Appendix 3

MINIMUM REVENUE PROVISION STRATEGY – 2012/2013

1. Background

Local Authorities have a statutory requirement to set aside each year part of their revenues as a provision for the repayment of debt, called the Minimum Revenue Provision (MRP). The provision is in respect of capital expenditure incurred in previous years and financed by borrowing.

Previously the Authority was required to follow a prescriptive MRP calculation as set out in former regulations 27, 28 and 29 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [SI 2003/3146, as amended]. This system was revised by the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 [SI 2008/414].

As part of those regulations the DCLG issued guidance recommending local authorities to prepare an annual statement of its strategic policy on making MRP, to be approved by the full Authority. The guidance provides for each authority to determine its own MRP within the given framework and also requires that the amount of MRP charged is a prudent amount.

The broad aim of a prudent amount is to ensure that the debt is repaid over a period that is either reasonably commensurate with the period over which the capital expenditure provides benefit, or, in the case of borrowing supported by formula grant, reasonably commensurate with the period implicit in the determination of that grant.

2. Strategic Options

The Authority is free to determine its own method for calculating a prudent provision, but the guidance includes four options for calculating MRP. The Authority can choose from or use a combination of the available options. The options are as follows:

Option 1 – Regulatory Method

This provides for local authorities to continue to calculate MRP in line with the minimum existing statutory charge of 4% of outstanding debt related to supported borrowing only, less an adjustment that ensures consistency with previous capital regulatory regimes no longer in force. This option is available for all capital expenditure incurred prior to 1 April 2008.

Option 2 – Capital Financing Requirement Method

This is very similar to the regulatory method but it does not take account of the adjustment that ensures authorities do not pay more MRP than under the previous capital regulatory regimes. For most authorities this method may not be appropriate as it would result in a higher level of provision than option 1.

Option 3 – Asset Life Method

This method is appropriate for calculating MRP in relation to debt incurred as unsupported borrowing (also known as prudential borrowing), and must be used for revenue expenditure capitalised by direction or regulation (such as that for equal pay). Under this option there are two methods available:

(i) **Equal instalment method.** This generates a series of equal annual amounts over the life of each asset that is financed by borrowing, with the life determined upon acquisition. This means that the charge to revenue closely matches the period of economic benefit of the asset.

(ii) **Annuity method**. This method links the MRP to the flow of benefits from an asset where the benefit is expected to increase in later years.

Under this option authorities should consider the type of assets that they finance through prudential borrowing, as the type of asset may have a significant impact on the level of MRP and the method used to calculate the MRP.

Finance Leases and PFI
The guidance indicates that for finance leases and on balance sheet PFI contracts, the MRP requirement is met by making a charge equal to the element of the finance lease rental that goes to write down the balance sheet liability under proper accounting practices. This is in effect a modified version of the annuity method of Option 3.

Option 4 – Depreciation Method

This method is appropriate for calculating MRP in relation to debt incurred as unsupported (prudential) borrowing. Under this method, MRP is equal to the amount of depreciation charged on assets funded from unsupported borrowing. This method may cause volatility in the annual charge for MRP because assets are revalued on a periodic basis, giving rise to significant changes in the amount of depreciation charged. Given this potential adverse impact on future budgets this option is not considered viable.

Use of Capital Receipts

In addition to the four options listed above, the Local Authorities (Capital Finance and Accounting) Regulations 2003 [SI 2003/3146] allow local authorities to use capital receipts to meet "any liability in respect of credit arrangements, other than any liability which, in accordance with proper practices, must be charged to a revenue account".

For both finance leases and PFI contracts, proper accounting practices require that the element of the annual rental relating to the repayment of the liability is used to write down that liability on the balance sheet and is not

charged to revenue. It therefore follows that local authorities are permitted to apply capital receipts to fund the principal element of the annual rental of a finance lease or on balance sheet PFI contract.

Strategy Adopted for 2011/12

In order to determine its MRP for 2011/12 and taking into consideration the available options the Authority applied the following strategy:

- For all capital expenditure incurred before 1 April 2008 and for all capital expenditure funded via **supported borrowing**; MRP to be calculated using Option 1 - The Regulatory Method.
- For all capital expenditure incurred after 1 April 2008 financed by **unsupported (prudential) borrowing**; MRP to be calculated using Option 3 – The Asset Life Method.
- For credit arrangements such as **on balance sheet leasing arrangements (finance leases)**; MRP charge to be equal to the principal element of the annual rental.
- For **on balance sheet PFI contracts**; capital receipts to be applied to fund the principal element of the annual rental.

Recommended Strategy for 2012/13 and future years

It is recommended that for 2012/13 the Authority adopt the same strategy for calculating MRP as that used for 2011/12, with the exception of PFI contracts, where the MRP charge will be equal to the principal element of the annual rental, rather than applying capital receipts.

By adopting the recommendations above the MRP charge for 2012/13 would be £3.055m, consisting of £1.279m for prudential borrowing schemes incurred after 1st April 2008, £1.776m for all other capital schemes. This amount has been included within the budget estimate for 2012/13.

Until the final cost model for the Merseyside Fire station scheme has been finalised, awaiting final construction build, no MRP has been determined, however as this is in effect a notional charge and in essence “funded from the PFI grant, it does not impact on the Authority’s “bottom line”. Once the construction phase has been completed the MRP calculation will be adjusted for this notional amount.

Should any variation to borrowing amounts occur then this may require a further MRP determination. Members will be asked to approve such changes at the appropriate times.

Subject to affordability considerations the Authority may make additional MRP payments to reduce future interest and MRP provisions.