Leicester
City Council

Council **Date: 26th November 2015**

Minimum Revenue Provision

Report of the Director of Finance

1. Introduction

1.1 This report seeks the Council's approval to a revised policy for making "Minimum Revenue Provision" (MRP), to apply from 2015/16.

1.2 The current policy requires charges to be made to revenue in excess of what accounting standards would require. This is because the charge was previously supported by government grant, which is no longer the case.

2. Background

2.1 MRP is the minimum amount which must be charged to taxpayers each year, in order to pay down debt incurred for previous years' capital expenditure. The essential principle is that a charge should be made over the period the Council benefits from the expenditure, so that future taxpayers do not pay for investment enjoyed by previous generations.

2.2 The Council is free to make revenue provision in excess of MRP – this is referred to as voluntary set aside, and can be useful in certain circumstances.

2.3 Sums charged as MRP can only be used to redeem debt, or in substitution for borrowing which would otherwise have taken place. Until it is required, the money has to be held in investments.

2.4 Until 2006/07, MRP was calculated as 4% of all outstanding borrowing. This was a requirement of statute, and we had no discretion. Change was introduced, partly to reflect the relaxation of capital controls which introduced prudential borrowing.

2.5 The Council now has the flexibility to set its own policy, provided this is prudent. Guidance issued by the Secretary of State has provided four options which could be considered prudent.

2.6 By law, the Council's policy for making MRP is a matter for the full Council, and the current policy was approved as part of the budget for 2015/16. Application of the policy is a matter for the Director of Finance.

2.7 Until 2010, the Government supported capital expenditure in two ways:-

(a) By means of grant;

(b) By "supported borrowing", through which Revenue Support Grant (RSG) was provided at 4% of the amount supported. In effect, this arrangement worked like a home owner's mortgage, with the Government (indirectly) paying off the debt.

2.8 Since 2010, the Government has exclusively supported capital spending by means of grant. This means that the only borrowing we undertake is unsupported (or "prudential") which we have to finance ourselves. The revenue situation is such that unsupported borrowing can only rarely be afforded.

2.9 The Council's current MRP policy provides that:-

(a) MRP on historic supported borrowing is charged to revenue at an amount equal to 4% of outstanding borrowing. This matched the receipt of RSG;

(b) MRP on unsupported borrowing is calculated in accordance with a set of principles for different types of asset, and is intended to ensure the charge reflects how long the asset is expected to last. At the same time, the policy facilitates more complex regeneration projects;

(c) Discretion is also provided to the Director of Finance to make additional voluntary set aside, where circumstances warrant. This provision has been used in circumstances where it was prudent to write down debt over 25 years, but asset lives could equally be estimated for a longer period.

2.9 Since 2013/14, RSG has no longer reflected need to spend, and has been cut proportionally by the Government each year. Thus the link between historic supported spending and RSG has been broken (RSG is now less than the cost of servicing the debt). In common with a number of other authorities, we are therefore seeking to re-visit our current policy.

3. <u>Changes</u>

3.1 A revised policy is attached for members' approval.

3.2 The new policy seeks to write down all borrowing in accordance with the same principles, with reference to asset lives. There is no separate provision for supported borrowing.

3.3 If the policy is approved, the effect would be to significantly reduce the charge we are required to make to the revenue account each year. This saving is, however, a "paper" one, in that it simply means the Council's debt burden will be paid down less quickly, and interest will be paid for longer. A further amendment to the policy is therefore proposed to enable the Director of Finance to make additional voluntary set aside to reduce the Council's overall debt burden. It is intended to use this flexibility to re-apply savings achieved in 2015/16 – we will use this money to write down debt on schemes which are almost fully paid for, reducing the revenue burden further in the medium term.

3.4 No other changes are proposed to the policy previously agreed by the Council.

3.5 It is noted that some other authorities have implemented changes to their policy retrospectively, which we do not recommend.

4. **Financial Implications**

4.1 Capital expenditure, where this is financed by borrowing, leads to the following revenue costs:-

(a) Minimum Revenue Provision, in respect of principal;

(b) Interest on outstanding sums.

4.2 Charges made for principal are notional, in that the Council does not borrow money for specific schemes. All borrowing needs are aggregated, and borrowing is undertaken when market conditions are appropriate, in line with the Council's treasury strategy.

4.3 The effect of the policy change, and the proposed use of additional set aside in 2015/16, would reduce the burden of MRP to the revenue budget. The outstanding lives of the historic assets mean the charge made will be between 2% and 3% of the current outstanding "debt". The table below shows the impact on the Council's bottom line budget, inclusive of the effect on interest. It also shows the year in which the changes will start to cost money, rather than save money:-

Percentage Charge	Saving				Break even	
	16/17 £m	17/18 £m	18/19 £m	19/20 £m	Pessimistic Interest Rates	Optimistic Interest Rates
3%	3.3	3.0	2.7	2.3	2024	2026
2%	6.4	6.0	5.5	4.8	2028	2033

4.4 The above table also assumes that voluntary set aside being made in line with the current policy will cease.

4.5 Given the application of the Council's managed reserves strategy, extra money is likely to be more helpful in the later years of the forthcoming budget strategy than in 2016/17. As part of preparing the budget, the Director of Finance will consider the further application of voluntary set aside: the aim will be to use savings achieved in the early years of the budget plan to reduce the Council's financial burden in later years. Any such proposals will be detailed in the forthcoming budget report.

4.6 This report does not apply to MRP chargeable to the HRA, to which different rules apply.

5. **Legal Implications (Kamal Adatia)**

5.1 In accordance with the Local Authorities (Functions and Responsibilities) (England) Regulations 2000, the alteration to our MRP policy is a matter which requires the approval of full Council.

6. **Report Author**

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2nd November 2015

Appendix

Minimum Revenue Provision Policy

1. Introduction

1.1 This policy sets out how the Council will calculate the minimum revenue provision chargeable to the General Fund in respect of previous years' capital expenditure, where such expenditure has been financed by borrowing. It is applicable from 2015/16.

2. Basis of Charge

2.1 Where borrowing pays for an asset, the debt repayment calculation will be based on the life of the asset.

2.2 Where borrowing funds a grant or investment, the debt repayment will be based upon the length of the Council's interest in the asset financed (which may be the asset life, or may be lower if the grantee's interest is subject to time limited restrictions).

2.3 Where borrowing funds a loan to a third party, the basis of charge will normally be the period of the loan (and will never exceed this). The charge would normally be based on an equal instalment of principal, but could be set on an annuity basis where the Director of Finance deems appropriate.

3. Commencement of Charge

3.1 Debt repayment will normally commence in the year following the year in which the expenditure was incurred. However, in the case of expenditure relating to the construction of an asset, the charge will commence in the year in which the asset becomes operational. Where expenditure will be recouped from future income, and the receipt of that income can be forecast with reasonable certainty, the charge may commence when the income streams arise.

4. Asset Lives

4.1 The following maximum asset lives are proposed:-

- Land – 50 years;
- Buildings – 50 years;
- Infrastructure – 40 years;
- Plant and equipment – 20 years;
- Vehicles – 10 years;
- Loan premia – the higher of the residual period of loan repaid and the period of the replacement loan;

4.2 In applying this policy to historic supported borrowing, the Director of Finance will estimate the expected remaining life of the assets financed, as at 01.04.15. This may be done in aggregate for all expenditure supported by borrowing.

5. **Voluntary Set Aside**

5.1 Authority is given to the Director of Finance to set aside sums voluntarily for debt repayment, where she believes the standard depreciation charge to be insufficient, or in order to reduce the future debt burden to the authority.

6. **Other**

6.1 In circumstances where the treasury strategy permits use of investment balances to support investment projects which achieve a return, the Director of Finance may adopt a different approach to reflect the financing costs of such schemes.

Mark Noble
2nd November 2015