Nottinghamshire County Council

Report to Finance and Property Committee

22 February 2016

Agenda Item: 10

REPORT OF THE SERVICE DIRECTOR – FINANCE, PROCUREMENT AND IMPROVEMENT

PROPOSED CHANGES TO THE COUNCIL'S MINIMUM REVENUE PROVISION POLICY

Purpose of the Report

1. To set out proposed changes to the Council's Minimum Revenue Provision Policy Statement.

Information and Advice

Background

2. Minimum Revenue Provision (MRP) is statutory requirement to make a charge to the Council's General Fund to make provision for the repayment of the Council's past capital debt and other credit liabilities.

3. 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.

4. 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".

5. In determining a prudent level of MRP the Council is under a statutory duty to have regard to statutory guidance on MRP issued by the Secretary of State. The Guidance provides four options which can be used by the Council when determining its MRP policy and a prudent amount of MRP. The Council however is entitled to depart from the Guidance if it has good reason to do so. The proposals in this paper are consistent with the Guidance.

Nottinghamshire County Council's Current Methodology

6. Since 2007, Nottinghamshire County Council has adopted the following methodologies as prescribed by previous statutory guidance:

   - That MRP for capital expenditure financed by borrowing prior to 1 April 2007 is based on the previous regulatory method, i.e. primarily based upon a 4% reducing balance of outstanding debt as at 31 March 2007 including an adjustment used in transition to the new system in 2004.

   - That MRP for capital expenditure financed by borrowing after 1 April 2007 is made on the basis of equal annual instalments over the estimated life of relevant assets. The Council has used one of the ready-made options from the previous statutory guidance: the 'straight line method'

   - That, for finance leases and "on Balance Sheet" PFI contracts, the MRP requirement is met by a charge equal to the element of the unitary charge applied to write down the liability.

Proposed Changes to Nottinghamshire County Council's Methodologies.

7. During 2015/16 officers have reviewed the Council's current approach and, having done so, make the following recommendations:-

   - For capital expenditure financed by borrowing before 1 April 2007, a change from the 'Regulatory Method' to a straight line (equal instalment) method for a period of up to 50 years, commencing in 2016/17 – an adaption to one of the ready-made options in the Guidance.

   - For capital expenditure financed by borrowing after 1 April 2007, a change from the 'straight line method' to the 'annuity method' - another of the ready-made options in the Guidance.

   - The work undertaken on the MRP methodology has revealed that there is an inconsistency between the useful economic lives of assets as used in the MRP model and the useful economic lives of assets as used to apply depreciation as set out in the Accounting Policies. It is proposed that these two approaches are brought into line.

   - An amount equal to the principal repaid on PFI and Finance Lease Liabilities is currently charged to MRP in the existing methodology. It is proposed that MRP relating to PFI and Finance Leases is charged to MRP in the same way as for all other capital expenditure by using the Annuity Method over the useful economic lives of assets. Again utilising one of the ready-made options in the Guidance.

8. The Service Director - Finance, Procurement and Improvement (Section 151 Officer) considers these proposals to be both prudent and more appropriate than the previous methodologies referred to in paragraph 7 above.

The Regulatory Method

9. The Regulatory Method currently in use applies a reducing balance to the outstanding indebtedness which results in the debt never being completely repaid because each year a charge of 4% is applied to the outstanding balance. In addition, a technical adjustment known as “Adjustment A” was established following the transition to the Prudential Borrowing Framework in 2005 (in Nottinghamshire’s case £2.722m). Under the current Regulatory Method, no MRP is charged on this amount and consequently it will never be repaid. It is the view of the Section 151 Officer that the omission to make provision for the full repayment of this debt is not consistent with prudent financial management.

10. The assumption in the Regulatory Method is that the Government continues to support the repayment of pre-2007 borrowing up to a level of 4% per year on the reducing balance. Due to the erosion of Revenue Support Grant (RSG) in recent years, that assumption is no long valid and it can no longer be implied that the 4% charge is supported by Government funding. It is therefore considered prudent to revise this charge to a 2% straight line approach which will ensure this liability is fully discharged regardless of further RSG reductions.

The Annuity Method

11. The annuity method makes provision for an annual charge to the General Fund which, unlike the current Straight Line 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 schedule of charges produced by the annuity method thus results in a consistent charge over an asset’s life, taking into account the real value of the annual charges when they fall due.

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

Commencement Date for MRP Provision

13. The Council is recommended to retain its approach of commencing MRP charges in the first year after the asset becomes operational.

Implications of Change in MRP Approach

Step 1 – Changing MRP on Pre- 2007/08 Capital Expenditure to straight-line repayment

14. It is proposed that the methodology for calculating MRP on capital expenditure financed from borrowing prior to April 2007 is changed from the ‘Regulatory Method’ to a fixed, straight line method (equal instalment) over a period of up to 50 years commencing in 2016/17. Whilst it is acknowledged that this method is not specifically recommended in the Guidance for pre April 2007 debt, it is considered prudent by the Section 151 Officer.

15. If the Council continued to apply the current Regulatory Method, £39m of the pre-2007 debt would remain outstanding in 50 years' time. The Council's proposed 2% fixed MRP methodology is prudent because it ensures that all of the debt is repaid over a shorter finite timeframe (including full repayment of Adjustment A).

16. A by-product of this step 1 is that it would result in a £5m reduction to the MRP charge in 2016/17 with on-going savings to 2032/33.

Step 2 – Changing MRP policy for post-2007/08 Capital Expenditure to the Annuity Method

17. It is proposed that the method calculating MRP on capital expenditure financed by borrowing after 1 April 2007 is changed from the straight line method to the annuity method.

18. Around £22.1 million less MRP would have been charged to revenue between 1 April 2007 and 31 March 2016 had steps 1 and 2 been adopted during that period.

19. A by-product of steps 1 and 2 is that it would result in a £9m reduction to the MRP charge in 2016/17 with on-going savings to 2035/36.

Step 3 – A review of Asset Lives

20. It is proposed that in addition to the adoption of Steps 1 and 2 above, the useful asset economic lives used in the MRP calculation be revised to ensure that they are in line with the useful economic lives as prescribed in the Council's accounting policies for depreciation purposes. This will ensure consistency in terms of using an accounting asset life that accurately reflects the period over which the Council will derive economic benefits by matching the profile of MRP charges to asset usage.

21. Around £26.3m less MRP would have been charged to revenue between 1 April 2007 and 31 March 2016 had steps 1 to 3 been adopted during that period.

22. It also identified a £10m reduction to the MRP charge in 2016/17 with on-going savings until after 2039/40.

Step 4 – An amendment of PFI/Finance Lease MRP Methodology

23. It is proposed that assets procured via PFI or Finance Lease are the subject of a MRP charge in the same way as all other capital expenditure, by using the Annuity Method over assets' useful economic lives. This harmonisation of approach is consistent with how PFI/Finance Lease assets are now included on the Council's Balance Sheet following the adoption of International Financial Reporting Standards (IFRS) in 2010/11 and is considered to be prudent.

24. The cumulative effect of all proposed steps is that around £42.5m less MRP would have been charged to revenue between 1 April 2007 and 31 March 2016 had these methods been adopted during that period.

25. A by-product of these steps is that it would result in £13m reduction to the MRP charge in 2016/17 with on-going savings to 2036/37.

Summary

26. The Section 151 Officer considers that the proposed changes to the annual MRP methodologies are individually and cumulatively prudent and recommends them to Members.

27. Having concluded that the proposed methodologies provide a prudent amount of Minimum Revenue Provision (MRP) for the repayment of debt, it has been identified that applying the current policy has led to MRP charges that exceed what prudence required during the period from 1 April 2007 to 31 March 2016. This has resulted in a cumulative charge at 31 March 2016 that is in excess of what would be considered prudent and appropriate under the proposed new methodology.

28. It is proposed that within the MRP policy for 2016/17 and subsequent years, there will be a realignment of MRP charged to the General Fund to recognise the excess sum of around £42.5 million. Under the proposals, MRP will be calculated on an annuity basis, but as if the annuity basis had been applied from 1 April 2007. This re-profiling of cumulative MRP is anticipated to apply over a number of financial years. MRP using the revised method is in the order of £11 million in 2016/17 and is projected to vary as the Council both incurs more capital expenditure and receive further capital receipts.

29. As already detailed, the critical consideration is to ensure that MRP Policy is prudent. The proposed options detailed above ensure responsible economic foresight and are consistent with the methods prescribed by the statutory guidance. The Section 151 Officer is also proposing that the following conditions should be added to the new policy:

    - Total MRP after applying realignment will not be less than zero in any financial year. This has the effect of freezing the cumulative MRP at the 2015/16 level until such time as that sum matches the cumulative total MRP calculated using the annuity method from 1 April 2007. This condition will ensure that there is no claw back of MRP from previous years, i.e. there will be no negative MRP.

    - The cumulative total of the MRP realignment will never exceed the amount of the calculated excess sum of around £42.5m.

      The process of MRP realignment will be reviewed on an annual basis when drafting the annual Treasury Management Strategy and MRP Policy (or more frequently if there is a mid-year revision for any reason, including the prudence of the realignment itself). It may therefore be the case that the cumulative total of realignment will never reach the level of the calculated excess sum of around £42.5 million, i.e. if at any point it ceases to appear prudent to continue it.

30. A legal opinion has been sought from external legal advisors with specific expertise in this area. They confirmed that the proposals outlined in this report fall within the Guidance as issued by the Secretary of State.

Statutory and Policy Implications

- This report has been compiled after consideration of implications in respect of crime and disorder, finance, human resources, human rights, the NHS Constitution (Public Health only), the public sector equality duty, safeguarding of children and vulnerable adults, service users, sustainability and the environment and ways of working and where such implications are material they are described below. Appropriate consultation has been undertaken and advice sought on these issues as required.

RECOMMENDATIONS

1) The Committee is asked to recommend that Full Council approves the revised Minimum Revenue Provision Policy statement for 2016/17.

Nigel Stevenson Service Director – Finance, Procurement and Improvement Division

For any enquiries about this report please contact:
Glen Bicknell - Senior Finance Business Partner, Senior Accountant

Constitutional Comments (HD 08/02/2016)

- The recommendation falls within the terms of reference for Finance and Property Committee

Financial Comments (GB 29/12/2015)

- The financial implications are stated within the report itself.

Background Papers and Published Documents

Except for previously published documents, which will be available elsewhere, the documents listed here will be available for inspection in accordance with Section 100D of the Local Government Act 1972.

- ‘None’

Electoral Division(s) and Member(s) Affected

’All’