ROTHERHAM BOROUGH COUNCIL – REPORT TO COUNCIL

1.	**Meeting:**	**Council**
2.	**Date:**	**8th July 2015**
3.	**Title:**	**Review of the Council's Minimum Revenue Provision (MRP) Profile**
4.	**Directorate:**	**Resources & Transformation**

5. Summary

5.1 This report outlines work undertaken to review and amend the current profile for reducing the Council's underlying need to borrow (Capital Financing Requirement - CFR) through the annual Minimum Revenue Provision charge to revenue (MRP) in respect of capital expenditure incurred prior to 2007/08 which was funded by borrowing. This has identified short to medium term revenue benefits and seeks approval.

5.2 The proposal seeks to bring a fairer approach for current and future Council Tax payers by:

- linking MRP to the average useful life of an asset which better reflects the economic benefit the Council gets from using the asset to deliver services over its useful life. This ensures that Council Tax payers are being charged each year in line with asset usage and prevents current taxpayers meeting the cost of future usage or future tax payers being burdened with charges relating to assets that are no longer in use.

- ensuring future Council Tax payers pay an amount for the use of the assets comparable in real terms to that being paid by current Council Tax payers, therefore taking account of the time value of money in the future.

5.3 Arising out of the above approval is also sought for an amendment to the Council's MRP Policy Statement applicable in 2014/15 and future financial years.

5.4 A paper has been submitted to the Council's auditors, KPMG, setting out the Council's proposal with regard to the MRP in relation to pre 2007/08 debt. KPMG have confirmed (27th May 2015) that they are not 'minded to challenge' the principles being put forward as the basis of change in providing for MRP. However, in doing so they have indicated that this does not 'fetter their discretion' to reconsider their position if new information comes to their attention. This reservation of position is in line with our expectation until such time as they give their opinion on the Council's 2014/15 Statement of Accounts.

5.5 The report also outlines a proposal to utilise unapplied capital resources to achieve short-term revenue benefits by repaying existing debt and seeks approval for this to be applied in the 2014/15 financial year.

5.6 The report was considered by Lead Commissioner Sir Derek Myers at his meeting held on 11th June 2015. The Lead Commissioner was Minded to Grant a Decision to approve the recommendations and following the five working day period for representations, a final decision, including a referral that Council adopt the recommendations, was taken on 22nd June 2015.

6. Recommendations

6.1 Council is asked to approve:

1. **the re-profiling of the Council's Minimum Revenue Provision charge for reducing the Council's underlying need to borrow on capital expenditure incurred prior to 2007/08 which was funded from borrowing and approve the transfer of the identified short-term revenue benefits to a new Council earmarked reserve titled 'MRP Adjustment Reserve'.**

2. **an amendment to the Council's Minimum Revenue Provision Policy Statement applicable in 2014/15 and future financial years, the revised wording for paragraph (a) of the Policy Statement to be:**

   "The MRP charge in relation to capital expenditure incurred prior to 2007/08 where the expenditure was funded by either supported or unsupported borrowing will be calculated using the expected useful life of the asset and the calculation of the provision will be by the annuity method."

3. **the use of unapplied capital resources to reduce the Council's underlying need to borrow and for this to be applied in the 2014/15 financial year.**

7. Proposals and Details

7.1 Background

7.1.1 Minimum Revenue Provision (MRP) arises because there is statutory requirement for local authorities to set aside some of their revenue resources as provision for reducing the underlying need to borrow (Capital Financing Requirement - CFR), i.e. the borrowing taken out in order to finance capital expenditure.

7.1.2 Prior to 1 April 2007, the set aside was specified as a percentage of the Council's CFR (with different percentages for HRA and General Fund). The CFR in turn was a complex calculation based on the balance sheet and the credit ceiling system from pre 1 April 2004. In the past, MRP and CFR have had significant implications for HRA subsidy and other government funding streams allocated from Government Depoartmental Budgets on an annual basis. Consequently, specific provisions were enacted to ensure that once these calculations had been made and audited, they could not be subsequently amended.

7.1.3 Since 1 April 2007, MRP requirements have been relaxed significantly and the **set aside is no longer a prescribed amount**. Department for Communities and Local Government (DCLG) guidance now permits a variety of methods to be used to calculate the MRP set aside and the guidance issued February 2012 sets out a number of possible methods a council might wish to follow, although even these are not exhaustive. MRP calculations no longer require formal approval by full Council and no longer impact on government funding, since:

- HRA self-financing in 2011/12 abolished both the housing subsidy regime and the requirement to charge MRP to the HRA; and

- the link between Government Revenue Support Grant and levels of supported borrowing has been eroded.

7.1.4 The core requirement now is simply that:

- The Council has an approved policy for calculating MRP; and

- The Council **sets aside an amount which it deems to be prudent**, having regard to the DCLG's statutory guidance.

7.1.5 In recent years, the Council has undertaken a number of reviews to establish whether there was any opportunity to secure revenue benefits whilst working within the core requirements. The focus of these was on capital expenditure incurred by the General Fund since 2007/08. Primarily this has involved the application of capital receipt funding to short life asset schemes from those schemes with longer asset lives and also switching to an annuity basis for the calculation of debt repayment (MRP). This has led to revenue savings being achieved which have been reflected in a reduction to the capital financing budget as shown in the approved Medium Term Financial Strategy. These changes have been considered and accepted by the Council's auditors, KPMG.

7.2 Option 1 - Amendment to the Current MRP Profile for Pre 2007/08 Capital Expenditure

7.2.1 Like many authorities the Council has continued to apply the previous regulatory approach, calculating MRP at 4% of the reducing balance on General Fund capital expenditure incurred prior to 2007/08 which was funded by borrowing.

7.2.2 As the previous reviews on post 2007/08 capital expenditure confirmed, there is increasing acceptance that MRP should more properly be linked to the average useful life of the assets involved and the current regulatory approach (a percentage basis) does not reflect this view. Currently, each year 4% of the outstanding (reducing) balance is provided for out of the revenue budget as MRP which means the debt will be finally repaid many years into the future (in the Council's case this is 500+ years).

7.2.3 Linking MRP to the average useful life of an asset is in keeping with the general principle of achieving a prudent approach set out in the DCLG guidance which is that the profile of MRP charges should reflect the economic benefit the Council gets from using the asset to deliver services over its useful life. This ensures that Council Tax payers are being charged each year in line with asset usage and prevents current taxpayers meeting the cost of future usage or future tax payers being burdened with “debt” relating to assets that are no longer in use.

7.2.4 A further review by Finance officers was started to examine what other options might be available to the Council. Whilst this work was progressing a ‘landmark’ acceptance by the auditors of South Yorkshire Passenger Transport Executive, KPMG, of a retrospective reprofiling of MRP charges came to light and this provided a further opportunity to re-examine the options again. Furthermore the recent Government Inspection report into Birmingham City Council referred to the City Council’s reprofiling of MRP as a method of securing short-term revenue benefits for the City Council and therefore the methodology adopted has been considered as part of our internal review.

7.2.5 The report also brought the issue to national prominance and has led to a number of local authorities questioning whether they have adopted the correct approach to determining their MRP charges in relation to pre-2007/08 debt. This is the subject of a Society of Municipal Treasurers’ questionnaire to its membership (April 2015).

7.2.6 The review has focussed on:

- the adoption of an annuity basis of calculating MRP in line with the methodology adopted for post 2007/08 capital expenditure;
- determining the number of years which could be applied as a proxy for the Council’s average asset life;
- determining the interest rate which could be applied in the calculation of MRP on an annuity basis;
- determining the financial implications of being able to retrospectively adjust the MRP charged from 2007/08 to date and into the future; and
- determining the financial implications of adjusting the MRP charged from 2014/15 onwards.

7.2.7 The views of the Council’s Treasury Management Advisers, Capita Asset Services, who are advising a number of other local authorities on this issue, have been sought and they are supportive of the proposal set out below.

7.3 The Proposal

7.3.1 A key consideration in determining a revised schedule is whether the outcome is **prudent**.

7.3.2 Does the current (regulatory) methodology achieve that aim? The methodology was set so as to match the implied support Government gave local authorities through the formula used to calculate Revenue Support Grant and over time that link has been eroded.

7.3.3 The current methodology ensures the debt will be fully repaid in 500 years time long after the assets are no longer in use. It also results in higher repayments in the early years which has potentially a disproportionate impact on current Council Tax payers.

7.3.4 A fairer way of matching the MRP charge to Council Tax payers with the use of the assets is to limit the repayment period to 50 years, this being an approximation of the average life for the Council's assets. In addition, it would seem fairer that future Council Tax payers pay an amount for the use of the assets comparable in real terms to that being paid by current Council Tax payers, therefore taking account of the time value of money in the future.

7.3.5 **Adopting an annuity basis for calculating the annual MRP charges meets this need and it is therefore proposed that this basis is now adopted for the calculation of the annual MRP charges on pre 2007/08 debt.** It is important to stress that the change in methodology eliminates the inequality created by the accelerated charging basis of the Regulatory Method. The proposed basis is fairer giving a more proportionate profile charge based on asset usage over the whole asset lives.

7.3.6 The annuity basis reflects a fairer methodology for Council Tax payers and an examination of the MRP charges made from 2007/08 reveals that the Council has over-provided during the period 2007/08 to 2013/14. This over-provision can be released back to revenue to ensure the total provision to the end of 2014/15 is in line with the reprofiled MRP schedule. **It is, therefore, also proposed that the revised methodology should be applied retrospectively to the start of 2007/08.**

7.3.7 An analysis of the actual Council loans outstanding at 31/03/07 and those which remained outstanding at 31/03/14 revealed an average interest rate of 6.26%. A further anaylsis of average asset lives suggests a period of around 44 years which when backdated to 2007/08 would equate to approximately 50 years.

7.3.8 In considering an appropriate interest rate to apply it is felt 4%, being in line with the reducing balance methodology and reflecting a reasonable approximation for an average rate of interest over the long-term, would provide a prudent basis for calculating the revised MRP charges using an annuity.

7.4 Accounting Policy & MRP Policy Statement Considerations

7.4.1 The Council's accounting policy on MRP is simply to set aside a prudent level of resources, and the method for achieving this is through the use of an accounting estimate. Changing the basis of the MRP calculation represents a change to the estimation technique employed, but not to the accounting policy itself. As with any provision, calculations can be reviewed on a cumulative basis and any over-provisions made in previous years can be corrected in the year that they were identified. That revision would not lead to a prior period adjustment in the Statement of Accounts.

7.4.2 Statutory requirements do not allow for having a negative MRP charge in any financial year. Whilst the adjustment to the MRP schedule will lead to immediate benefits greater than the estimated MRP charge in 2014/15, the Council will still be making a positive charge in 2014/15, the adjustment is a correction to the total amount previously provided for and in line with normal accounting practice this would be seen as two separate transactions.

7.4.3 A paper has been submitted to the Council's auditors, KPMG, setting out the Council's proposal with regard to the MRP in relation to pre 2007/08 debt. KPMG have confirmed

(27th May 2015) that they are not 'minded to challenge' the principles being put forward as the basis of change in providing for MRP. However, in doing so they have indicated that this does not 'fetter their discretion' to reconsider their position if new information comes to their attention. This reservation of position is in line with our expectation until such time as they give their opinion on the Council's 2014/15 Statement of Accounts.

7.4.4 Assuming the proposal is to be adopted, there is also a need to approve an amendment to the Council's MRP Policy Statement.

7.4.5 The current Policy Statement reads as follows:

(a) The MRP charge in relation to borrowing for capital expenditure incurred prior to 2007/08 will be unaffected by the regulations;

(b) The MRP charge in relation to capital expenditure incurred since 2007/08 where the expenditure is funded by either supported or unsupported borrowing will be calculated using the expected useful life of the asset at the point the asset is brought into use. The calculation of the provision will be either the annuity method or the equal instalments method depending on which is most appropriate; and

(c) The MRP charge in relation to capital expenditure incurred since 2007/08 where the expenditure is funded by a 'capitalisation directive' (e.g. equal pay) will be calculated on the basis of the specified period(s) set down within the regulations. The calculation of the provision will be either the annuity method or the equal instalments method depending on which is most appropriate.

7.4.6 Acceptance of the proposal will require an amendment to paragraph (a) and the suggested form of words is:

"The MRP charge in relation to capital expenditure incurred prior to 2007/08 where the expenditure was funded by either supported or unsupported borrowing will be calculated using the expected useful life of the asset and the calculation of the provision will be by the annuity method."

7.5 Option 2 – Apply available capital resources to fund post 2007/08 Capital Expenditure previously financed by borrowing

7.5.1 The Council has retained capital balances of unapplied capital receipts and unapplied capital grants and whilst these can be set aside to finance future capital expenditure it is also permissable for these balances to be used to reduce the Council's underlying borrowing need (CFR). This is not a repayment in a physical sense of repaying debt to the PWLB (the lender) for example thereby reducing interest charges rather they are used internally to finance the capital programme.

7.5.2 The review undertaken (referred to previously in Section 7.2.1) also included an examination of whether it was acceptable to apply some of the Council's unapplied capital resources retrospectively, effectively reduce the Council's underlying borrowing need which existed in earlier years and reversing previously charged MRP in relation to that debt. It is still uncertain that this further option would be an acceptable approach but the proposal being put forward here is not to apply the resources retrospectively.

Instead it only relates to the MRP charge for 2014/15 and thus does not require any change in existing policies.

8. Finance

8.1 Pre 2007/08 Capital Expenditure

8.1.1 The retrospective reprofiling of MRP on the £156.677m borrowing need which was outstanding at 31/03/2007 will result in a one–off revenue benefit of £34.789m as at 31/03/2015.

8.1.2 Further revenue benefits of £23.363m will accrue over the period from 2015/16 to 2029/30. £3.093m of this figure would be available in 2015/16 with the annual amount thereafter reducing progressively by around £200k p.a.

8.1.3 From 2030/31 the revised annual MRP will be greater than the annual amounts under the current profile. The additional cost over the 27 years to 2056/57, when the borrowing need is fully extinguished, equates to appoximately £2.9m p.a. – it should be noted that the annual impact is lower in the earlier years e.g. in 2030/31 the impact is an additional cost of about £91k.

8.1.4 Under the existing schedule a sum £20.244m would still be repayable over the 450+ years from 2057/58. Taking account of the time value of money the proposed new MRP profiling schedule more accurately reflects the financial burden on the Council Tax payers for the use of the assets over their useful lives.

8.1.5 It is important to recognise that most of the revenue benefits are short to medium term as ultimately the full debt has to be repaid and the MRP charged against the revenue budget. Suitable budgetary provision in line with the new profile would be required in the Council's MTFS. At this point in time it is proposed that the identified short-term revenue benefits are placed in a new Council earmarked reserve titled 'MRP Adjustment Reserve'.

8.2 Post 2007/08 Capital Expenditure

8.2.1 In determining the MRP charge for 2014/15 it is proposed that £6.263m of uncommitted capital receipts/grants are utilised to reduce the borrowing need enabling it to free up revenue resources which would have been chargeable to the Budget in the year (and future years). This will lead to a short term revenue benefit in 2014/15 of £4.537m and further benefits of £0.843m in 2015/16 and £0.883m in 2016/17 respectively.

8.2.2 In proposing this approach, and utilising £6.263m of available capital resources, the Council would still be left with £22.509m of uncommitted capital resources to fund future capital expenditure. This figure is slightly higher, but largely in line with the c£20m that was forecast in the Council's recent 2015/16 budget report.

9. Risks and Uncertainties

9.1 Whilst the arguments in favour of re-profiling seem to be sound and a positive final confirmation that it is acceptable will only be received from KPMG once the external audit of the Council's 2014/15 Statement of Accounts is concluded and a positive unqualified opinion on this matter is given. KPMG, as of the 27th May 2015, have indicated that they are not minded to challenge the principles being put forward by the Council for reprofiling its MRP charge.

10. Policy and Performance Agenda Implications

10.1 The proposed change in approach to MRP profiling will ensure that Council Tax payers of both today and the future make a fair contribution to the cost of providing and using assets over the whole asset lives.

10.2 The identification of short-term revenue benefits will provide greater flexibility as the Council manages the implementation of both the Corporate and Children's Safeguarding Improvement Plans in a climate of on-going restrictions on resources for at least the term of the next Parliament.

11. Background Papers and Consultation

Lead Commissioner Sir Derek Myers Meeting – 11th June 2015
DCLG guidance on the Minimum Revenue Provision
The Council's Treasury Advisers – Capita
The Council's Auditors - KPMG
Rotherham MBC's Statement of Accounts (including Accounting Policies)
The way forward: an independent review of the governance and organisational capabilities of Birmingham City Council – plus the internal BCC officer report to Members on MRP re-profiling

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