Revised Annual Minimum Revenue Provision Statement 2024/25

1 Background

1.1 Where the Authority finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Authority to have regard to the former Ministry of Housing, Communities and Local Government's Guidance on Minimum Revenue Provision (the MHCLG Guidance) most recently issued in 2018.

1.2 The broad aim of the MHCLG Guidance is to ensure that capital expenditure is financed over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

1.3 The Guidance provides suggested methods for the calculation of MRP that the DLUHC consider to be prudent, however the Guidance and legislation do not define what is prudent. It is for each Authority to determine a prudent repayment based on its own individual circumstances, considering the medium and long-term financial plans, current budgetary pressures, future capital expenditure plans and funding needs.

1.4 The current MRP policy has not been changed since 2017/18. The changes to the financial landscape which the Authority is now faced, including recent increases in interest rates and inflationary impacts across all Authority service areas mean it is sensible to review the Policy now.

1.5 Any change to the Authority's MRP Policy needs to consider:

- Its appropriateness and compliance with the MRP guidance.
- Affordability, prudence and sustainability with regard to current revenue budgets of the Authority, balanced against deferring costs of future Authority Taxpayers.
- The Authority's future capital programme in terms of complexity, variability and deliverability.
- Capital Financing Requirement (CFR) forecasts and the level of borrowing proposed by the Authority in future years.
- S73 officer consideration of what constitutes a prudent provision.

1.6 The Authority has commissioned Arlingclose to advise on this matter and the associated report and recommendation is attached at Annex (i). All the policy recommendations have been adopted.

2 Current Minimum Revenue Provision Policy

2.1 For non-PPP or Finance lease assets the Authority makes MRP based on the expected asset life on a reducing balance basis.

2.2 For PPP and finance lease assets MRP is made ion a straight-line basis over the period of the PP contract.

2.3 There is currently some £36m in respect of unknown assets that forms part of the CFR relating to the period between 2008 and 2017. Currently no MRP is charged on this element of the CFR.

3 Proposed Changes to existing Policy

3.1 It is proposed to use the annuity method as opposed to the straight-line or reducing balance method for MRP being made on the asset life basis and the pre-2008 supported borrowing CFR. The interest rate to be used when calculating the annuity will be the PWLB certainty rate for annuity loans for the remaining life of assets at the date of the policy change (1st April 2024) for existing borrowing and average certainty rate for annuity loans for the relevant lives of assets in the year of acquisition for subsequent capital expenditure.

3.2 It is proposed to make MRP over the asset life rather than contract length for PPP Assets where the ownership of the assets pass to the Authority at the end of the contract or the assets continue to provide a benefit to the Authority over their life.

3.3 It is proposed to write off the element of the CFR built up between 2008 and 2017 over 10 years.

4 Rationale for Changes

Annuity Method

4.1 The annuity method is an acceptable method for making MRP and is explicitly mentioned in the statutory guidance on MRP. The annuity method spreads the total capital financing costs (MRP plus interest) evenly over the asset life, similar to a repayment mortgage. When MRP is made it increases the Authority's cash balances, therefore, reducing overall debt costs or increasing income from investment balances. The straight-line approach keeps MRP itself even, but as interest costs reduce over time, it front loads the total financing costs.

4.2 As the annuity method is an approach where overall costs to Authority taxpayers over the life of an asset is even is more prudent as Authority taxpayers are getting an even benefit from the assets. However, it should be noted that overall costs are slightly higher when using the annuity method as the principal is repaid more slowly resulting in higher overall interest costs. Conversely, when factoring in the time value of money the annuity method becomes a more suitable option.

PPP Useful Asset Lives

4.3 The Authority considers that it is prudent to provide for MRP over the asset life rather than the contract period. This is provided that the, where the asset life is longer than the contract length, the Authority are likely to gain ownership of the asset or the asset is likely to continue to provide a service-related benefit to the Authority and taxpayers in respect of the Merseyside Districts once the contract expires. This is because making MRP over the life of the asset fairly charges the Authority and associated tax-payers over the period that benefits are received from the asset.

4.4 The life of PPP assets is assumed to be 5 years after the contract expiry date, which is line with the contractual requirement in respect of the handback of assets.

Other elements of the CFR

4.5 Arlinglose recommends that unknown elements of the CFR are written off over 10 years.

5 Revised MRP Policy Statement

5.1 The MHCLG Guidance requires the Authority to approve an Annual MRP Statement each year and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance:

- For capital expenditure incurred before 1st April 2008 MRP will be determined on an annuity basis using the 50-year PWLB annuity rate in 2007/08 (4.68%) assuming a remaining life of 34 years.

- The element of the CFR bult up from 1st April 2008 to 31st March 2017 will be written off over ten years on an annuity basis using the PWLB 10-year annuity rate in 2024 (4.93%).

- For capital expenditure incurred after 31st March 2017 up to 31st March 2023, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset on an annuity basis using the PWLB annuity rate in the year the expenditure was incurred, starting in the year after the asset becomes operational. MRP on purchases of freehold land will be charged over 50 years. MRP on expenditure not related to fixed assets but which has been capitalised by regulation or direction will be charged over 20 years.
- For PPP assets where the asset passes to the Authority at the end of the contract or the Authority continues to receive service benefit from the assets beyond the life of the contract, MRP will be determined over the remaining life of the assets on an annuity basis using the rates of interest implicit within the PPP schemes for the remaining life of the assets.

- For assets acquired by leases or through PPP contracts (where the asset does not pass to the Authority at the end of the contract or the Authority does not receive service benefits beyond the life of the contract), MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.

- For capital expenditure loans to third parties, the Authority will make nil MRP unless (a) the loan is an investment for commercial purposes and no repayment was received in year or (b) an expected credit loss was recognised or increased in-year, but will instead apply the capital receipts arising from principal repayments to reduce the capital financing requirement instead. In years where there is no principal repayment on loans that are investments for commercial purposes, MRP will be charged in accordance with the MRP policy for the assets funded by the loan, including where appropriate, delaying MRP until the year after the assets become operational.

- MRP on transferred debt is provided for on an annuity basis in line with schedules sent to the Authority from the Lead authority administering the debt.

- Capital expenditure incurred during 2024/25 will not be subject to a MRP charge until 2025/26 or later.

6 Financial Implications

6.1 Based on the Authority's capital financing requirement (CFR) at 31st March 2024, the charges for MRP under the revised and previous MRP policies are shown below[1]:

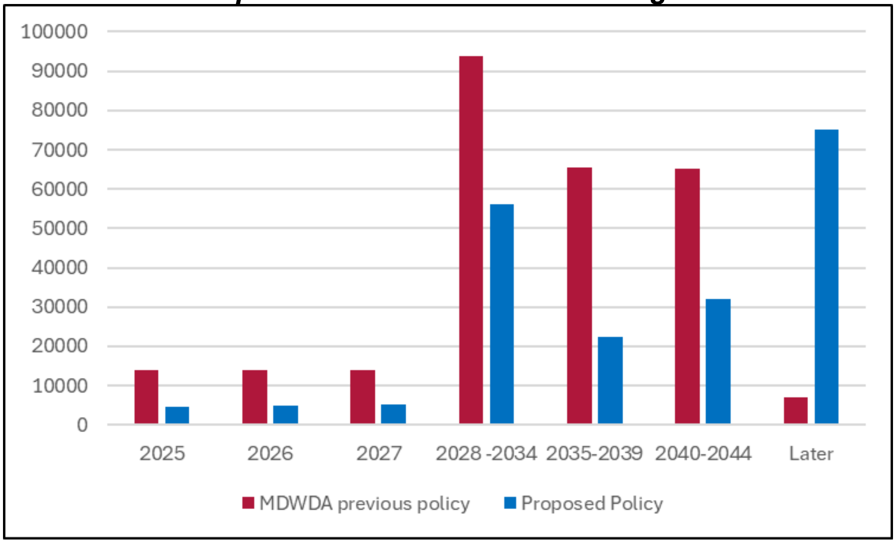
Table 1: Proposed charges for MRP

	2025 £000	2026 £000	2027 £000	2028 - 2034 £000	2035- 2039	2040-2044 £000	Later £000	Total £000
Annuity Pre 2008	51	53	56	469	440	553	2,428	4,050
Annuity 2008 - 2024	2,870	3,011	3,160	26,938	0	0	0	35,979
Annuity PPP	1,596	1,848	2,143	28,703	22,042	31,537	72,611	160,480
CFR at 31.03.2024	**4,516**	**4,913**	**5,358**	**56,110**	**22,482**	**32,090**	**75,039**	**200,509**

Table 2: Comparison of previously planned and proposed charges for MRP

	2025 £000	2026 £000	2027 £000	2028 - 2034 £000	2035- 2039 £000	2040-2044 £000	Later £000	Total £000
MDWDA previous policy	13,300	13,294	13,287	75,783	45,845	45,753	7,028	214,290
Proposed Policy	4,516	4,913	5,358	56,110	22,482	32,090	75,039	200,509
Saving/(cost)	**8,784**	**8,381**	**7,929**	**19,674**	**23,363**	**13,662**	**-68,011**	**13,781**

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



6.2 There are revenue savings over the first four years, arising from the change to the annuity rate on PPP liabilities - offset by the additional charge for the £36m expenditure from 2008 to 2020 upon which no MRP was previously being made.

6.3 The recommended approach starts to cost more than the current plan in 2045-46. This is particularly apparent in the six years after the RRC PPP contract ends. However, this increased cost is mitigated by:

- The proportion of the PPP costs relating to the repayment of debt incurred by the private sector will no longer be prevalent once the PPP contracts expire.

[1] Note that in order to focus purely on the implications of the proposed change in policy, the figures on this page exclude the implications of IFRS 16, which means the gross figures – but not the net - differ slightly from those contained within the Arlingclose report at Annex (i).

- Costs incurred in respect of new debt taken on to fund capital expenditure in the coming decade will be lower under the recommended policy.

6.4 The reason for the overall reduction in MRP by £72m from £274m to £203m is as follows:

Table 3: Explanation of the difference

	£000
Additional assets subject to MRP	-35,979
PPP lifecycle expenditure no longer capitalised	49,760
Total	**13,781**

Additional Assets subject to MRP

6.5 This represents the expenditure incurred from 2008 to 2008 which, as identified elsewhere in this report, no provision is currently being made

PPP Lifecycle expenditure no longer capitalised

6.6 Arlingclose has advised that lifecycle expenditure relating to the projects would usually be funded from revenue in the year it is incurred. This contradicts the Authority's previous practice of writing it off through MRP over a number of years. This treatment has been adopted for 2024-25 and the calculations assume this will continue over the remaining life of the PPP projects. However, this policy will be kept under review and a different approach adopted where the Authority believes the value of the asset is being enhanced.

6.7 Arlingclose's report is provided at Annex (ii) to this report and the implications for the for the Authority's overall financial position are outlined in the Outturn report to be presented to the Authority following this report.