Mae'r ddogfen yma ar gael yn Gymraeg **Agenda Item No 9**

Report to	**North Wales Fire and Rescue Authority**
Date	**18 December 2017**
Lead Officer	**Ken Finch – Treasurer**
Contact Officer	**Sandra Forrest**
Subject	**Minimum Revenue Provision**

PURPOSE OF REPORT

1 The purpose of this report is to seek approval for a revision to the MRP Policy for 2017/2018, and to agree the MRP Policy for 2018/2019.

EXECUTIVE SUMMARY

2 Following a review of the Fire Authority's current MRP Policy it has been identified that by changing the method for making the MRP a significant saving opportunity would be delivered. The annual saving to the revenue budget has been calculated at £366k. If the revision is approved for 17/18 savings could be achieved against the 17/18 budget, this is detailed in the Provisional Outturn Report which is on the agenda.

3 The change also introduces a more equitable method for apportioning the costs associated with the capital programme.

4 The technical information with regards the change in policy is included in Appendix 1 and Members are requested to consider carefully the information contained within this overall report.

5 Wales Audit Office were apprised of the proposed changes at the end of September 2017. They are unable to provide an opinion at this stage but will do so when the accounts are subject to audit. However, the proposed changes are in line with the changes made by Conwy CBC and other Local Authorities in North Wales whose accounts have been audited following the revision to the policy with no issues highlighted with regards the changes.

RECOMMENDATIONS

6 Members are requested to approve the revisions to the MRP policy for 2017/18 and the MRP policy for 2018/19:

(i) Revisions to the policy for 2017/18 – for capital expenditure incurred before 1 April 2017 and any subsequent expenditure the MRP policy will be to repay the capital expenditure incurred on Land and Buildings using the Asset Life Method-straight line.

Amended from - MRP policy will be to repay 4% of the outstanding balance of capital expenditure incurred on Land and Buildings (excluding Wrexham Fire Station new build).

(ii) MRP policy for 2018/19 - For capital expenditure incurred before 1 April 2018 and any subsequent expenditure the MRP policy will be to repay:-

- the capital expenditure incurred on Land and Buildings using the Asset Life Method-straight line.

- Vehicles, Plant, Equipment and Infrastructure the MRP will be based on the estimated life of the assets.

- the expenditure incurred on the new Wrexham Fire station be re-paid over the life of the lease held with the Wales Ambulance Service Trust (50 years).

IMPLICATIONS

Wellbeing Objectives	The recommendation to change the MRP policy from reducing balance to straight line ensures that the costs are spread more evenly across taxpayers benefiting from the capital expenditure. This is not considered as compromising the ability of future generations to meet their own needs merely that future generations pay for assets from which they benefit.
Budget	Provides a saving which can assist with current and future financial planning.
Legal	No specific legal implications as the Authority is acting in a prudent manner.
Staffing	There is no impact on staffing issues.
Equalities/Human Rights/ Welsh Language	No implications.
Risks	The impacts of a change in MRP policy has long term effects that cannot be readily undone.

APPENDIX 1

1. BACKGROUND TO CAPITAL EXPENDITURE AND FINANCING

1.1 Capital expenditure is generally expenditure on assets which have a life expectancy of more than one year e.g. buildings, infrastructure improvements, vehicles, machinery etc.

Capital expenditure is funded from a combination of capital receipts, revenue contributions, scheme specific grants, and debt in the form of borrowing or other long term financing arrangements such as leasing.

Borrowing can either be:

Supported borrowing - funding is provided by Welsh Government (WG) through the Revenue Support Grant (RSG) to cover the revenue debt financing costs of interest and repayment costs, or

Unsupported borrowing (commonly referred to as prudential borrowing) – Authorities have the freedom to determine the level of borrowing considered affordable in revenue debt financing costs with no support from WG.

For Fire Services in Wales all borrowing is unsupported.

1.2 The annual charge to the revenue account for repaying debt is known as the Minimum Revenue Provision (MRP). The following regulations refer to this charge:-

Local Authorities are required each year, under the Capital Finance and Accounting Wales Amendment Regulations 2008, to set aside some of their revenue resources as provision for the repayment of debt.

Regulation 22 of the 2008 Regulations requires an authority to make an amount of MRP each year which it considers to be “prudent”, although the Regulations themselves do not define “prudent provision”.

Regulation 21(B) of the 2008 Regulations requires local authorities to have regard to guidance issued by Government.

1.3 Welsh Government has issued guidance for the setting of MRP policy. It states that the broad aim of prudent provision is to ensure that the debt is repaid over a period that is reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by WG, reasonably commensurate with the period implicit in the determination of that grant.

The WG guidance provides 4 options for making “prudent provision” outlined below but states in its supporting commentary that:

“The options are those likely to be most relevant for the majority of authorities but other approaches are not meant to be ruled out, provided they are fully consistent with the statutory duty to make prudent revenue provision. Authorities must always have regard to the guidance, but having done so, may in some cases consider that a more individually designed MRP approach is justified.

The decision on what is prudent is for the Authority and it is not for the Welsh Government to say in particular cases whether any proposed arrangement is consistent with the statutory duty."

1.4 In letter to all local authorities the Auditor General for Wales concurred that it is for each authority to determine what a "prudent" policy is.

1.5 Options for Prudent Provision within WG Guidance

1.5.1 Option 1 - Regulatory Method

For capital expenditure funded from supported borrowing which is supported through funding in the RSG, authorities may continue to use the formula specified in the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 (the regulations which preceded the 2008 Regulations). <u>This does not apply to Fire services in Wales.</u>

1.5.2 Option 2 - Capital Financing Requirement (CFR) Method

For capital expenditure funded from supported borrowing which is supported through funding in the RSG, the MRP is calculated as 4% of the Capital Financing Requirement at the 1^{st} of April in a year.

1.5.3 Option 3 - Asset Life Method

MRP is calculated using annual instalments over the estimated life of the asset.

This can be calculated using the "straight line" method or the "annuity" method. To illustrate the difference, as an example an asset which is purchased at a cost of £4m which has an estimated useful life of 50 years:

Straight line method - equal annual MRP charge £4m / 50 years = £80,000.

Annuity or inflation method – annual MRP charge that takes the time value of money in the form of inflation into consideration in respect of the above

Year 1 = £47k
Year 2 = £48k
Year 3 = £49k
Year 4 = £50k
Year 5 = £51k etc.

1.5.4 Option 4 - Depreciation Method

Alternatively, provision is made in accordance with the standard rules for depreciation accounting. The method is similar to option 3 above.

1.5.5 WG guidance requires that either option 3 or 4 be used for all capital expenditure which is to be financed by unsupported borrowing or other long term liabilities. Options 1 and 2 are not permitted for this use unless it can be shown that these methods are more prudent.

Current MRP Policy

1.5.6 The Authority's current MRP policy is as follows:

Capital expenditure funded by unsupported borrowing on the basis of Option 2 – CFR Method - for Land and Buildings only.

Capital expenditure funded by unsupported borrowing on the basis of Option 3 - Asset Life Method – for Vehicles, Plant, Equipment and Infrastructure.

1.5.7 The amount of outstanding capital expenditure which needs to be repaid as at the 31st March 2017 is £33,661,943.

1.6 Review of the Authority's MRP Policy

1.6.1 WG recommend that before the start of the financial year a statement of the policy on making MRP in that financial year be approved. Each year the policy is reviewed and this year given the current financial position consideration was given as to whether savings could be made on MRP whilst still complying with regulation.

1.6.2 A review of the policy was undertaken by Conwy CBC officers who looked at revising the policy along the same lines as have been made at other Authorities in Wales.

1.6.4 The current policy for unsupported borrowing for short life assets was reviewed and it was considered that the current Asset Life Method was appropriate and provided the most prudent approach so this will remain unchanged.

For unsupported borrowing on Land and Buildings a comparison of the options available was undertaken and included:

4% reducing balance (option 2),
straight line – equal repayment (option 3), and
annuity / inflationary method (option 3),

1.6.6 4% Reducing Balance Method

The method implies that borrowing will be repaid over a 25 year period (in that 100% / 4% = 25), however as the calculation applies the 4% to the reducing balance it takes much more than 25 years to fully repay the borrowing.

The graph and Table 2 below shows the MRP repayment profile of the £17m capital expenditure on Land and Buildings outstanding as at 31 March 2017:

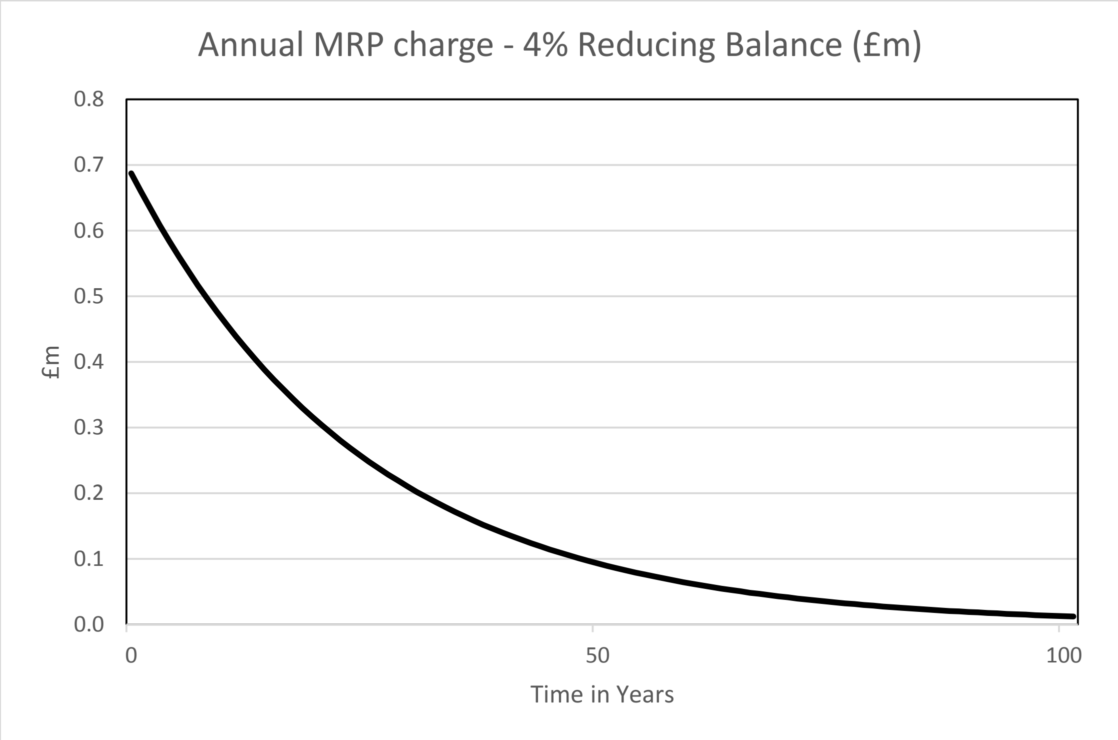


Table 1 below provides information relating to the first five years of the full analysis used in the graph above.

TABLE 1

Year	Annual MRP £m	Outstanding Capital Expenditure £m
2016/17	0.688	17.189
2017/18	0.660	16.501
2018/19	0.634	15.842
2019/20	0.608	15.208
2020/21	0.584	14.600

In 50 years' time £2.3m of capital expenditure will still be outstanding, and in 100 years' time £302k will be outstanding. It would take 174 years before the balance is below £20k. This supports the view that this method is not the most prudent option to take.

1.6.7 Straight Line Method

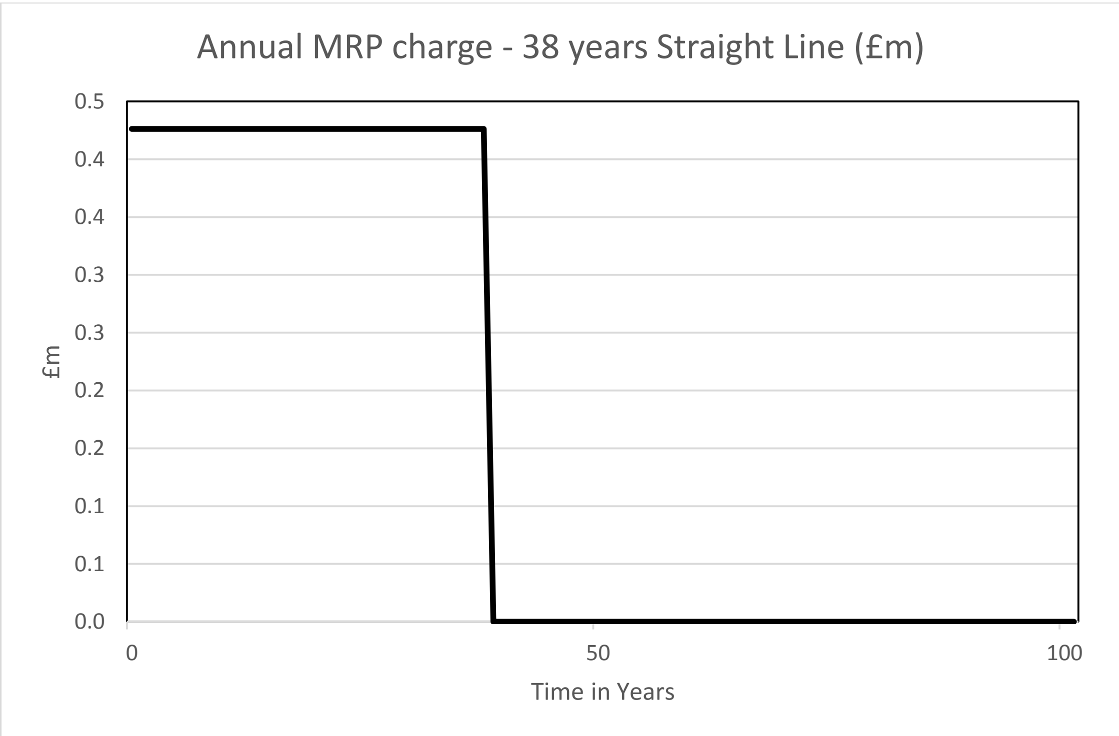
The method calculates an equal annual MRP charge to the revenue account over the useful estimated life of an asset.

For all new capital expenditure on Land and Buildings the charge will be based on the asset life so will be straight forward.

For historic capital expenditure on Land and Buildings the expenditure can be split between expenditure on Land and Expenditure on Buildings. The proxy life assessed for Land is 100 years. The life for Buildings is 40 years based on an assessment by the Valuer of the expected life of a Fire Station. This has been used as a proxy for the asset life as the property portfolio consists mainly of this type of asset.

The repayment of the £17.2m historical capital expenditure on Land and Buildings annual charge will be £439k. After 38 years the balance on expenditure on Buildings will have been repaid (Valuation was undertaken 2 years previously so asset life at that point was 40 years).

The graph below illustrates this:



1.6.8 Annuity / Inflation Method

The method is similar to straight line in that MRP is charged to revenue over the assets useful life and fully repaid at the end of the useful life. An annuity rate is set for the period to reflect that over time the value of money decreases due to inflation. This produces a consistent and "real" charge to the tax payer of using the asset over its life, however, at today's prices it is an increasing charge. 2% is the rate commonly used, being the Bank of England's target rate for inflation. With this option the MRP rises over time.

1.7 Conclusions

1.7.1 The annuity/inflation method is not suitable from a budgetary perspective and as costs are weighted towards the latter part of the repayment period future generations will be paying more for assets that are being utilised today which does not meet the requirements of the Well Being of Future Generations Act. Therefore this method has been excluded.

1.7.2 Under the 4% reducing balance method the costs are weighted towards the early part of the repayment period and future generations will still be paying in the year 2190. This method does not represent a fair way to spread the costs for the use of the Authority's assets. This method is prudent as more of the asset is repaid earlier but on a cost share basis it is not equitable.

1.7.3 The straight line method is more closely aligned to the life of the Authority's assets and costs are spread more evenly among tax payers who will benefit from the assets. This method is prudent and more equitable on a cost share basis.

1.7.4 Based on the conclusions above the preferred method is the straight line method.

1.7.5 The recommendation is to change the repayment profile of the outstanding balance of capital expenditure on Land and Buildings of £17.2m as at 31 March 2017 to the straight line method repaid over the asset life.

1.7.6 New capital expenditure on Land and Buildings funded by unsupported borrowing incurred from 2017/18 onwards be repaid over the life of the asset.

1.7.7 This represents an in year change to the MRP policy from option 2 capital financing requirement method to option 3 asset life method.

2. LIST OF ACCESSIBLE BACKGROUND DOCUMENTS

2.1 Various Welsh Government papers, including:

Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003.

Capital Finance and Accounting Wales Amendment Regulations 2008.

Guidance on Minimum Revenue Provision.

The Well-being of Future Generations (Wales) Act 2015.

3. GLOSSARY OF TERMS

Capital Expenditure: Expenditure on the acquisition of non-current assets or expenditure that extends the life or value of an existing asset.

Capital Financing Requirement (CFR): A measure of the capital expenditure incurred that has yet to be financed from capital receipts, capital grants or revenue financing.

Minimum Revenue Provision (MRP): A charge made to revenue to repay outstanding capital expenditure. Authorities must determine their own prudent MRP charge each year, taking into consideration statutory guidance issued by the Government.

Prudential Code: The code of practice drawn up by the Chartered Institute of Public Finance and Accountancy (CIPFA) to underpin the requirements of the Local Government Act 2003 in respect of an authority's duty to determine the affordability, prudence and sustainability of its capital investment needs.

Revenue Expenditure: All expenditure incurred by an authority that cannot be classified as capital expenditure.

Revenue Support Grant (RSG): Is paid to each authority from the Welsh Government as a contribution towards the cost of providing services.

Unhypothecated Supported Borrowing (USB), commonly referred to as Supported Borrowing: Each year WG provides Authorities with a Supported Borrowing allocation. WG then includes funding to cover the revenue costs associated with the supported borrowing for future years within the RSG. The Authority decides how this funding is spent. In Wales Fire Services are not allocated supported borrowing so this will not apply.

Prudential Borrowing and the Prudential Code. Authorities set their own policies on acceptable levels and types of borrowing with regard to the approved level of capital expenditure. The main objectives of the code are to ensure the strategy approved is prudent, affordable and sustainable.