of 25 years. This method should only be adopted for a council's historic debt liability as at 31 March 2008 or for new "supported" capital expenditure applied within the year.

ii) Option 2 – Capital Financing Requirement (CFR) Method - This is a simplified version of Option 1, which provides for MRP to be calculated solely on the non-housing element of the CFR.

iii) Option 3- Asset life Method – charge the total amount borrowed to revenue over the expected life of the asset. Either in equal annual instalments aligned to the life of the asset which is determined at the discretion of the Council, for example a 50 year asset generates a 1/50th or 2% charge. Or using an annuity method (which more closely reflects the fact that an asset deteriorates slowly at first and more rapidly during its later years).

iv) Option 4 – Depreciation method – charge the total amount borrowed in accordance with depreciation accounting, which would mean that the rate at which the MRP is charged could increase (or, more rarely, decrease) from year to year.

2.7 For balance sheet liabilities relating to finance leases and on balance-sheet PFI contracts, the MRP Guidance states that the requirement to make prudent MRP would be regarded as met by a charge equal to the element of the rent/charge that goes to reduce the Balance Sheet liability. This would have the effect that the total impact on the bottom line would be equal to the actual rentals paid for the year.

2.8 The key principle of MRP is that the annual amount set aside should be prudent. The relevant regulations state that Local Authorities are required to have regard to the MRP guidance when setting MRP Policy. The guidance gives flexibility in how it calculates MRP, providing the calculation is deemed prudent.

2.9 A practice across the sector in recent years, as austerity has made balancing budgets more difficult, has been to assess whether past charges of MRP have resulted in a prudent set aside, which in turn has seen councils generating savings as they move to new methods or releasing cash as they make backdated adjustments.

2.10 The Council's 2017-18 MRP Policy reviewed and approved by Full Council is:

a) The policy for charging MRP on historic supported borrowing is on the asset life method calculated on an equal instalment basis over 50 years.

b) Unsupported or prudential borrowing MRP is based on the Asset Life method – that is, the expenditure financed from borrowing is divided by the expected asset life. For schemes funded before 31st March 2012 the MRP is calculated on the annuity basis and for schemes funded after 1st April 2012 the MRP is calculated on an equal instalment basis.

c) Since 2009-10 the appropriate financing costs for the Council's Building Schools for the Future (BSF) Private Finance Initiative (PFI) schemes have been included in MRP calculations. Appropriateness includes an on going consideration of asset lives.

2.11 The policy change to historic supported borrowing was introduced in 2016-17. Prior to this, MRP for capital expenditure pre 1 April 2008 was charged at 4% on a reducing balance basis. At this time the change to the policy was not applied backwards to 2008.

2.12 Following an MRP review, two further changes are being proposed to the policy. These are:

- To apply the 2% straight line method on its historic supported borrowing back to 2008-09.
- The future charge for PFI schools being calculated using asset lives.

3 MRP Changes

SUPPORTED BORROWING

3.1 The Council currently charges MRP for supported borrowing and historic debt prior to 2008-09 using the straight line method over 50 years at £6.47m per annum. This method has been applied by the Council from 2016-17 and has the effect of reducing the debt liability to a period of 50 years from the previous 4% Reducing Balance method and has already provided a reduction in the MRP provision. The change to a straight line method was considered prudent because it reduces the repayment period from over 150 years down to 50 years.

3.2 Work has been undertaken to calculate a notional overpayment of MRP since 2008 by the re-profiling of MRP on the supported borrowing using the current 2% MRP Policy. If it had wished to, the Council would first have been permitted to make this change when the current MRP requirements were introduced in 2008-09. If the policy had changed in 2008-09, the MRP on this tranche of debt would have been lower than was actually charged during the years between 2008-09 and 2015-16, but would now be at a higher level than currently and would be fully repaid seven years earlier than under the current MRP policy.

3.3 This proposal seeks to provide a prudent provision for debt repayment that is also a fair approach for current and future Council Tax payers whilst giving due regard to the MRP guidance.

PRIVATE FINANCE INITIATIVE

3.4 The statutory guidance expresses a view that a prudent provision for PFI schemes will be made when the annual MRP is equal to the part of the Council rent/charge that goes to reduce the Balance Sheet liability. This is on the presumption that this is the only part of the payment not charged directly to revenue and thus an MRP for this amount will reconcile the overall charge to revenue to the total payment for that year.

3.5 The argument for changing the approach is that this is an oversimplification and the whole of the asset is paid for during the unitary charge contract period which is less than the actual asset life. It is proposed that for 2018-19 this part of the policy is brought in line with the main MRP Policy and the charge of principal to the revenue account is over the life of the asset.

3.6 The Council currently has the following PFI schemes, relating to ten Schools:

- August 2008: Building Schools for the Future (BSF) Phase 1 – a 25 year contract for the building and maintenance of three schools. The contract expires in August 2033.
- March to May 2011: BSF Phase 2 – a 25 year contract for the building and maintenance of four mainstream Secondary Schools and three co-located Special Needs secondary Schools. The contract expires in 2035-36.

3.7 The policy is currently to charge the principal element to the revenue account over the term of the PFI agreement being 25 years. The estimated asset life for the Bradford Schools PFI is 50 years.

3.8 The Phase 1 and Phase 2 schemes came in to use 10 and 8 years ago so this means that there is an asset life of 40 and 42 years left.

4. FINANCIAL & RESOURCE APPRAISAL

4.1 The Assistant Director of Finance and Procurement considers that the proposed changes to the annual MRP methodologies are individually and cumulatively prudent and recommends them to Members.

4.2 This scenario is judged to achieve a more prudent provision to repay the Council's supported borrowing and provides greater fairness to current and future council tax payers.

SUPPORTED BORROWING

4.3 The calculated over provision for the period 2008 to 2016 is £52m based on the actual MRP charged to revenue versus the MRP that would have been charged if the supported borrowing element was to be repaid over 50 years i.e. 2% at that point.

4.4 The total recalculated overprovision is £52m but any recovery can not result in a negative MRP charge. As the Council has a positive Capital Financing Requirement it must make a prudent MRP provision. A prudent approach is considered to be phasing the reduction in MRP over a number of years.

4.5 The calculated MRP charge for 2017-18 is £24.7m for all debt and past liabilities. The Council is proposing to reduce its MRP charge for 2017-18 to a nominal amount of £1m (releasing £23.7m of the overprovision) with further reduced amounts charged in 2018-19 and 2019-20 until the over provision has been recovered.

4.6 The overprovision will be transferred to a MRP Adjustment Reserve in order to build resilience for any changes resulting from the fair funding review or slippage in agreed savings proposals.

4.7 It should be recognised that this change would reduce the rate of repayments of borrowing over the period during which the overprovision is being applied, which will lead to the Council incurring additional interest costs in the meantime. However, in the current climate of low interest rates it is considered that this would be an acceptable cost given the benefits to be gained from the change.

4.8 Recalculating the 2008 to 2016 supported borrowing charge does mean that the annual MRP charge increases from 2018-19 by £2.6m. The table below demonstrates the reduction over the next three years and the position after the overprovision has been used to reduce the MRP.

Years	**Release of Overprovision for supported borrowing £'m**	**On going Supported borrowing MRP increase £'m**	**Total cash £'m**
2017-18	-23.7	0	-23.7
2018-19	-23.7	2.6	-21.1
2019-20	-5.1	2.6	-2.5
2020-21 to 2034-2035	0	41.7	41.7
2035-36 to 2057-2058	0	57.4	57.4
2058-2059 to 2065-2066	0	-51.8	-51.8
Total	**-52.5**	**52.5**	**0**

PFI

4.9 A change in policy to charge the principal element over 42 and 40 years rather than the current 25 would create a saving of £3.9 million in 2018-19 and £14.7 million in 2019-20 to 2022-23. Savings would continue to be made for a further 13 years ranging in value from £1.8 million to £6.2 million. Years 19 to 42 will see a charge to the revenue account where there is none at present but with the time value of money taken into account the sum is modest. These savings relate to Council funded budgets for PFI schools.

Years	Current basis £'m	Asset life £'m	Difference £'m
2018-19	8.2	4.3	(3.9)
Years 2-5	31.9	17.2	(14.7)
Years 6-10	48.9	21.5	(27.4)
Years 11-20	88.6	43.1	(45.5)
Years 21-30	0	43.1	43.1
Years 31-40	0	43.1	43.1
Years 41-50	0	5.3	5.3
TOTAL	**177.6**	**177.6**	**0**

4.10 Although this change in Policy will lengthen the period over which the MRP charge is made, it is still prudent as it will better match the set aside period with the service potential of the assets. The change means that council tax payers will be charged for the cost of these buildings over the full period of time for which they are expected to be in use.

4.11 The Council's proposed change for the two PFI schemes is considered to be prudent. As newly constructed assets, the asset life could be in excess of 50 years. Therefore, it would appear to be reasonable for the Council to provide for its PFI on the same basis, by charging MRP on a straight-line basis over the remainder of the 50 years outstanding at 2018-19.

4.12 The total impact of both changes is summarised below.

Years	Release of Overprovision for supported borrowing £'m	On going Supported borrowing MRP increase £'m	Private Finance MRP reduction £'m	Total cash £'m
2017-18	-23.7	0	0	-23.7
2018-19	-23.7	2.6	-3.9	-25.0
2019-20	-5.1	2.6	-3.4	-5.9
2020-21 to 2034-2035	0	41.7	-92.8	-51.1
2035-36 to 2057-2058	0	57.4	94.8	152.2
2058-2059 to 2065-2066	0	-51.8	5.3	-46.5
Total	**-52.5**	**52.5**	**0**	**0**

5. RISK MANAGEMENT AND GOVERNANCE ISSUES

5.1 The uncertainties regarding the funding that will be available to the Council and the control of the capital programme are considered within the Quarter 1 Finance Position Statement 2018-19 and the Medium Term Financial Strategy 2019-20 to 2021-22 and beyond Reports.

5.2 Changes to PFI asset lives or impairments could impact on the calculation of the annual MRP charge. The MRP Policy will be reviewed annually and approved by

Council.

5.3 The existing governance arrangements for controlling the capital programme remain appropriate.

6. LEGAL APPRAISAL

6.1 The legal basis for Minimum Revenue Provision (‘MRP’) is set out in the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 as amended (‘the Regulations’). The Regulations provide that local authorities are under a duty to make an amount of MRP which it considers to be ‘prudent’. Local Authorities are obliged by the Local Government Act 2003 to have regard to statutory guidance on MRP. A local authority must make a statement setting out its policy on making prudent provision for MRP to full Council for approval.

6.2 In determining the level of a prudent MRP, local authorities are required to ‘have regard’ to statutory guidance issued by the government. This means that local authorities should not take a substantially different course from that set out in the guidance, but may deviate from its detailed requirements where they determine there is good reason to do so. The statutory guidance sets out that the broad aims of a prudent MRP policy should be to ensure that borrowing is repaid either over the life of the asset which the capital expenditure related to or, for supported borrowing, the period assumed in the original grant determination.

6.3 The amendments to the Guidance in February 2018 make it more difficult to identify an estimated overprovision after the 31 March 2018 accounting period. However the Council is looking to apply the overprovision to the 2017-18 year.

6.4 Advice has been sought from specialist counsel on the lawfulness of the proposed amendments to the Council’s MRP policy, in relation to supported borrowing for the period from 2008-2009 and a change with respect to the future charge levied to fund the cost of building PFI schools. Counsel advises that both these proposed changes are lawful for the following reasons:

a) the Council will continue to adhere to the broad aim of the Guidance;
b) the concept of prudence is for the Council as decision maker, within the bounds of reasonableness, to asses and evaluate and decide what weight, if any, is to be given to a consideration;
c) there is liberty to deviate from guidance on admissible grounds and for good and articulated reason;
d) the Council has to have regard to the Guidance but this does not mean that the Guidance cannot be departed from for cogent reasons;
e) the adoption of the proposals is in accordance with Regulation 28 of the 2003 Regulations in that it complies with the duty to have regard to the Guidance and general public law principles.

7. OTHER IMPLICATIONS

7.1 EQUALITY & DIVERSITY

There are no equality and diversity implications.

7.2 SUSTAINABILITY IMPLICATIONS

There are no sustainability implications.

7.3 GREENHOUSE GAS EMISSIONS IMPACTS

There are no greenhouse gas emissions implications.

7.4 COMMUNITY SAFETY IMPLICATIONS

There are no community safety implications.

7.5 HUMAN RIGHTS ACT

There are no Human Rights Act implications.

7.6 TRADE UNION

There are no Trade Union implications.

7.7 WARD IMPLICATIONS

There are no Ward implications.

7.8 AREA COMMITTEE ACTION PLAN IMPLICATIONS (for reports to Area Committees only)

Not applicable.

7.9 IMPLICATIONS FOR CORPORATE PARENTING

There are no Corporate Parenting implications.

7.10 ISSUES ARISING FROM PRIVACY IMPACT ASSESEMENT

There are no Privacy Impact implications.

8. NOT FOR PUBLICATION DOCUMENTS

None

9. RECOMMENDATIONS

9.1 Note the contents of the report and the proposed changes to the MRP Policy.

9.2 The Executive recommends to Council that:

a) The 2018-19 MRP policy for PFI assets is brought in line with the main MRP Policy and the charge of the principal to the revenue account is over the life of the school building assets.
b) For 2017-18 calculate the MRP on Supported Borrowing for 2008 to 2016 on a 2% straight line method. The overprovision of £52m will be included in a reserve and applied to reduce the annual MRP charge from 2017-18 onwards.

9.3 Executive recommends to Council that the MRP Policy be amended to reflect the following conditions:

i) Total MRP after applying previous overpayment will not be less than zero in any financial year.

ii) The same amount of principal has to be repaid over time irrespective of the method, the recommendation will be to hold the £52m freed up from the change in policy in an earmarked reserve, and it will be used to reduce the annual MRP cost.

iii) The changes to MRP are agreed, releasing the overprovision of £52m over the coming years. As the overprovision is released, and given our balanced financial plan, the cash saving is credited to a dedicated earmarked MRP Adjustment Reserve so that future usage can be appropriated and monitored.

iv) The PFI budgetary saving is used to reduce the net reported cost pressure in 2018-19.

v) That the following checkpoints are met, and the implications of each are understood, before future usage of the proposed MRP Adjustment Reserve is determined:

a) Formal 2018-19 monitoring to determine likely outturn and further detailed understanding of structural cost pressures.

b) Review of the Medium Term Financial Strategy (MTFS) to determine detailed anticipated budgetary gaps over the next three years.

c) Clarity on future savings delivery, including the Demand Management strategy, for 2019-20 and 2020-21.

d) Finalising the 2019-20 and 2020-21 detailed budget process.

vi) Subject to the outcomes noted above, consideration is given to a future voluntary repayment of outstanding capital debt using any residual amount set aside. This would therefore designate this move as a last resort insurance policy to protect against any negative consequences associated with the uncertainties outlined above.

10. BACKGROUND DOCUMENTS

- The Council's Capital Investment Plan for 2017-18 onwards - Executive 21st February 2017 and Council 23rd February 2017
- The Council's Capital Investment Plan for 2018-19 onwards - Executive 20th February 2018 and Council 22nd February 2018
- Annual Finance and Performance Outturn Report 2017-18 Executive 10th

July 2018

- Medium Term Financial Strategy 2019-20 2022-23 Executive Report 10th July 2018