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Arlingclose Ltd:

Independent treasury management services

Review of Minimum Revenue Provision Policy and Practice

Merseyside Waste Disposal Authority

June 2025



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1.0 Executive Summary

- 1.1 Minimum revenue provision (MRP) is the revenue charge for the original cost of capital expenditure. The authority has some discretion over the calculation of MRP charges, with an over-riding legal requirement for the annual charge to be "prudent".
- 1.2 The authority's current MRP policy is to use the reducing balance method for pre-2008 expenditure and the straight-line asset life method for expenditure incurred later, including on PPP schemes.

Current MRP

- 1.3 We have reviewed the council's calculation of MRP, which plans to make a total of £207m of MRP, the vast majority of this over the next 21 years. However, this is based on a capital financing requirement of £200m plus £43m of capital expenditure yet to be incurred totalling £243m, so there is a shortfall of £36m to be charged in addition to current plans.
- 1.4 We note that MRP on public private partnership (PPP) schemes is being made over the contract term, not the longer asset life, which is increasing costs.
- 1.5 We also note that MRP is being made on PPP lifecycle capital expenditure that has yet to be incurred, and for which the authority is therefore not yet benefiting. It is now planned to fund these costs from revenue as incurred in the future.

Recommended MRP

- 1.6 We recommend using the annuity asset life method for all capital expenditure. This sees MRP charges increase as the interest cost reduces over time, leading to a broadly flat total charge for interest plus MRP on each asset over its useful life, similar to a repayment mortgage. It does not result in any total savings, since the same total capital expenditure must be financed, but it generates significant revenue savings in the early years.
- 1.7 Other changes include: spreading PPP MRP charges over the asset's useful lives, rather than the shorter contract term; taking a refund for MRP charges already made on future PPP lifecycle capital expenditure; and correcting for the £36m of past expenditure missing from the current MRP calculations.
- 1.8 The net impact is £33m of revenue savings for the first six years until 2030 compared to current plans, followed by £16m of additional cost in the five years to 2035, £11m savings in the next six years to 2041 and £64m cost in later years. The net cost of £36m relates to the capital expenditiure on which no MRP is currently being made. The additional cost principally arises in 2045to 2050 when the larger PPP contract has expired but the assets are expected to remain in use.
- 1.9 An accompanying spreadsheet gives full details of all our calculations.



2.0 Introduction

- 2.1 Minimum revenue provision (MRP) is the method by which the capital cost of debt-funded capital expenditure is charged to revenue, normally over the useful lives of the relevant assets. There is government guidance on the methods of calculating MRP.
- 2.2 To date, the authority has adopted a policy of calculating MRP as 4% of the capital financing requirement for expenditure incurred before 1st April 2008 in line with option 2 in the guidance, and on a straight-line asset life basis in line with option 3(a) of the guidance for expenditure incurred on or after that date.
- 2.3 Arlingclose has been commissioned to (a) review the authority's existing MRP calculation with reference to the current policy and (b) calculate the impact of changing policy, while remaining fully compliant with the government guidance, with a view to making revenue savings.
- 2.4 In preparing this report, we have relied upon a spreadsheet of capital expenditure and MRP since 2018 supplied by authority officers named "ck MRP, CFR + PPP liability calcs Apr 2004 ~ working v2".
- 2.5 We have used an unpublished draft balance sheet for 31.03.2024 included in the above spreadsheet as the baseline for our review. This was then updated for the prior period adjustment we have recommended as a result of our review of PPP accounting. If there are further changes to the accounts during the audit process then the savings we provide may change.
- 2.6 This review does not take account of additional capital expenditure that may be incurred beyond 31.03.2025, including as a result of remeasuring the PPP liabilities due to the adoption of the IFRS 16 Leases accounting standard. The IFRS 16 remeasurements during 2024/25 are however included.



Minimum Revenue Provision

- 3.1 Minimum revenue provision (MRP) is the method by which the capital cost of debt-funded capital expenditure is charged to revenue.
- 3.2 Local authorities have a legal duty to charge their General Fund with a prudent amount of MRP each year. Government MRP guidance defines prudence as aligning the period over which MRP is charged to one that is commensurate with the period over which the capital expenditure provides benefits.
- 3.3 The guidance provides a number of options for calculating prudent MRP but is clear that other calculations methods may also be considered prudent. Straight-line and annuity methods over the assets' useful lives are the most commonly used methods.
- 3.4 The annuity method is conceptually superior since it spreads the total capital financing costs (interest plus MRP) evenly over the asset life, similar to the principal and interest on a repayment mortgage, personal loan or finance lease. The straight-line approach keeps MRP itself even, but since interest costs reduce as the debt is paid off, it front-loads the total financing cost.
- 3.5 The guidance allows local authorities to change their MRP calculation methods going forward, but changes cannot be backdated to create an overpayment that results in a credit to the General Fund.
- 3.6 Arlingclose recommends calculating MRP on the annuity asset life method for most capital expenditure. Proxy asset lives can be used where no better information is available due to the passage of time.



3.0 Capital Financing Requirement

- 4.1 The concept of the capital financing requirement (CFR) was introduced by the Prudential Code in 2003. It reflects all the capital expenditure incurred by a local authority that has yet to be permanently financed. Debt (including PPP liabilities) may temporarily fund capital expenditure, but must eventually be repaid, leaving a requirement for permanent financing. MRP is the usual route of providing that financing.
- 4.2 The CFR therefore rises with debt-funded capital expenditure and reduces with MRP. Since MRP is calculated based on that expenditure, it provides the means for the CFR to eventually reach zero.
- 4.3 The Prudential Code defines the CFR as being calculated direct from the balance sheet. It is the sum of all the capital assets minus the balances on the Capital Adjustment Account and the Revaluation Reserve. This is effectively the entirety of all past capital expenditure minus all past capital financing.
- 4.4 The CFR calculation is shown in table 1 below for year end dates in 2008, 2018 and 2024. The final year includes the prior period adjustment.

	31.03.2008	31.03.2018	31.03.2024
	£000s	£000s	£000s
Property, plant and equipment	23,361	335,215	313,297
PPP deferred income	0	0	-76,699
Capital Adjustment Account	-15,578	14,783	41,128
Revaluation Reserve	0	-10,962	-77,217
Actual CFR (per the balance sheet)	7,783	339,036	200,510

Table 1: Calculation of the capital financing requirement



4.0 Existing MRP Calculation

- 5.1 MRP is being made on the 31.03.2008 CFR on a 4% reducing balance basis, in line with option 2 in the government guidance.
- 5.2 The authority entered into two PPP agreements in 2011/12 for £17.0m and in 2017/18 for £297.9m and has been making MRP on a straight line basis.
- 5.3 The CFR also increased by £35.9m between 2008 and 2018 for unknown reasons, and by small amounts in 2018/19 and 2019/20; no MRP has been made on these amounts.
- 5.4 The MRP methods currently in use are shown in table 2 below, reconciled back to the CFR.

Table 2: CFR split by MRP method

	31.03.2008 £000s	31.03.2018 £000s	31.03.2024 £000s
4% reducing balance	7,783	5,174	4,050
2008 to 2018 unknown, no MRP		35,918	35,918
Spend 2018/19, no MRP			20
Spend 2019/20, no MRP			41
WMRC PPP		10,728	23,611
RRC PPP		287,216	136,869
Total CFR	7,783	339,036	200,509

5.5 Table 3 below shows the years over which the MRP is currently planned to be charged. Note that a balancing figure is needed to reconcile this to the CFR since the straight line MRP currently calculated for the resource recovery centre (RRC) PPP includes lifecycle capital expenditure for future years that has not yet been incurred and therefore is not yet in the CFR.

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MRP method	2025	2026	2027	'28 to '34	'35 to '44	'45 to '54	Later	Total
Reducing balance	166	160	154	922	947	640	1,061	4,050
Straight line - PPP	13,445	13,425	13,425	73,227	84,382	5,327	0	203,231
Total MRP plans	13,611	13,585	13,579	74,150	85,329	5,967	1,061	207,281
Assets with no MRP plan								35,979
Future PPP capex								-42,751
CFR 31.03.2024								200,509

Table 3: Existing plan for MRP £'000

- 5.6 The above figures are all set out in detail on the "MRPbefore" page of the accompanying spreadsheet.
- 5.7 In the next section of this report, we advise on corrections for the assets with no MRP plan and the MRP already made on PPP lifecycle assets not yet acquired. We also show how a change of MRP policy can reduce the revenue cost of MRP for the authority.



5.0 Recommended MRP Calculation

6.1 We recommend making various changes to the authority's MRP policy and practice.

Pre-2008 expenditure

- 6.2 MRP is being made on the 31.03.2008 CFR on a 4% reducing balance basis, which is the basis upon which the government formerly provided revenue support grant to local authorities for the revenue cost of capital expenditure. Since the 2010-2015 coalition government's changes to the distribution of revenue support grant, the logic for making 4% reducing balance MRP no longer applies, although it remains part of the government guidance as option 2.
- 6.3 The reducing balance basis also suffers from the drawback that it never fully writes down the balance to zero. It therefore makes more sense for a pool of assets that is still being added to, rather than a closed pool.
- 6.4 Many local authorities have therefore moved away from the reducing balance method and now charge pre-2008 expenditure over an asset life basis, either using the straight-line or the annuity basis. Records of actual assets funded from borrowing tend not to be available, and therefore it is common to assume a 50-year asset life from 2008. This reflects the fact that the assets acquired were likely a combination of freehold land with an infinite useful life, building and infrastructure with approximately a 50-year life and vehicles and equipment with shorter lives.
- 6.5 We believe that the annuity method is technically superior to the straight-line method as described below.
- 6.6 We therefore recommend that the authority charges MRP on the remaining balance of its pre-2008 expenditure over 36 years starting in 2024/25 (equivalent to 50 years from 2008/09). The appropriate interest rate to use in the annuity formula is the average PWLB 50-year annuity rate in 2007/08, which was 4.68%.

Post-2008 expenditure

- 6.7 Ignoring the two PPP schemes for the time being, which we cover later, the authority increased its CFR by £35.9m between 2008 and 2018 for which no records are held and by a further £0.1m in 2018/19 and 2019/20.
- 6.8 It is unclear whether this relates to equipment with short (5-10 year) or property with longer (25-50 year) asset lives.
- 6.9 We therefore recommend charging MRP on the annuity asset life basis over ten years using an interest rates of 4.93% being the average PWLB annuity rates for ten year loans in 2023/24.

Expenditure on PPP schemes

- 6.10 MRP is being made on the two PPP schemes on a straight-line basis over the contract lives. However, unlike a lease where the assets are usually returned at the end of the contract, with PPP schemes the authority retains the assets. MRP should therefore be spread over the longer asset life instead.
- 6.11 Officers have advised that the assets for both schemes are expected to remain in use for five year after the contracts end. MRP normally starts the year after the asset becomes operational and therefore the final charge can be made six years after the contract end date.



- 6.12 Again, the annuity basis is the most appropriate. With PPP schemes, the implicit interest rate in the leases can be used, which is 19.64% for the WMRC scheme and 12.45% for the RRC scheme.
- 6.13 The PPP liability for the RRC scheme was previously planned to increase each year with lifecycle capital expenditure. The current MRP method spreads the entire MRP charge over a straight line, meaning that £11.5m MRP has been made in the past on expenditure that has not yet been incurred. We suggest correcting this as a reduction in the overall MRP charge. It is now planned to charge lifecycle capital expenditure to revenue.
- 6.14 Note that these calculations for the PPP schemes have been completed before consideration of the impact of the new IFRS 16 accounting standard. This is likely to result in more of the unitary charge being spread over the asset lives via MRP, leading to a further savings over the contract life.

Annuity method

- 6.15 An annuity is a contract that pays a fixed amount each year that includes both interest on the initial principal sum plus a partial return of that principal. Because the principal is being repaid over time, the interest cost, calculated as a fixed interest rate multiplied by the outstanding principal reduces over time. With the total annuity payment being constant, but the interest element reducing, the principal element therefore increases over time.
- 6.16 Repayment mortgages, personal loans and finance leases are all common examples of annuities. The straight-line of equal instalments method is simpler to calculate on paper, but the ubiquitous use of spreadsheets now limits that advantage.
- 6.17 The government guidance on MRP includes the annuity asset life method as one of the ready-made options for calculating MRP. We believe it is superior to the straight-line method, since it provides for a flat capital financing cost when both MRP and interest payable are considered. Using the straight-line method on the other hand means that the capital financing cost starts higher and falls over time, when in practice the effect of inflation means that the council's ability to meet that cost is more likely to rise than fall over time.
- 6.18 To calculate an annuity, a suitable interest rate must be chosen. For assets funded from borrowing, we recommend using the average PWLB rate for new annuity loans with a term equal to the useful asset life in the year of the capital expenditure, with the certainty rate discount deducted where appropriate. This broadly reflects the council's interest cost as the expenditure is incurred. For finance leases and PPP liabilities, we recommend using the interest rate implicit in the lease.
- 6.19 In line with government guidance for changing methods on past expenditure, the revised calculation starts with the outstanding CFR for each asset at 31st March 2024 and uses the annuity method going forward over the remaining useful life. Previous years' MRP has not been recalculated.
- 6.20 This does not create an overall revenue saving, since the same outstanding CFR is charged over the same useful life. But it creates savings in earlier years at the expense of higher costs in later years. As explained above, this is entirely appropriate since the interest cost for each asset will be reducing at a broadly equivalent rate, and is fully in line with government guidance.

Impact of change

6.21 Our recommended MRP charges are summarised in table 4 below, and shown in detail on the "MRP after" page of the accompanying spreadsheet. A comparison of the current planned and recommended MRP charges are shown in table 5 and chart 1 below.



MRP method	2025	2026	2027	'28 to '34	'35 to '44	'45 to '54	Later	Total
Annuity - pre-2008	51	53	56	469	993	1,570	858	4,050
Annuity - 2008 to 2020	2,870	3,011	3,160	26,938	0	0	0	35,979
Annuity - PPP	1,682	1,956	2,279	31,188	49,703	66,663	0	153,471
Total MRP charges	4,603	5,020	5,494	58,595	50,697	68,233	858	193,500
Lifecycle capex	1,308	1,790	1,962	17,127	27,572	0	0	49,760
Total revenue charges	5,911	6,810	7,456	75,722	78,269	68,233	858	243,260
Future PPP capex								-42,751
CFR 31.03.2024								200,509

Table 4: Recommended charges for MRP and lifecycle capital expenditure £'000

Table 5: Comparison of current planned and recommended charges for MRP £'000

	2025	2026	2027	'28 to '34	'35 to '44	'45 to '54	Later	Total
MWDA current plans	13,611	13,585	13,579	74,150	85,329	5,967	1,061	207,281
Arlingclose advice	5,911	6,810	7,456	75,722	78,269	68,233	858	243,260
Saving/(cost)	7,700	6,774	6,122	-1,573	7,060	-62,266	203	-35,979

6.22 The £24m increase in our advised charges relates to the £36m capital expenditure incurred between 2008 and 2020 upon which no MRP is currently being made. The law was changed in 2024 to ensure that local authorities make MRP on their entire CFR and do not exclude any elements of the CFR from the MRP calculation.



Chart 1: Current planned vs advised MRP charges £'000

6.23 As can be seen, there are revenue savings in many years, arising from the change to annuity rate on the earlier years of PPP schemes and the refund for MRP already made on future lifecycle expenditure. These are offset by the additional charge for the £36m 2008 to 2020 expenditure upon which no MRP was being made and the impact of the annuity method on the later years and the spreading of charges past the contract life of PPP schemes when the authority was planning to use the assets without needing to make any MRP charge, having fully charged it over the contract lief instead.



- 6.24 This analysis looks only at capital expenditure already incurred by the authority, plus the planned PPP lifecycle works. The authority is likely to incur additional capital expenditure funded from borrowing in future financial years, and changing policy to the annuity method will therefore result in additional savings to those shown above.
- 6.25 Example savings on MRP in the first year are shown below for different asset lives, based on £1 million capital expenditure and forecast PWLB rates for 2025/26. However there is no overall saving over the whole asset life, since the full amount spent must be charged as MRP over the asset life.

	Annuity	Annuity	Straight-	Year 1
Asset life	rate	MRP	line MRP	saving
5 years	4.50%	182,792	200,000	17,208
10 years	4.75%	80,437	100,000	19,563
20 years	5.40%	28,986	50,000	21,014
30 years	5.85%	12,987	33,333	20,347
40 years	5.95%	6,543	25,000	18,457
50 years	5.95%	3,502	20,000	16,498

Table 6: First year MRP charge on £1m capital expenditure under different calculation methods



6.0 Next Steps

- 7.1 Our calculations are based on the authority's unpublished draft 2023/24 balance sheet. The March 2024 CFR should be checked against the final audited accounts when these are available.
- 7.2 Once any internal approvals have been received, a revised MRP policy should presented to a meeting of the authority for approval with the change to the asset life annuity method backdated to 2024/25.
- 7.3 The budget and medium term financial plan should be updated to include the projected savings on MRP in the current and future years.
- 7.4 The affordability of future capital plans should be assessed based on annuity rather than straightline MRP.
- 7.5 We are happy to give a short presentation to officers and members if this would assist in any way.