Annual MRP Statement

Background:

1. For many years local authorities were required by Statute and associated Statutory Instruments to charge to the Revenue Account an annual provision for the repayment of debt associated with expenditure incurred on capital assets. This charge to the Revenue Account was referred to as the Minimum Revenue Provision (MRP). In practice MRP represents the financing of capital expenditure from the Revenue Account that was initially funded by borrowing.

2. In February 2008 the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 [Statutory Instrument 2008/414] were approved by Parliament and became effective on 31st March 2008. These regulations replaced the formula based method for calculating MRP which existed under previous regulations under the Local Government Act 2003. The new regulations required a local authority to determine each financial year an amount of MRP which it considers to be prudent. Linked to this new regulation, the Department of Communities and Local Government (CLG) produced Statutory Guidance which local authorities are required to follow, setting out what constitutes a prudent provision.

3. The CLG Guidance recommends that before the start of the financial year, a statement of MRP policy for the forthcoming financial year is approved by Full Council.

4. The broad aim of the Policy is to ensure that MRP is charged over a period that is reasonably commensurate with the period over which the capital expenditure which gave rise to the debt provides benefits. In the case of borrowing supported by Revenue Support Grant, the aim is that MRP is charged over a period reasonably commensurate with the period implicit in the determination of that grant. MRP is not required to be charged to the Housing Revenue Account. Where a local authority's overall CFR is £nil or a negative amount there is no requirement to charge MRP.

5. The move to International Financial Reporting Standards (IFRS) means that Private Finance Initiative (PFI) schemes and Operating Leases may be brought onto the Balance Sheet. Where this is the case, such items are classed in accounting terms as a form of borrowing. CLG has therefore proposed amending the Capital Finance Regulations to ensure that the impact on the Revenue account is neutral, with MRP for these items matching the principal repayment embedded within the PFI or lease agreement.

MRP Options:

6. Four options for prudent MRP provision are set out in the CLG Guidance. Details of each are set out below with a summary set out in Table 1:

Option 1 – Regulatory Method:

7. This method replicates the position that would have existed under the previous regulatory environment. MRP is charged at 4% of the Authority's underlying need to borrow for capital purposes; the Capital Financing Requirement (CFR). The formula includes an item known as "Adjustment A" which was intended to achieve neutrality between the CFR and the former Credit Ceiling which was used to calculate MRP prior to the introduction of the Prudential System on 1st April 2004. The formula also took into account any reductions possible related to commutation of capital related debt undertaken by central government.

8. The General Fund MRP charge using this method is estimated at £0.407m for 2011/12.

Option 2 – CFR Method:

9. This method simplifies the calculation of MRP by basing the charge solely on the authority's CFR but excludes the technical adjustments included in Option 1. The annual MRP charge is set at 4% of the non-housing CFR at the end of the preceding financial year.

10. The General Fund MRP charge for this method is £nil for 2011/12.

Option 3 – Asset Life Method:

11. Under this method MRP is determined by the life of the asset for which the borrowing is undertaken. This can be calculated by either of the following methods:
(a) Equal Instalments: where the principal repayment made is the same in each year, or
(b) Annuity: where the principal repayments increase over the life of the asset.

    The annuity method has the advantage of linking MRP to the benefits arising from capital expenditure, where these benefits are expected to increase over the life of the asset.

12. MRP commences in the financial year following that in which the expenditure is incurred or, in the year following that in which the relevant asset becomes operational. This enables an MRP "holiday" to be taken in relation to assets which take more than one year to be completed before they become operational.

13. The estimated life of the asset will be determined in the year that MRP commences and will not be subsequently revised. However, additional repayments can be made in any year which will reduce the level of payments in subsequent years.

14. If no life can be reasonably attributed to an asset, such as freehold land, the life is taken to be a maximum of 50 years. In the case of freehold land on which a building or other structure is constructed, the life of the land will be treated as equal to that of the structure, where this would exceed 50 years.

15. In instances where central government permits revenue expenditure to be capitalised, the Statutory Guidance sets out the number of years over which the charge to revenue must be made. The maximum useful life for expenditure capitalised by virtue of a direction under s16(2)(b) is 20 years

16. MRP in respect of PFI and Operating Leases brought onto the Balance Sheet under IFRS falls under Option 3.

17. The General Fund MRP charge using this method is estimated at £0.209m for 2011/12.

Option 4 - Depreciation Method:

18. The depreciation method is similar to that under Option 3 but MRP is equal to the depreciation provision required in accordance with proper accounting practices to be charged to the Income and Expenditure account.

19. The General Fund MRP charge for this method is £nil for 2011/12

Conditions of Use:

20. The CLG Guidance puts the following conditions on the use of the four options:

    Options 1 and 2 can be used on all capital expenditure incurred before 1st April 2008 and on Supported Capital Expenditure on or after that date.

Options 3 and 4 are considered prudent options for Unsupported Capital Expenditure on or after 1st April 2008. These options can also be used for Supported Capital Expenditure whenever incurred.

MRP Policy for 2011/12:

21. It is proposed that for 2011/12 the Council adopts Option 1 for Supported Borrowing and Option 3 for Unsupported Borrowing. For Option 3, the annuity method for calculating MRP will be used when applicable as it has the advantage of linking MRP to the benefits arising from capital expenditure, where these benefits are expected to increase over the life of the asset.

Table 1

MRP under the CLG Guidance

<table>
<tr><th>MRP Options</th><th>1
Regulatory Method</th><th>2
CFR Method</th><th>3
Asset Life Method</th><th>4
Depreciation Method</th></tr>
<tr><td rowspan="3">Classifications of Capital Expenditure impacting on the CFR</td><td colspan="2">Capital expenditure incurred before 1 April 2008</td><td colspan="2"></td></tr>
<tr><td colspan="2">Supported Capital expenditure incurred after 1 April 2008</td><td colspan="2">Unsupported Capital expenditure incurred after 1 April 2008</td></tr>
<tr><td colspan="2"></td><td>Expenditure capitalised by virtue of a Direction under s16(2)(b) of the Local Government Act 2003</td><td></td></tr>
<tr><td>MRP Basis</td><td>Former regulations 28 and 29</td><td>4% of Non-Housing CFR</td><td>Equal Annual Instalments of Principal</td><td>Depreciation</td></tr>
<tr><td rowspan="5">Aspects of MRP charges</td><td colspan="2">CFR excludes element attributable to Unsupported Capital Expenditure</td><td>EIP commences when asset operational</td><td>Depreciation MRP commences when asset operational</td></tr>
<tr><td colspan="2" rowspan="4"></td><td>Freehold land 50 years.</td><td>Depreciation MRP ceases when CFR component is £Nil</td></tr>
<tr><td>Freehold land with structure >50 years</td><td>Depreciation MRP not adjusted for capital receipt</td></tr>
<tr><td>Capitalisation periods</td><td>Depreciation MRP based on proportion of asset financed from "borrowing".</td></tr>
<tr><td>PFI/Operating Leases brought on Balance Sheet under IFRS</td><td></td></tr>
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