## 5.2 Appendix 6

# Minimum Revenue Provision (MRP) for Debt Repayment

# Supported Borrowing November 2016

**Annexe B of this report is not for publication as it contains exempt information of the description in paragraphs 14 and 21 of Schedule 12A of the Local Government Act 1972.**

## Reasons for this Report

The purpose of this report is to appraise Audit Committee of the Council's approach to the Minimum Revenue Provision (MRP) policy recommended by the Council's S151 Officer for Council approval as part of the Budget Proposals Report 2017/18.

For the Housing Revenue Account (HRA) and all other unsupported borrowing, the Council's approach continues to be based on Welsh Government (WG) guidance, primarily in relation to consideration of useful life of expenditure. This is deemed appropriate and not part of any proposed change in the MRP policy.

The scope of the remainder of this report focusses only the proposed Council approach to MRP for supported borrowing in the Council Fund.

## Key Definitions to aid understanding

What is supported borrowing?

Supported borrowing is expenditure for which the Welsh Government Contributes towards the Council's interest and provision for debt repayment costs through the annual Revenue Support Grant (RSG). This element of RSG is determined by WG on a formula basis and the amount provided by WG can be traced back to detailed spreadsheets provided by WG on request as part of the settlement.

What is unsupported borrowing?

Borrowing where associated interest and debt repayment costs must be met from Council Tax, the need to make savings, additional income generation or sale of capital assets.

What is the Capital Financing Requirement (CFR)?

Where Capital Expenditure is incurred and there is no cash resource to pay for it immediately, via capital receipts, grants or other contributions, this will increase the Council's CFR. It represents Capital expenditure historically incurred but not yet paid for. This ultimately results in the requirement to undertake external borrowing i.e the need to borrow. The Council will have a Capital Financing Requirement at 01.04.2017 of £270.5million in relation to Council Fund supported borrowing which has been accumulated over many years.

What is Minimum Revenue Provision (MRP)?

The Council has a Statutory Duty to set aside each year from its annual revenue budget an amount ‘which it considers to be prudent’ towards the eventual repayment of the CFR / Borrowing (Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003. This is known as the Minimum Revenue Provision and it is the method of spreading the cost of capital expenditure funded by borrowing.

Similar to decisions to undertake capital expenditure funded by borrowing, decisions in respect of the allocation of MRP have short, medium and very long term impacts. Impacts of changes in policy decisions should be considered over that time horizon including consideration of the Wellbeing and Future Generations Act 2015.

The Council approves a MRP policy as part of the budget at the start of each year.

**Effectively MRP is the method of spreading the cost of Capital expenditure incurred to be paid for borrowing s been funded by Supported Borrowing both historically and in the future.**

The Well-being of Future Generations (Wales) Act 2015’ (the Act)
In complying with the Act a local authority must ensure that its decisions are sustainable, whereby “the needs of the present are met without compromising the ability of future generations to meet their own needs”, and recognise “the importance of balancing short term needs with the need to safeguard the ability to meet long term needs”.

## Regulatory Requirements in Respect of MRP

The responsibility for determining what is prudent is entirely a matter for the authority on the advice of the Council’s S151 Officer. It is not the role of the Welsh Government or the external auditor to determine in cases whether any proposed arrangement is prudent.

The external auditor does have a responsibility however to consider whether or not an authority has complied with its statutory duty in their approach to setting MRP.

Setting and making changes to MRP Policy

Statute requires full Council to approve a MRP policy and any changes to it in advance of each financial year and this is currently done as part of the Budget Proposals Report each year on the advice of the S151 Officer. Consideration should be given to highlighting significant changes in MRP policy to those charged with governance and scrutiny.

Key aim of MRP

The broad aim of a 'prudent provision' is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits to service delivery or in the case of borrowing supported by the Welsh Assembly, reasonably commensurate with the period implicit in the determination of Revenue Support Grant.

WG Guidance on MRP

Legislation does not define what constitutes a 'prudent provision'. Instead WG has provided guidance issued in 2008 and examples to interpret that term. The Guidance is included as Annexe A. The examples in the guidance are based primarily on use of either :-

- the allocations included in any Central Government grant or
- the useful life of the expenditure that is created that is ultimately to be paid for by borrowing

Whilst authorities must have statutory regard to that guidance, WG state that other approaches should not be ruled out if they are deemed prudent and individually designed for each local authority circumstance.

Prudential Code for Capital Finance in Local Authorities

Setting a 'Prudent Provision' is part of the wider obligation the Council has in respect of the requirements of the Prudential Code for Capital Finance in Local authorities to ensure its capital plans and linked treasury management activities are prudent, affordable and sustainable in the short, medium and long term.

## Cardiff Council's previous reviews / approach to MRP

The Council has historically either exceeded or matched the MRP expected to be provided by WG as part of their revenue budget settlement to Cardiff.

Prior to 2016/17

Where affordability has allowed, the Council has since 2004 taken a prudent approach to repayment of supported borrowing. This has been as a result of: -

- Increased use of unsupported borrowing to pay for capital expenditure commitments approved by the Council to balance the capital programme, representing an enhanced risk to future affordability.
- Concern over the useful life over which expenditure funded by supported borrowing would continue to provide benefits.

The initial aim was to ensure supported borrowing was provided for over a twenty-five-year straight line basis. In 2013/14 a review of the approach to MRP was undertaken by Council officers, supported by an independent review by the Council's Treasury Management advisors. In recognition of the difficult budgetary position faced by the Council at the time, most of the benefit accumulated in the revenue base budget for MRP was released as revenue savings to support the budget process. A small element of prudence was retained by providing for supported borrowing on a 4.5% reducing balance compared to the 4% reducing balance basis implicit in the determination of Revenue Support Grant from the Welsh Assembly Government towards MRP.

2016/17 Review of supported Borrowing MRP

Following a further review in 2016/17 the medium term financial plan assumed that in 2017/18, the MRP on supported borrowing would reduce to match that assumed by WG i.e. be consistent with the period implicit in the determination of Revenue Support Grant from the Welsh Assembly Government towards MRP. This would be in accordance with WG Guidance on MRP at 4% on a reducing balance basis.

## Different approaches recently being taken by Local authorities to MRP on Supported Borrowing

A number of authorities in England and Wales have amended their policies relating to supported borrowing away from the 4% reducing balance to levels which are considered to reflect average asset useful economic life of 33, 40 & for some even 50 years. They have also chosen to change the basis from reducing balance to straight line.

The reducing balance approach allocates a higher charge to earlier years and a lower charge to latter years. The rational for this formulaic approach is that in the years when expenditure is first incurred, this period is when most of the benefits are used and in addition it is the time when maintenance costs are minimal. It is only in latter years when revenue maintenance costs would be higher thus coinciding with a lower revenue provision for debt repayment.

A straight line approach to MRP would charge the same amount p.a. of MRP across a time period to be determined to ensure the full amount of debt outstanding is repaid in full. The straight line approach assumes that all users benefit equally from use of the assets over the period.

Confidential Annexe B highlights data gathered by WG as part of their review of different approaches being undertaken in Wales.

## Factors considered in developing a recommendation

Every authority's circumstances may be different and may result in different approaches to MRP. However, it is important that a range of factors specific to local authority circumstances are considered in determining a prudent approach.

The factors below were considered to support the approach. Whilst there are some indicators of strengthening the existing approach which would have a greater cost to the annual revenue budget, there were no indications of a weakening of the current approach i.e. charging less MRP in the short term.

| Issues to consider | Indicator of **Retaining** existing policy of 4% Reducing Balance | Indicator of **Strengthening** existing policy | Indicator of **Weakening** existing policy |
|---|---|---|---|
| | X | X | X |
| Consider what annual sums we have spent our supported borrowing on historically and propose to do in future years. Disabled adaptations, renovation grants, property asset renewal, highways resurfacing & minor works, parks playgrounds, ICT, Vehicles etc. How long will these continue to provide benefits to the Council, without further capital expenditure? Note some expenditure does not create an asset of the Council. Some of what we spend may have a useful life of less than 10 years. | | X<br>Given what we have spent our funding on and propose to do, the existing approach does not cover extending life of any provision or passing greater costs to the future does not seem appropriate | |
| Do we have processes and budgets in place to maintain our key property and highway infrastructure to a standard that preserves their useful life to ensure continued service delivery? i.e. we are making significant headway in reducing the backlog of maintenance. | X<br>Current budgets are under significant strain to meet existing backlogs of maintenance. | | |
| Should any revenue provision for MRP be consistent per annum on the assumption that the expenditure paid for by supported borrowing provides equal benefit to users and Council tax payers across a number of years? | X<br>Most realistic scenario is costs in future will rise due to lack of maintenance. Risk that assets used and created today are more likely to result in additional costs in future | | |
| Are we content that after allowing for inflation costs and time value of money, that the balance remaining after a significant period of time using the reducing balance approach is not financially material or would we prefer the balance remaining to be nil? | X<br>Yes, demonstrated by NPV analysis. WG would cover in settlement in any case. Inflation and time value of money makes any balance financially immaterial. Options considered to make one off contributions to reduce | | |

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| | any such balance where affordability allows | | |
| Are the original reasons for adopting a more prudent approach to MRP still a concern e.g. current level of unsupported borrowing? | | **X**<br>Given we were aiming to maintain a buffer should ITS schemes not perform, then yes, concerns still remain. Lost most of previous buffer. | |
| Professional judgement of the S151 officer and senior finance management team | **X**<br>This is deemed to be the option to sustain in the long term, making additional Voluntary Debt Repayment where opportunities allow in future years | | |
| Having a higher level of MRP creates more scope to undertake and make further investment sustainable and affordable in the long term. Do we have future pressures in Capital programme that need to be funded that are likely to increase the level of unsupported borrowing required? | **X**<br>City Deal<br>Band B schools match funding<br>Maintaining existing assets<br>Allowing scope for members to undertake additional investment to improve service delivery. | | |
| Given WG has issued guidance indicating 4% minimum, whilst other approaches are deemed feasible, do we want to be charging less than the example indicated in guidance? | | **X**<br>Based on our areas of expenditure, we would like to charge more. However minimum but not less. - What WG provide us in RSG is all we can now afford. | |
| WG currently calculate and allocate the Capital Financing element of the SSA based on 4% reducing balance. Is the approach reasonably commensurate with the period implicit in the determination of that grant? What are the implications of not matching? | **X**<br>Yes, the approach proposed would be consistent with WG MRP policy. | | |

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| Do we recognise that WG could also in future change the distribution of RSG to reflect changes in authority needs? Accordingly any change by the Council could be a short term measure, requiring a future budget adjustment. | **X**<br>Could provide a short term benefit, but may simply delay finding savings should WG change its approach. | | |
| Does the MRP Policy allocate the CFR to the Council fund over a prudent period? Will future tax payers be funding the cost of assets / expenditure incurred some years ago long after they have been scrapped? | **X**<br>Whilst not hypothecated the Council's approach to MRP would be in accordance with amounts included in the annual WG Settlement and WG guidance. | | |
| Any decision on MRP policy is one that impacts over a thirty, 40 or 50-year period. Does the Council have certainty re future financial position of local authorities to allow such a decision to be made? | **X**<br>An approach inconsistent and lower to that included in WG formula for RSG is a risk | | |
| The Council has provided additional MRP in previous years recognising the risk of additional unsupported borrowing being undertaken e.g. for invest to save schemes. Has this risk diminished? | | **X**<br>Risks still remain, which would necessitate a more prudent approach, but need to balance with affordability | |
| Maintaining a prudent level of MRP increases financial resilience towards meeting unknown cost pressures in both Capital and revenue budgets. Are General and earmarked reserves an alternative option to meet such pressures? | | **X**<br>Benchmarking shows that the Council has one of the lowest levels of earmarked reserves as % of revenue budget | |
| Balancing short-term needs with the need to safeguard the ability to also meet long-term needs Does the approach ensure no adverse impact on affordability for future generations? | | **X**<br>Given the expenditure we fund using supported borrowing then we would like to charge more. However have to balance charge with affordability and WG requirements. | |

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| Is the approach consistent with the prudential code requirements to ensure Capital expenditure is prudent, affordable and sustainable? | **X**<br>Any reduction in MRP will mean the CFR will fall more slowly than planned, thus resulting in additional borrowing interest costs. Weakens Treasury Management Strategy | | |
| Is this part of a well thought out capital financing strategy or a knee jerk reaction to financial pressures? (Grant Thornton advice for members scrutinising MRP) | **X**<br>Moving to an extreme would be considered a knee jerk reaction unless it can be demonstrated previous concerns are not relevant. | | |

## Recent Regulatory comments on different approaches to MRP on Supported Borrowing

<u>Auditor General Wales</u>
The Auditor General for Wales (AGW) wrote to all local authorities in January 2016, and advised that where an amendment to current MRP policy is being considered, a local authority should take account of 'The Well-being of Future Generations (Wales) Act 2015' (the Act).

In complying with the Act a local authority must ensure that its decisions are sustainable, whereby "the needs of the present are met without compromising the ability of future generations to meet their own needs", and recognise "the importance of balancing short term needs with the need to safeguard the ability to meet long term needs".

<u>National Audit Office report for Department for Communities and Local Government</u>

The NAO undertook a report in England in June 2016 in relation to 'Financial Sustainability of Local Authorities – Capital Expenditure and Resourcing'. Whilst this covered a number of areas, it commented on different approaches to MRP currently being considered and made the following comments and recommendations: -

- Increases in debt servicing costs means further borrowing by some authorities may not be affordable calling into question capacity to invest and maintain their core assets
- The report advises the DCLG to give capital a greater focus in the next spending review, although it understands why revenue has been a priority
- CIPFA should consider the long term implications of decision making in its planned review of the prudential code.
- Authorities need to strike an appropriate balance between short term and long term considerations. 'A variety of decisions by authorities, including changing minimum revenue provision charges and reducing long term maintenance spending have prioritised the short term over the long term in their judgement of what is prudent'. The Report recommends that the DCLG examine the variety of approaches to recalculating MRP currently used by Local Authorities and consider whether it needs to review its existing guidance to the sector.

<u>Welsh Government</u>

The Authority's underlying duty for MRP is to make prudent provision and ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits or the period implicit in the determination of the RSG.

## The Council's Recommended approach to MRP on its Supported Borrowing

The Council has considered for many years' different approaches to MRP, so the analysis above and that considered by other Local authorities is not new. Whilst there may be short term savings arising from a different approach and whilst recognising that there may be some shortcomings with the current approach, the approach recommended in the MRP Policy is to retain MRP on supported borrowing at 4% on a reducing balance basis. i.e. same basis as included in WG Revenue Grant Support per annum. Where affordability allows, additional Voluntary Debt repayment from revenue should be considered.

This approach is to continue unless WG change the approach to providing support as part of the RSG formula or any revision to MRP Guidance either in Wales or in England

Whilst there is significant pressure to adopt an alternative approach that results in "pain free" short term savings, such decisions on MRP have long term implications and have to be based on localised professional judgement including consideration of the factors above.

The recommended approach has the clear support of the S151 officer in continuing to make tough decisions now which: -

- do not weaken the financial resilience of the Council as a result of future uncertain events
- need to be prioritised and afforded now and in the future and
- also minimises risk of significant costs being passed on to future generations given the periods of time involved.

The overall MRP policy proposed to be submitted for Council approval as part of the February 2017 budget proposals report is included at Annexe C

## Annexes

Annexe A – Options for prudent provision – Extract from WG Guidance (First Issued 2008)

Annexe B – (Confidential) WG data on Welsh Local Authority approaches to Supported Borrowing

Annexe C - Prudent Repayment of Capital Expenditure – Annual Minimum Revenue Provision (MRP) Policy Statement 2017/18