Warwickshire and West Mercia Police and Crime Commissioners
Warwickshire and West Mercia Chief Constables

Joint Audit Committee
11 January 2017

Review of Minimum Revenue Provision

Report of the Treasurer

Recommendations

It is recommended that the Joint Audit Committee:

(a) Support the harmonisation of the calculation of Minimum Revenue Provision (MRP) across the alliance;
(b) Support the change of Policy to calculate MRP on a straight-line method for supported capital expenditure prior to 1 April 2008;
(c) Support the change of Policy to calculate MRP on an annuity method for unsupported capital expenditure incurred since 1 April 2008;
(d) Support the effective date of the changes to be 1 April 2017; and
(e) note the savings for the revenue budget as set out in section 4 below.
(f) Recommend that the Police and Crime Commissioners for Warwickshire and West Mercia approve the changes to the Minimum Revenue Provision (MRP) policy outlined in this report.

1. Introduction

(a) Definition of MRP

MRP is the method by which local authorities charge their revenue accounts over time with the cost of their capital expenditure that was originally funded by debt. Before the 2007/08 financial year, the method of calculating MRP was specified in legislation, however from 2007/08 onwards, local authorities have been free to set their own policy on calculating MRP, with the sole legislative proviso being that the amount calculated must be one that the Police and Crime Commissioner (PCC) considers to be "prudent".

MRP is intrinsically linked to the concept of the capital financing requirement (CFR) in the Prudential Code. The CFR represents the total of all the past capital expenditure, less the total capital financing applied (e.g. use of capital receipts, revenue reserves, grants etc.) other than debt (borrowing).

Debt is only a temporary form of finance, as loans must be repaid. The CFR therefore represents the PCC's underlying need to borrow for capital purposes, and the amount that has yet to be permanently financed. MRP is the main method of permanently financing that expenditure.

Effectively MRP charges to revenue the principal element of the borrowing used to finance the purchase/enhancement of assets over the life of the relevant asset. The interest element of borrowing is charged to revenue directly from either the interest charged on the loans with, say the Public Works Loan Board - PWLB ("external borrowing"); or the loss of investment interest from using cash balances to fund the capital expenditure (known as "internal borrowing").

The actual timing of the repayment of principal to the lender depends on the terms of the loan. MRP ensures that the PCC has the funds available to repay a loan when it is due so that future taxpayers are not unduly charged for capital funding decisions made in the past.

(b) Government MRP Guidance

The Department for Communities and Local Government (CLG) has issued guidance on the calculation of MRP, including a number of methods which it considers to be prudent. The guidance is clear that authorities are also free to devise other methods they consider prudent. Broadly speaking, the guidance suggests that:

- MRP on all capital expenditure incurred before 1st April 2008, and on expenditure funded by supported borrowing thereafter, is equal to 4% of the opening CFR with some optional adjustments, although an approach differing from that exemplified is not ruled out;
- MRP on expenditure incurred from April 2008 onwards that is funded by unsupported "prudential" borrowing should be calculated by reference to the asset's useful life, using either a straight line or an annuity method, starting in the year after the asset becomes operational.

CLG are currently consulting on amendments to the MRP guidance, such as considering the period over which the capital expenditure provides a benefit to the PCC when assessing useful lives and also stating a maximum useful life for buildings of 40 years. We have considered and incorporated these recommendations into our review.

(c) Current PCC MRP Policies

Both PCCs currently calculate MRP in accordance with the CLG guidance, using the CFR method for supported borrowing and the straight-line option for prudential borrowing (unsupported capital expenditure). However, there are inconsistencies between the two forces regarding the useful lives used for the calculation of the MRP on a straight-line basis.

2. Review of MRP

At a time of increasing pressure on the revenue budget, savings in the annual cost of MRP may reduce the need for savings to be made in front line services. The Treasurer commissioned Arlingclose to conduct a review of MRP, focussing on supported capital expenditure and the capital expenditure funded by prudential borrowing since April 2008, for which complete records were easily available.

The Finance team have scrutinised the results of Arlingclose's review and have made some changes that we considered appropriate for our local circumstances.

The main recommendation by Arlingclose was to amend the method of calculating MRP on unsupported borrowing since 1 April 2008 from the straight-line method to an annuity method, based on the average interest rates of annuity loans prevailing at the time of the initial borrowing and the useful lives of the assets.

The annuity method is the cheapest MRP option in the early years, and maintains a constant impact on the revenue account over the useful life of the asset being financed, once interest costs are taken into account, with no cost thereafter.

CIPFA also support the use of the annuity method for calculating MRP. In their publication "Practitioners Guide to Capital Finance in Local Government" it is stated that "it is arguably the case that the annuity method provides a fairer charge than equal instalments as it takes account of the time value of money, whereby paying £100 in 10 years' time is less of a burden than paying £100 now. The schedule of charges produced by the annuity method thus results in a consistent charge over an asset's life, taking into the real value of the amounts when they fall due. The annuity method would then be a prudent basis for providing for assets that provided a steady flow of benefits over their useful life."

Grant Thornton have been consulted regarding the outcomes of the review and the proposals made by the Treasurer and are supportive of the changes to the MRP Policy effective from 1 April 2017.

3. Findings of the Review

The findings of the review are as follows:

(a) Warwickshire PCC's MRP on supported borrowing was being adjusted by a calculation known as "Adjustment A" from 1 April 2008. Adjustment A is the amount used at the start of the Prudential system which ensured the move to the CFR system from the Credit Ceiling system did not result in an increased MRP charge. Adjustment A was being applied on an annual basis and was calculated as £666k. On checking this calculation and that for previous years it became apparent that Warwickshire PCC is increasing the CFR by the Adjustment A figure when the purpose of Adjustment A is to ensure that MRP was not increased when the CFR method replaced the Credit Ceiling. The MRP Guidance is clear that where Adjustment A results in a higher MRP charge then the Adjustment should not be considered in the MRP calculation.

Therefore an overprovision of £239,760 has been made in respect of MRP during the period 1st April 2008 to 31st March 2017. We are recommending that the MRP charge for 2017/18 is reduced by this figure to reflect the correction of this adjustment. Ongoing savings will be £27k per annum.

(b) MRP on supported borrowing (ie pre-2008) for both Warwickshire and West Mercia was being calculated on a reducing balance method. The reducing balance method uses a fixed percentage charge each year and means that the balance never reduces to zero. It is more prudent to use the straight line-method and it is recommended that this is adopted from 1 April 2017 for supported borrowing.

The straight-line method will ensure that all of the MRP is accounted for over the relevant period with no residual amount remaining. As the records are not available to show the individual capital expenditure that makes up the supported borrowing, it is prudent to use a straight-line method of MRP over a maximum period of 40 years. This will result in savings of around £180k in 2017/18 for Warwickshire as well as ongoing savings (see section 4. below) and a minimal amount for West Mercia;

(c) MRP on unsupported borrowing since 1 April 2008 for both Warwickshire and West Mercia was being calculated on a straight-line basis (based on useful lives). Based on a review of the annuity method and taking into account the advice from Arlingclose and the guidance from CIPFA above, it is recommended that a prudent provision for MRP can be made using the annuity method with effect from 1 April 2017. This will result in savings of £324k in 2017/18 for Warwickshire and £218k in 2017/18 for West Mercia. Further ongoing savings will be made over the period of the Medium Term Financial Plan, as shown in section 4. below.

(d) Asset lives for Warwickshire and West Mercia have been reviewed and amended to ensure that MRP will be spread over the period over which the capital expenditure provides a benefit to the PCC, and to ensure that a consistent basis is used for both PCCs. The useful lives that have been calculated by the valuers of the assets for the Statements of Accounts have been taken into consideration in this exercise. Where assets are no longer held or the remaining MRP was less than £10k, these have been fully written off in 2017/18;

(e) The effective date of all of the changes above has been taken as 1 April 2017.

4. Ongoing Savings

Savings in MRP over the period of the MTFP are as follows:

Warwickshire

Year	**2017/2018**	**2018/2019**	**2019/2020**	**2020/2021**	**2021/2022**
Current Supported	£468,240	£428,870	£411,716	£395,247	£379,437
Current Adjustment "A"	£26,640	£26,640	£26,640	£26,640	£26,640
Current Unsupported	£811,103	£542,960	£542,960	£542,960	£530,160
Current Total	**£1,305,983**	**£998,470**	**£981,316**	**£964,847**	**£936,237**
Revised Supported	£285,750	£285,750	£285,750	£285,750	£285,750
Adjustment "A" not required	-£239,760	£0	£0	£0	£0
Revised Unsupported	£487,394	£384,690	£399,562	£415,033	£417,744
Revised Total	**£533,384**	**£670,440**	**£685,312**	**£700,783**	**£703,494**
SAVING:	**-£772,599**	**-£328,030**	**-£296,004**	**-£264,064**	**-£232,743**

West Mercia

Year	2017/2018	2018/2019	2019/2020	2020/2021	2021/2022
Current supported	£11,240	£11,240	£11,240	£11,240	£11,240
Current Unsupported	£1,492,813	£1,469,233	£1,469,233	£1,325,992	£1,325,992
Current Total	**£1,504,053**	**£1,480,473**	**£1,480,473**	**£1,337,232**	**£1,337,232**
Revised Supported	£11,240	£11,240	£11,240	£11,240	£11,240
Revised Unsupported	£1,274,999	£1,071,907	£1,116,072	£936,737	£976,825
Revised Total	**£1,286,239**	**£1,083,147**	**£1,127,312**	**£947,977**	**£988,065**
SAVING:	**-£217,814**	**-£397,326**	**-£353,161**	**-£389,255**	**-£349,167**

5. Recommendations

It is recommended that the Joint Audit Committee support the changes to the MRP Policy for both Warwickshire PCC and West Mercia PCC with effect from 1 April 2017, as set out in the above report, and recommend that the Police and Crime Commissioners approve these changes.

Elizabeth Hall
Treasurer

11 December 2017