SOUTH YORKSHIRE
SYMCA
MAYORAL COMBINED AUTHORITY

Audit, Standards and Risk Committee

Tuesday, 24 September 2024

Treasury Management Update – Minimum Revenue Provision

Is the paper exempt from the press and public? No

Reason why exempt: Not applicable

Purpose of this report: Monitoring/Assurance

Is this a Key Decision? No

Has it been included on the Forward Plan of Key Decisions? Not a Key Decision

Portfolio: N/A

Portfolio Holder: N/A

Lead Chief Executive: N/A

Director Approving Submission of the Report:
Gareth Sutton Director of Resources & Investment/s73 Officer

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Executive Summary

At the Audit, Standards and Risk Committee on 17 July 2024, Members were presented with an updated Treasury Management Strategy for the MCA and OPCC (Office of the Police and Crime Commissioner) combined.

Members requested further information on the respective approaches adopted by the MCA and OPCC for making charges to revenue for the repayment of debt or minimum revenue provision (MRP).

This paper provides the further information requested.

What does this mean for businesses, people and places in South Yorkshire?

The MRP policy forms part of the Treasury Management Strategy which, in turn, is an integral part of the budget, which provides the resource to deliver upon South Yorkshire's aspirations.

Recommendations

The Committee is asked to note the MRP policy adopted by the MCA and OPCC.

Consideration by any other Board, Committee, Assurance or Advisory Panel
Audit and Standards Committee 17 July 2024

1. **Background**

The updated Treasury Management Strategy presented to the Audit, Standards and Risk committee on 17 July 2024, included an updated MRP Policy statement which set out the approaches to determining MRP adopted by the MCA and OPCC. The MRP Policy Statement is appended as appendix A for ease of reference.

2. **Key Issues**

2.1 Where local authorities finance capital expenditure with debt, they must set aside an amount of money each year from revenue to ensure that debt can be repaid. The duty to make charges to revenue is known as the Minimum Revenue Provision or MRP. The approach to determining the annual charges to revenue for the repayment of debt (MRP) are governed by Statutory MRP guidance. The broad aim is to put aside revenue over time to reduce debt used to finance capital expenditure to nil commensurate with the period over which the capital expenditure provides benefits. However, statutory guidance allows authorities flexibility over how this is achieved.

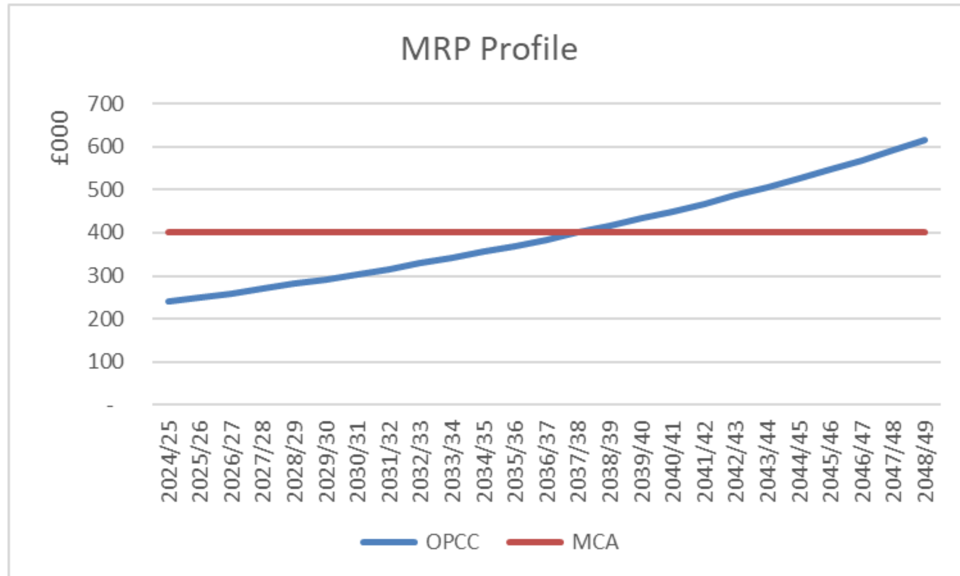
2.2 Both the MCA and OPCC have adopted the Asset Life method for determining MRP. This results in MRP charges being made over the estimated useful life of an asset financed by debt when brought into use. The exception to this is OPCC debt arising up to and including 2007/08 where, as permitted by the Statutory MRP Guidance, the old rules for determining MRP on a 4% reducing balance basis have continued to be applied.

2.3 The profiling of the MRP charges under the Asset Life Method adopted by the MCA and OPCC are as follows:

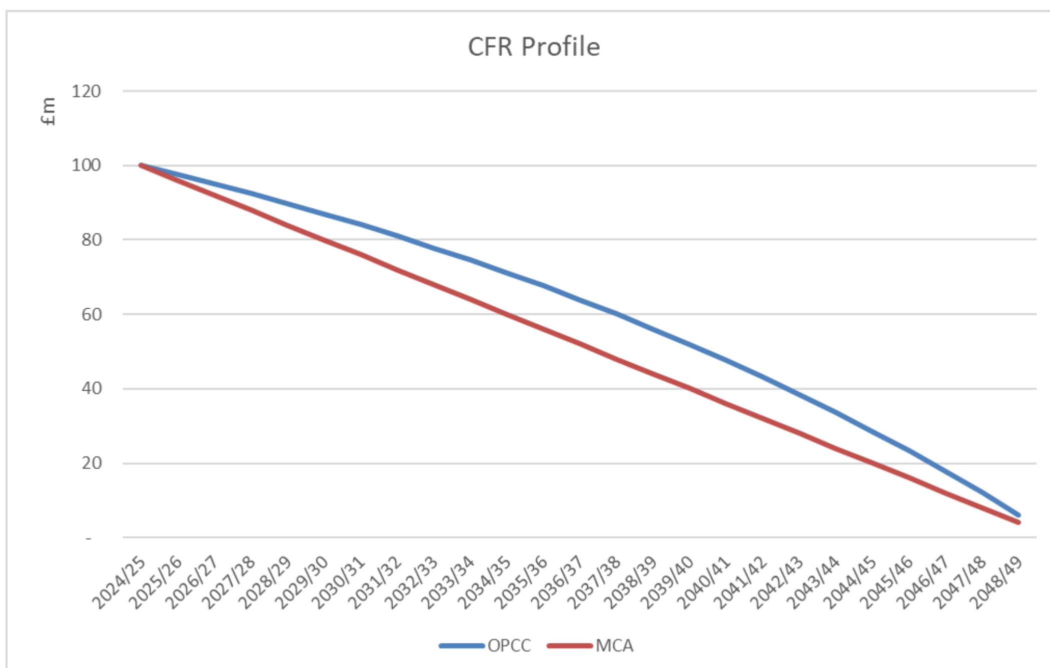
The MCA charges MRP on an equal annual instalment basis, whereas

The OPCC charges MRP on an annuity profile

This results in a different profile for charging MRP. This has been illustrated in the graph below. In this example, the capital expenditure is £10m with an asset life of 25 years.

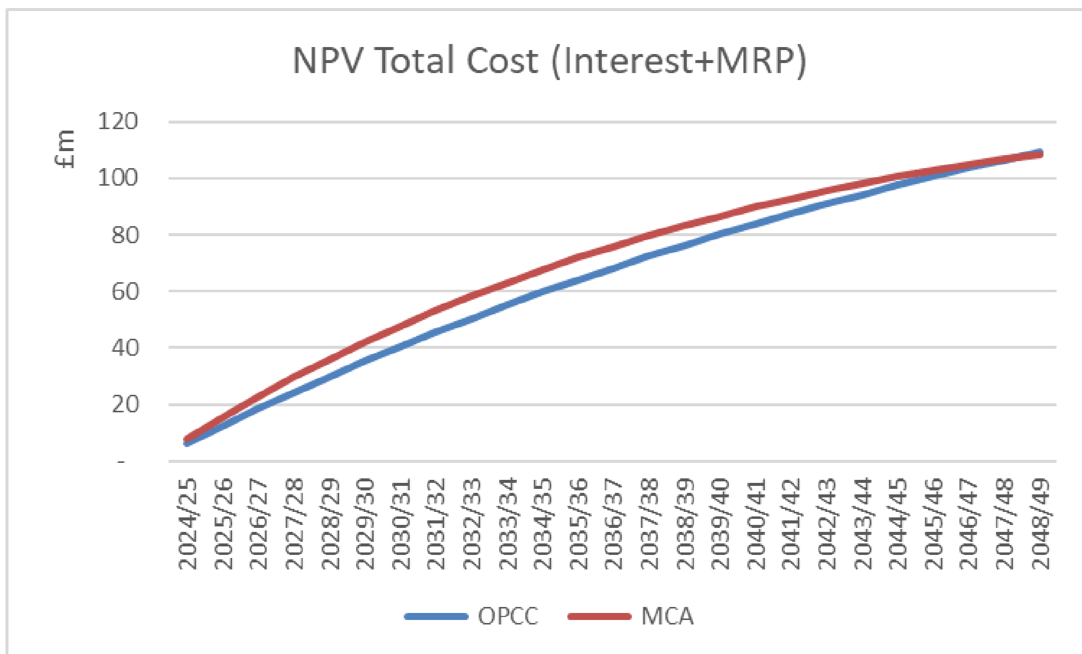


2.4 The rate at which MRP is charged determines the rate at which the underlying need to borrow or Capital Financing Requirement (CFR) is written down. The underlying need to borrow is not the same for each organisation. To illustrate the impact of using the straight line method, as opposed to the annuity method, the graph below shows the rate at which a CFR of £100m would be written down over the same time horizon.



2.5 This illustrates that over the long term, both methods ultimately achieve the same end result of reducing debt by the same amount over a time horizon approaching 25 years.

2.6 In addition, a supplementary exercise has been carried out to assess the capital financing cost of the CFR in present value terms over the same time horizon. Capital financing costs have been estimated annually as a notional 4% interest charge on the outstanding CFR and added to the MRP charge for the year. The cost has then been discounted back to present value terms by applying the discount rate adopted within HM Treasury's Green Book for option appraisal of 3.5%. The results are shown in the table below.



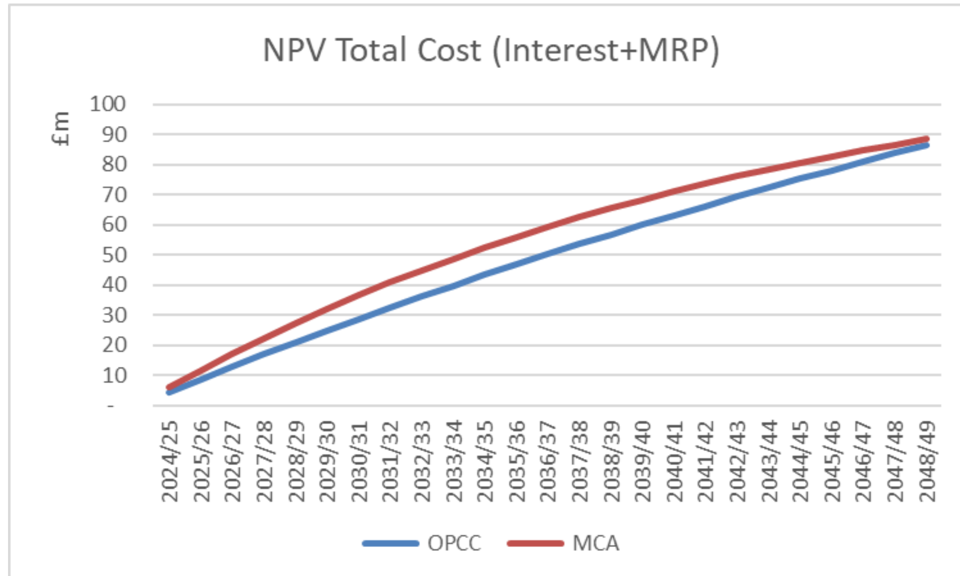
2.7 This similarly illustrates that the cumulative cost in present value terms is broadly similar over a long term time horizon approaching 25 years.

2.8 Both the straight line and annuity methods are specified in the statutory guidance on MRP under Option 3: the Asset Life Method. This is a simpler alternative to the use of depreciation accounting (Option 4) which represent the two policy options for capital expenditure after 1st April 2008.

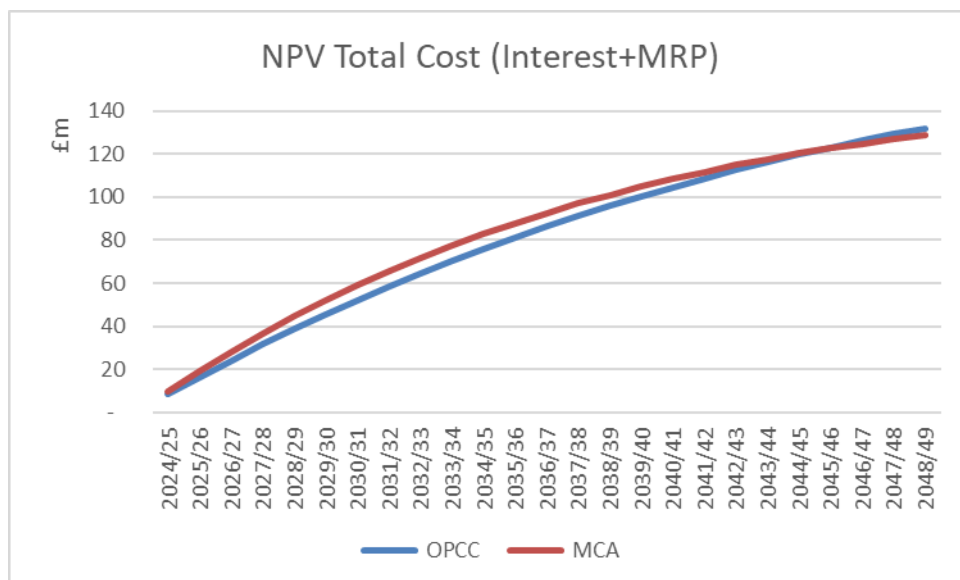
2.9 The annuity method might better reflect the flow of benefits from an asset where the benefits are expected to increase in later years. This could include capital expenditure in connection with projects promoting regeneration or administrative efficiencies or schemes where revenues will increase over time.

2.10 Whilst both allow for the full value of capital expenditure the increasing profile of the annuity method increases the interest rate risk (as less is put aside to repay debt in the earlier years). Conversely, in a low interest rate environment, the straight line method would generate greater cash balances with a low rate of return.

2.11 The following graphs show the cumulative discounted cost using an interest rate of 2% and 6% respectively. At an interest rate of 2% the straight line method has a higher overall NPV with an additional cost of c.£2m over 25 years (compared with a cumulative NPV of £86.4m for the OPCC).



2.12 At an interest rate of 6% the annuity method has a higher overall NPV with an additional cost of c.£3.3m over 25 years (compared with a cumulative NPV of £128.7m for the MCA).



2.13 Both examples are for illustrative purposes only. The risk of either approach should be managed through the Treasury Management Strategy, that is, the debt and investment portfolio.

3. Options Considered

3.1 **Option 1** – maintain the approaches to MRP in relation to MCA and OPCC debt as they exist currently

3.2 **Option 2** – change the existing approach of the MCA and/or OPCC to bring them into line

3.3 Option 1 has been retained as the existing approaches have been used for financial planning purposes and both achieve the broad aim of writing down the CFR over the longer term (c. 25 years) and have similar capital financing costs in present value terms.

4. Consultation on Proposal

N/A

5. Timetable and Accountability for Implementing this Decision

5.1 The updated 2024/25 Treasury Management Strategy including the MRP Policy Statement appended as appendix A is due to be approved by the MCA Board on 10 September 2024.

6. Financial and Procurement Implications and Advice

6.1 There are no financial implications of adopting the recommended proposal as the methods described in para 2.3 are the ones used for financial planning purposes.

7. Legal Implications and Advice

7.1 The MRP approaches adopted by the MCA and OPCC are compliant with statutory MRP Guidance.

8. Human Resources Implications and Advice

8.1 There are no human resources implications related to this report.

9. Equality and Diversity Implications and Advice

9.1 There are no equality and diversity implications related to this report.

10. Climate Change Implications and Advice

10.1 There are no climate change implications related to this report.

11. Information and Communication Technology Implications and Advice

11.1 There are no information and communication technology implications related to this report.

12. Communications and Marketing Implications and Advice

12.1 There are no communications or marketing implications related to this report.

List of Appendices Included:

A. MRP Policy Statement

Background Papers:

None.

Minimum Revenue Provision (MRP) Policy Statement

This Policy Statement has been prepared having regard to the Revised Statutory MRP Guidance issued in 2018 and has regard to the revised Statutory MRP Guidance that will be implemented with effect from 1 April 2025.

The broad aim of MRP is for an authority to make a prudent provision by charging revenue over time to reduce its Capital Financing Requirement. In doing so, an authority should align the period over which they charge MRP to one that is commensurate with the period over which its capital assets/expenditureprovides benefits either in terms of service potential or economic return.

Under Regulation 27 of the *Local Authorities (Capital Finance and Accounting) (England) Regulations 2003* local authorities are required to charge MRP to their revenue account in each financial year in respect of all capital expenditure financed by debt. Regulation 28 gives local authorities flexibility in how they calculate MRP, providing the calculation is 'prudent'. In calculating a prudent provision, local authorities are required to have regard to statutory guidance on determining MRP which offers a number of options for meeting this requirement. These comprise;

Option 1: Regulatory Method
Option 2: CFR Method
Option 3: Asset Life Method
Option 4: Depreciation Method

In addition, an authority may charge an amount greater than the statutory minimum should it wish to doso.

The MCA approved the following MRP statement for financial year 2024/25:

MRP on the residual Capital Financing Requirement at the end of 2015/16 relating to capital expenditureincurred before 1 April 2008, is being charged on a flat line basis over fifty years. This is considered a more prudent approach to the "regulatory method" adopted up to and including 2015/16, as it better aligns the charges to revenue to the benefits the related assets deliver.

MRP on capital expenditure incurred since 1 April 2008, financed by unsupported borrowing, will be based on the 'asset life method'. This means that MRP will be based on the estimated useful life of the assets created. The MCA will apply a maximum life of 50 years to new assets unless a suitably qualifiedprofessional advisor advises that an asset will deliver service functionality for more than 50 years or where an asset is a lease or PFI asset, and the length of the lease/PFI contract exceeds 50 years.

MRP will commence in the year after an asset becomes operational to align charges to revenue to theeconomic benefits generated from those assets.

MRP on capital loans and capital grants awarded to partners and third parties financed by borrowing willbe charged over the useful life of the assets concerned.

MRP on capital expenditure on assets not owned by the MCA or on assets for use by others will similarlybe charged over the useful life of the assets concerned. MRP on expenditure capitalised

by virtue of a statutory direction, repayment of capital grants or loans received, or acquisition of share capital, will be charged over a period not exceeding the maximum period specified by regulation.

Where a PFI or right-of-use asset is on balance sheet, MRP will be charged at an amount equal to the element of the payment that goes to write down the balance sheet liability.

The revised Statutory MRP Guidance that comes into effect on 1 April 2025 has been amended to state explicitly that capital receipts cannot be used to directly offset a prudent charge for MRP that has been properly determined in accordance with the guidance. The MCA has previously discussed with DLUHC proposals to use borrowing to accelerate delivery of the South Yorkshire Renewal Plan and to apply Gainshare capital to meet the requirement to set aside an amount to repay debt in lieu of charging revenue (the Authorised Limit and Operational Boundary provide headroom to take out additional borrowing in 2024/25 should this eventuality arise). The revised Statutory MRP Guidance is silent on this matter but DLUHC have indicated that the amendments made to the guidance in this regard are not intended to impact on existing arrangements which are considered prudent.

The PCC approved the following MRP statement for financial year 2024/25

a. For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

Existing practice MRP will follow the existing practice outlined in the DLUHC regulations (option one), which provides for an approximate 4% reduction in the borrowing need (CFR) each year.

b. From 1 April 2008 for all unsupported borrowing (including leases) the MRP policy from 2019/20 will be:

Asset life method MRP will be based on the estimated life of the assets, in accordance with the regulations (option three), whereby the annuity method has been adopted.