Agenda Item No

# The Vale of Glamorgan Council

## Audit Committee: 31st January 2018

## Report of the Head of Finance

## Proposal to Amend to Minimum Revenue Provision 2018/19 Policy

### Purpose of the Report

1. To present to those charged with governance details of the proposed changes to the Minimum Revenue Provision Policy for 2018-19.

### Recommendation

1. That Audit Committee approve the proposed amendment to the Minimum Revenue Provision Policy for 2018/19 for supported borrowing.

### Reasons for the Recommendations

1. To ensure that the members of the Audit Committee, as those charged with governance, approve the proposed amendment to the Minimum Revenue Provision Policy prior to the requirement to approve the full 2018-19 Minimum Revenue Provision Policy by full Council in accordance with statutory deadlines.

#### Background

2. The Council is required by statute to set aside a Minimum Revenue Provision (MRP) to repay debt.
3. MRP is the method that Local Authorities use to charge their revenue accounts over time with the cost of their capital expenditure that was originally funded by debt. Before 2007/08, the method of calculating MRP was specified in legislation, from 2007/08 onwards local authorities have been free to set their own policy on calculating MRP with the sole legislative proviso being that the amount calculated should be one that the Council considers to be ‘prudent’.
4. Welsh Government has issued guidance on what constitutes prudent provision and this requires the Council to approve an annual statement of its policy on calculating MRP.
5. The Council has capital expenditure funded by debt which can be categorised into three distinct groups;

- Housing Revenue Account (HRA) Capital Financing Requirement
- General Fund Unsupported Capital Financing Requirement /Prudential Borrowing

- General Fund Supported Capital Financing Requirement

6. These do not equate to external borrowing for the Council as a significant portion of the current Capital Financing Requirement is funded from Internal Borrowing.

7. **HRA Capital Financing Requirement -** MRP for HRA borrowing is currently calculated using a 2% reducing balance method for existing balances which is set out in regulation. From 1st April 2021 any new debt will need to be accounted for based on either the asset life or depreciation methodology.

8. **General Fund Unsupported Capital Financing Requirement** - The 2017/18 MRP Policy brought before Audit Committee on 20th February 2017 and Full Council on 1st March 2017 recommended that MRP for all unsupported/prudential borrowing is linked to the expected asset life of the scheme for which the capital expenditure is incurred. For instance MRP repayments relating to the funding requirement for 21st Century Schools is calculated as equal instalments over the expected asset life, which in this case is 65 years.

9. **General Fund Supported Borrowing -** The MRP for this type of capital expenditure funded by debt is currently accounted for by charging a contribution at 4% of the reducing balance that is outstanding at the beginning of each financial year. This approach is only permitted for supported borrowing as it is supported by the Government through the Revenue Support Grant (RSG) system. Historically the Council would have received an element of grant linked to the 4% reducing balance method and this therefore resulted in the current approach being used to calculate MRP on the supported element of the CFR.

## Relevant Issues and Options

## MRP Policy Review

10. At a time of increasing pressure on the revenue budget a number of local authorities across the UK have reviewed their MRP Policies to ensure there is a balance of prudent provision and not overprovision. This can help to realise savings in the revenue budget. In Wales reviews have already been carried out by Torfaen, Merthyr Tydfil , Conwy, Denbighshire, Flintshire, Rhondda Cynon Taff, Caerphilly, Newport and Monmouthshire. These Councils have either implemented or have proposals to implement their revised MRP policies.

11. The Council commissioned Arlingclose Ltd to carry out a review of the MRP policy in December 2016. Arlingclose highlighted some alternative approaches that the Council could adopt linking the supported CFR with the average remaining asset lives of its assets the capital expenditure for which could be linked to the Supported Borrowing CFR.

12. This approach is included as a method that WG outline as prudent in WG guidance. The Auditor General for Wales (AGW) stated that;

    *The MRP should be set at a level reasonably commensurate with the expected life of the asset or reasonably commensurate with the period implicit in the determination of Revenue Support Grant (RSG).*

    *Where an authority wishes to charge its MRP for supported borrowing at an amount lower than 4% reducing balance, they would expect the authority to demonstrate that:*

    *The lower charge more accurately reflects the lives of assets employed by the authority.*

## Methodology

13. The Council is legally obliged to have regard to the guidance which is intended to enable a more flexible approach to assessing the amount of annual provision than was required under the previous statutory requirements. The guidance offers four main options under which MRP could be made, with an overriding recommendation that the Council make prudent provision to redeem its debt liability over a period which is reasonable commensurate with that over which the capital expenditure is estimated to provide .

14. Taking into account the guidance that the Council must adhere to the Arlingclose review outlined three broad options for the Council;

- Capital Financing Method at a 4% reducing balance (currently used and only permitted for supported borrowing)
- The Equal Instalment Asset Life Method
- The Annuity Asset Life Method

## Options for the Calculation of MRP

15. **Capital Financing Method at a 4% reducing balance -** This is the approach currently adopted by the Council. Based on this approach the current charge for 2017/18 will be £4.314m and the projected charge for 2018/19 will be £4.275m. It is important to note that when using the reducing balance approach, whilst the vast proportion of repayment will take place over the first 25 years, a loan of £2m would take 147 years to clear to less than £5k and significantly longer to clear completely. At the end of the 40 year asset life 20% of the balance would still be outstanding.

16. **The Straight Line Asset Life Method -** Under this approach the MRP charge on the supported borrowing CFR would be applied in equal instalments across the 40 year period that Council Tax Payers would expect to see some benefit from the asset. The 2018/19 MRP charge using this approach would be £2.672m as outlined in Appendix 1 enabling a saving of up to £1.603m to be realised on a continuing basis as a result of adopting this approach.

17. **The Annuity Asset Life Method -** This is the cheapest MRP option early on in the life of the asset, the approach takes into account the time value of money whereby paying £100 in 10 years' time is less of a burden that paying £100 now. The schedule of charges produced by the annuity method provides a fairer charge than equal instalments as it takes into account the real value of the amounts when they fall due. However as this approach results in a lower charge in earlier years and a higher charge in later years this approach is problematic from a budgetary point of view as additional budget would need to be identified in later years. The 2018/19 MRP charge using this approach would be £1.424m as outlined in Appendix 1 enabling a saving of up to £2.851m to be realised in 2018-19 as a result of adopting this approach however additional budget would need to be identified to fund increased MRP repayments over the life of the asset.

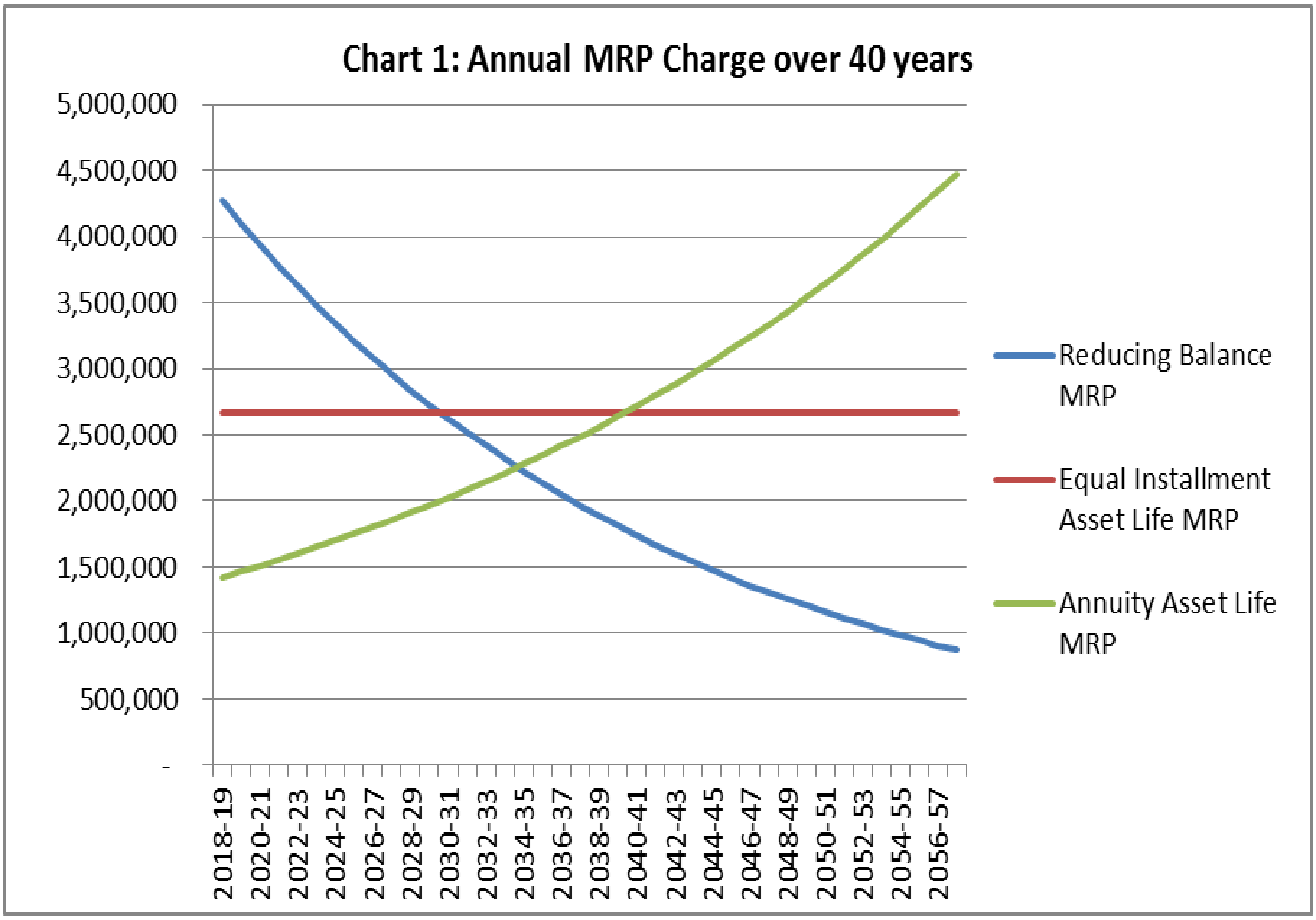
## Capital Financing Requirement

18. MRP is intrinsically linked to the concept of the capital financing requirement (CFR) in the Prudential Code. The CFR represents the total of all the Council's past capital expenditure, less the total capital financing applied other than debt. Debt is only a temporary form of finance as loans must be repaid. The CFR therefore represents the Council's underlying need to borrow for capital purposes, and the amount that

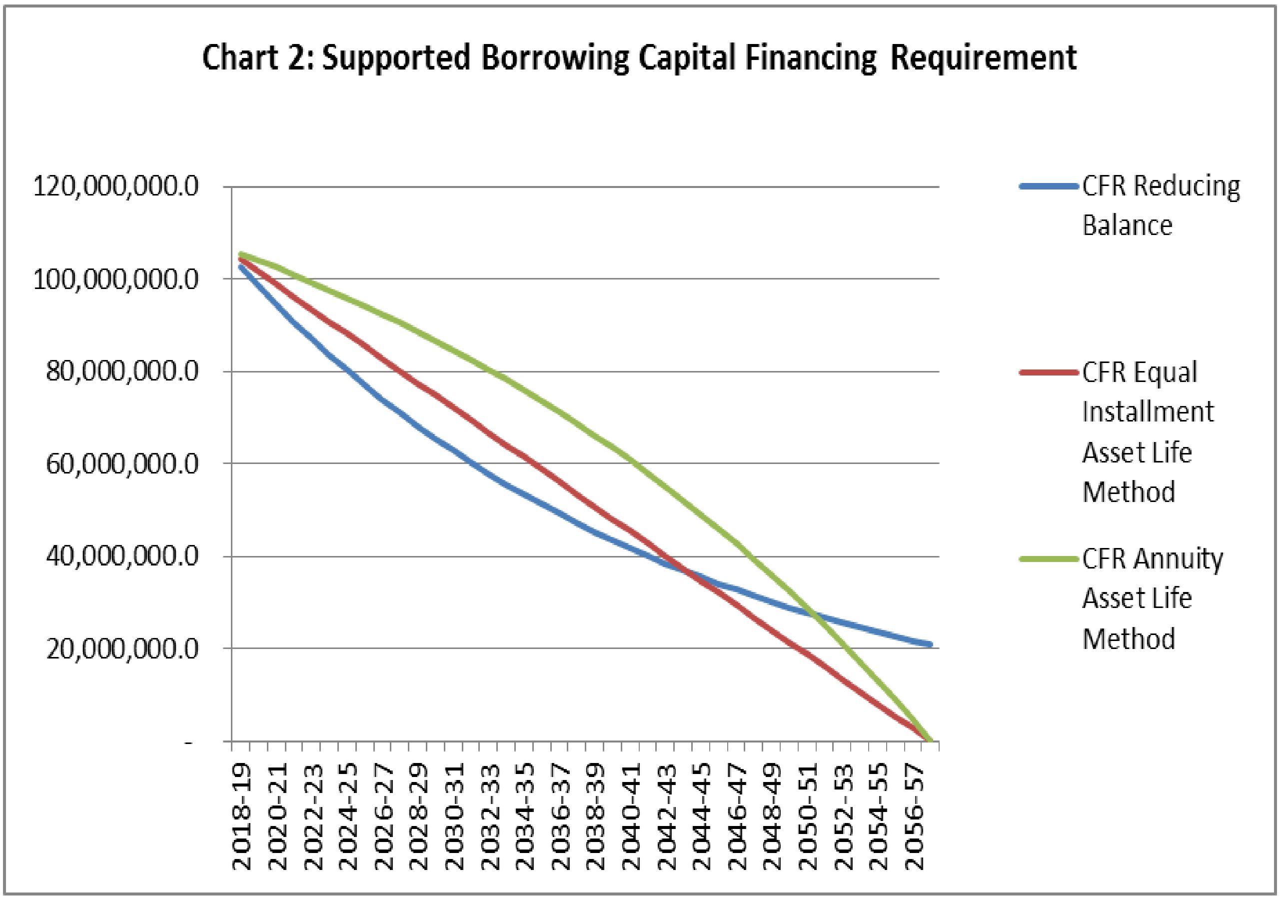
has yet to be permanently financed. MRP is the main method of permanently financing that expenditure.

19. The supported CFR at 31st March 2017 is £106,886,629, using the current reducing balance approach only 80% of the debt will be repaid at 31st March 2058 as illustrated in Appendix 1. Under the Asset Life approaches shown at Options 2 and 3 the outstanding CFR will be fully repaid at 31st March 2058 which is when the projected useful economic lives of the Council' s building assets will have expired. The annuity repayment have been illustrated using an interest rate of 2.98% which is the average 40 year annuity PWLB rate (with certainty rate discount applied) at 30th September for the past five years.

20. The estimated repayments for our supported borrowing CFR using the three approaches are set out in full in Appendix 1 and is illustrated graphically below;




21. The graph above shows that the 4% reducing balance method and the 40 year straight line method both start with the larger repayments. By year 17 the annuity repayments have risen above the reducing balance repayments and in year 23 the annuity repayments have risen above the equal instalment sum. The Council is concerned that whilst the annuity approach reflects the real cost to the taxpayer over time this approach, although it generates significant savings at the commencement, requires significant budgetary pressures as the annuity repayments rise over the life of the asset.




22. Another drawback of the reducing balance method is shown in chart 2, which demonstrates the cumulative impact of MRP on reducing the CFR. After 40 years when the assets financed have reached the end of its useful life and is no longer providing any benefit to the Council only 80% of the capital expenditure funded by borrowing will have been repaid. Taxpayers in future years will be required to fund the remaining £21m on these assets that are no longer in use.

## Wellbeing of Future Generations

23. The general purpose of borrowing is to spread the cost of building our assets over a number of years, thereby making such expenditure affordable. By financing such expenditure by loan rather than from the revenue budget it has the effect of spreading these costs over the useful economic life of the asset, whilst it is used to deliver services to the council taxpayer. This spreading avoids front loading costs for service potential onto current taxpayers, where current taxpayers pay for creating assets that deliver services for many years in the future. The changed policy seeks to more equitably align the repayment of debt to the assessed lives of the Council's assets.

## Investment Income

24. If the revenue savings generated by lower MRP are taken rather than being banked in reserves, then cash balances will fall by an equal sum. This will lead to reduced investment income although with short term interest rates forecast to remain low this would be a very small effect. A £1.6m reduction in MRP at an average interest rate of 0.3% would equate to lost investment income of approximately £4,800 per annum.

## Impact and Opportunity for Review

25. The impact of the revised policy will be kept under review and the MRP policy can be changed at any time by full Council decision. As the MRP policy has to be approved by Council each year there will be an opportunity to revisit any decision at least annually however consideration will need to be taken of the budget savings that are being made as a result of the change.

## Resource Implications (Financial and Employment)

26. The application of an equal instalment method over the average asset life (40 years) to the Councils Supported Borrowing CFR is the Section 151 Officers preferred methodology for the Council as it is fully consistent with the statutory duty to make prudent revenue provision for the redemption of debt. Whilst this will lead to a higher CFR profile initially than the existing approach it ensures that the capital expenditure financed by borrowing is repaid within the expected asset life rather than extending beyond it.

27. The Initial Revenue Proposals were reported to Council on 20th November 2017 and included a saving of £1.5M which is contingent on an amended MRP policy being adopted for 2018/19 that utilises the equal instalment methodology for the calculation of MRP. This approach is projected to generate a saving of £1.603m against existing estimated MRP charges, the additional revenue saving could be used to fund further savings and further protect front line services.

## Sustainability and Climate Change implications

28. None as a direct consequence of this report.

## Legal Implications (to Include Human Rights Implications)

29. Compliance with the Local Government Act 2003 and CIPFA's Code of Practice for Treasury Management in the Public Services is mandatory.

## Crime and Disorder Implications

30. None as a direct consequence of this report.

## Equal Opportunities Implications (to include Welsh Language issues)

31. None as a direct consequence of this report.

## Corporate/Service Objectives

32. This meets the objective to provide effective Treasury Management. This is linked to the corporate objectives generally in that any savings made can be used to assist other services in meeting their objectives.

## Policy Framework and Budget

33. The proposals in this report are in accordance with the policy framework and budget.

## Consultation (including Ward Member Consultation)

34. The Head of Finance has liaised with Wales Audit Office and the Independent Treasury Management Advisors (Arlingclose Limited).

## Relevant Scrutiny Committee

35. Corporate Performance and Resources

## Background Papers

None

## Contact Officer

Principal Accountant - Resources

## Officers Consulted

Engagement Lead - Wales Audit Office

## Responsible Officer:

Section 151 Officer

Appendix 1

| | Estimated Supported Borrowing | Option 1: Capital Financing Requirement Reducing Balance (Current Approach) | | Option 2: Equal Installment Asset Life Method | | | Option 3:Annuity Asset Life Method | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Balance | MRP Provision | Balance | MRP Provision | Variance to Option 1 | Balance | MRP Provision | Variance to Option 1 |
| CFR | 31/03/2018 | 106,886,629.0 | | 106,886,629 | | | 106,886,629 | | |
| 2018-19 | Year 1 | 102,611,163.8 | 4,275,465 | 104,214,463 | 2,672,166 | - 1,603,299 | 105,462,619 | 1,424,010 | -2,851,455 |
| 2019-20 | Year 2 | 98,506,717.3 | 4,104,447 | 101,542,297 | 2,672,166 | - 1,432,281 | 103,996,174 | 1,466,445 | -2,638,001 |
| 2020-21 | Year 3 | 94,566,448.6 | 3,940,269 | 98,870,131 | 2,672,166 | - 1,268,103 | 102,486,028 | 1,510,146 | -2,430,123 |
| 2021-22 | Year 4 | 90,783,790.7 | 3,782,658 | 96,197,965 | 2,672,166 | - 1,110,492 | 100,930,880 | 1,555,148 | -2,227,510 |
| 2022-23 | Year 5 | 87,152,439.0 | 3,631,352 | 93,525,799 | 2,672,166 | - 959,186 | 99,329,389 | 1,601,491 | -2,029,860 |
| 2023-24 | Year 6 | 83,666,341.5 | 3,486,098 | 90,853,633 | 2,672,166 | - 813,932 | 97,680,173 | 1,649,216 | -1,836,882 |
| 2024-25 | Year 7 | 80,319,687.8 | 3,346,654 | 88,181,467 | 2,672,166 | - 674,488 | 95,981,811 | 1,698,362 | -1,648,291 |
| 2025-26 | Year 8 | 77,106,900.3 | 3,212,788 | 85,509,301 | 2,672,166 | - 540,622 | 94,232,838 | 1,748,974 | -1,463,814 |
| 2026-27 | Year 9 | 74,022,624.3 | 3,084,276 | 82,837,135 | 2,672,166 | - 412,110 | 92,431,745 | 1,801,093 | -1,283,183 |
| 2027-28 | Year 10 | 71,061,719.3 | 2,960,905 | 80,164,969 | 2,672,166 | - 288,739 | 90,576,979 | 1,854,765 | -1,106,139 |
| 2028-29 | Year 11 | 68,219,250.5 | 2,842,469 | 77,492,803 | 2,672,166 | - 170,303 | 88,666,942 | 1,910,038 | -932,431 |
| 2029-30 | Year 12 | 65,490,480.5 | 2,728,770 | 74,820,637 | 2,672,166 | - 56,604 | 86,699,985 | 1,966,957 | -761,813 |
| 2030-31 | Year 13 | 62,870,861.3 | 2,619,619 | 72,148,471 | 2,672,166 | 52,547 | 84,674,413 | 2,025,572 | -594,047 |
| 2031-32 | Year 14 | 60,356,026.8 | 2,514,834 | 69,476,305 | 2,672,166 | 157,332 | 82,588,479 | 2,085,934 | -428,900 |
| 2032-33 | Year 15 | 57,941,785.8 | 2,414,241 | 66,804,139 | 2,672,166 | 257,925 | 80,440,384 | 2,148,095 | -266,146 |
| 2033-34 | Year 16 | 55,624,114.3 | 2,317,671 | 64,131,973 | 2,672,166 | 354,495 | 78,228,276 | 2,212,108 | -105,563 |
| 2034-35 | Year 17 | 53,399,149.8 | 2,224,965 | 61,459,807 | 2,672,166 | 447,201 | 75,950,247 | 2,278,029 | 53,064 |
| 2035-36 | Year 18 | 51,263,183.8 | 2,135,966 | 58,787,641 | 2,672,166 | 536,200 | 73,604,333 | 2,345,914 | 209,948 |
| 2036-37 | Year 19 | 49,212,656.4 | 2,050,527 | 56,115,475 | 2,672,166 | 621,639 | 71,188,511 | 2,415,822 | 365,295 |
| 2037-38 | Year 20 | 47,244,150.2 | 1,968,506 | 53,443,309 | 2,672,166 | 703,660 | 68,700,697 | 2,487,814 | 519,308 |
| 2038-39 | Year 21 | 45,354,384.2 | 1,889,766 | 50,771,143 | 2,672,166 | 782,400 | 66,138,746 | 2,561,951 | 672,185 |
| 2039-40 | Year 22 | 43,540,208.8 | 1,814,175 | 48,098,977 | 2,672,166 | 857,991 | 63,500,450 | 2,638,297 | 824,121 |
| 2040-41 | Year 23 | 41,798,600.4 | 1,741,608 | 45,426,811 | 2,672,166 | 930,558 | 60,783,531 | 2,716,918 | 975,310 |
| 2041-42 | Year 24 | 40,126,656.4 | 1,671,944 | 42,754,645 | 2,672,166 | 1,000,222 | 57,985,649 | 2,797,882 | 1,125,938 |
| 2042-43 | Year 25 | 38,521,590.2 | 1,605,066 | 40,082,479 | 2,672,166 | 1,067,100 | 55,104,390 | 2,881,259 | 1,276,193 |
| 2043-44 | Year 26 | 36,980,726.6 | 1,540,864 | 37,410,313 | 2,672,166 | 1,131,302 | 52,137,269 | 2,967,121 | 1,426,257 |
| 2044-45 | Year 27 | 35,501,497.5 | 1,479,229 | 34,738,147 | 2,672,166 | 1,192,937 | 49,081,729 | 3,055,541 | 1,576,312 |
| 2045-46 | Year 28 | 34,081,437.6 | 1,420,060 | 32,065,981 | 2,672,166 | 1,252,106 | 45,935,133 | 3,146,596 | 1,726,536 |
| 2046-47 | Year 29 | 32,718,180.1 | 1,363,258 | 29,393,815 | 2,672,166 | 1,308,908 | 42,694,768 | 3,240,365 | 1,877,107 |
| 2047-48 | Year 30 | 31,409,452.9 | 1,308,727 | 26,721,649 | 2,672,166 | 1,363,439 | 39,357,841 | 3,336,927 | 2,028,200 |
| 2048-49 | Year 31 | 30,153,074.8 | 1,256,378 | 24,049,483 | 2,672,166 | 1,415,788 | 35,921,473 | 3,436,368 | 2,179,990 |
| 2049-50 | Year 32 | 28,946,951.8 | 1,206,123 | 21,377,317 | 2,672,166 | 1,466,043 | 32,382,701 | 3,538,772 | 2,332,649 |
| 2050-51 | Year 33 | 27,789,073.7 | 1,157,878 | 18,705,151 | 2,672,166 | 1,514,288 | 28,738,474 | 3,644,227 | 2,486,349 |
| 2051-52 | Year 34 | 26,677,510.8 | 1,111,563 | 16,032,985 | 2,672,166 | 1,560,603 | 24,985,649 | 3,752,825 | 2,641,262 |
| 2052-53 | Year 35 | 25,610,410.3 | 1,067,100 | 13,360,819 | 2,672,166 | 1,605,066 | 21,120,990 | 3,864,659 | 2,797,559 |
| 2053-54 | Year 36 | 24,585,993.9 | 1,024,416 | 10,688,653 | 2,672,166 | 1,647,750 | 17,141,164 | 3,979,826 | 2,955,410 |
| 2054-55 | Year 37 | 23,602,554.2 | 983,440 | 8,016,487 | 2,672,166 | 1,688,726 | 13,042,739 | 4,098,425 | 3,114,985 |
| 2055-56 | Year 38 | 22,658,452.0 | 944,102 | 5,344,321 | 2,672,166 | 1,728,064 | 8,822,182 | 4,220,558 | 3,276,456 |
| 2056-57 | Year 39 | 21,752,113.9 | 906,338 | 2,672,155 | 2,672,166 | 1,765,828 | 4,475,851 | 4,346,330 | 3,439,992 |
| 2057-58 | Year 40 | 20,882,029.4 | 870,085 | - | 2,672,155 | 1,802,070 | - 0 | 4,475,851 | 3,605,767 |
| Total Repaid | | 80% | 86,004,600 | 100% | 106,886,629 | | 100% | 106,886,629 | |
| Balance Remaining | | 20% | 20,882,029 | 0% | - | | 0% | - | |