

Revised Minimum Revenue Provision Methodology

Background

Chesterfield Borough Council recently commissioned its treasury advisors, Arlingclose, to undertake a review of its MRP calculations for non-Housing Revenue Account (HRA) unsupported and supported capital expenditure. The objective of the review was to determine whether current arrangements are appropriate and whether alternative arrangements impacting on Council Tax could be put in place that would remain prudent.

Following the review the Council has considered Arlingclose's report and is proposing to amend its MRP methodology for the 2017/18 financial year onwards. This is in line with MHCLG's Draft MRP Guidance which indicates that revisions to MRP should be based on the Residual CFR i.e. retrospective calculations should not be undertaken.

The 2016/17 CFR and MRP items are summarised as follows:

		CFR	MRP	CFR	MRP Basis
		31-Mar-16	2016/17	31-Mar-17	
		£	£	£	
Non-HRA	Supported Capital Expenditure	5,538,008.64	-221,520.35	5,316,488.29	4.00%
Non-HRA	Unsupported Capital Expenditure	8,924,010.90	-245,668.02	8,678,342.88	Asset Life - Equal Instalment
		14,462,019.54	-467,188.37	13,994,831.17	

The Council is currently applying MRP at 4% of the previous year's Non-HRA Supported Capital Expenditure CFR.

The remaining element of the non-HRA CFR is in respect of Unsupported Capital Expenditure. MRP for this expenditure is currently applied on a straight line basis over the estimated lives of the related assets.

Supported Non-HRA Capital Expenditure:

The Council has currently adopted Option 2 – the CFR Method of MHCLG's MRP Guidance for supported capital expenditure. The Council's Supported CFR as at 31st March 2017 was £5.316m. Under Option 2 MRP is charged at 4% of the previous year's Supported CFR.

From 2017/18 onwards the Council proposes adopting an Annuity based calculation for MRP on the supported capital expenditure element of the CFR. A calculation has been undertaken using an Annuity Rate of 2% over 40 years. The percentage chosen corresponds with the Monetary Policy Committee's inflation target rate of 2%. MRP will increase by this percentage each year. This reflects the time value of money and produces a consistent charge to Council Tax payers. The annuity period of 40 years has been selected as a period over which the capital expenditure could be expected to provide a benefit to Council Tax payers. A straight line approach has also been calculated for comparison purposes.

The results of these methods of calculation are compared to the existing methodology below:

Chesterfield Borough Council									
Supported Borrowing CFR and MRP									
Year	Year ending 31st March	Closing CFR	Current Method MRP	Closing CFR	Inflation based MRP	Closing CFR	Straight Line MRP	Difference between Current Method MRP and Inflation MRP	Difference between Current Method MRP and Straight Line MRP
		Adjustment A --->	£0						
			4%		2%		40		
		£	£	£	£	£	£	£	£
	2017	5,316,488		5,316,488		5,316,488			
1	2018	5,103,828	212,660	5,228,470	88,018	5,183,576	132,912	124,641	79,747
2	2019	4,899,675	204,153	5,138,691	89,779	5,050,664	132,912	114,374	71,241
3	2020	4,703,688	195,987	5,047,116	91,574	4,917,751	132,912	104,413	63,075
4	2021	4,515,541	188,148	4,953,711	93,406	4,784,839	132,912	94,742	55,235
5	2022	4,334,919	180,622	4,858,437	95,274	4,651,927	132,912	85,348	47,709
6	2023	4,161,522	173,397	4,761,257	97,179	4,519,015	132,912	76,217	40,485
7	2024	3,995,061	166,461	4,662,134	99,123	4,386,103	132,912	67,338	33,549
8	2025	3,835,259	159,802	4,561,029	101,106	4,253,190	132,912	58,697	26,890
9	2026	3,681,849	153,410	4,457,901	103,128	4,120,278	132,912	50,283	20,498
10	2027	3,534,575	147,274	4,352,711	105,190	3,987,366	132,912	42,084	14,362
11	2028	3,393,192	141,383	4,245,417	107,294	3,854,454	132,912	34,089	8,471
12	2029	3,257,464	135,728	4,135,977	109,440	3,721,542	132,912	26,288	2,815
13	2030	3,127,166	130,299	4,024,348	111,629	3,588,629	132,912	18,670	-2,614
14	2031	3,002,079	125,087	3,910,487	113,861	3,455,717	132,912	11,225	-7,826
15	2032	2,881,996	120,083	3,794,349	116,138	3,322,805	132,912	3,945	-12,829
16	2033	2,766,716	115,280	3,675,887	118,461	3,189,893	132,912	-3,181	-17,632
17	2034	2,656,047	110,669	3,555,057	120,830	3,056,981	132,912	-10,162	-22,244
18	2035	2,549,805	106,242	3,431,810	123,247	2,924,068	132,912	-17,005	-26,670
19	2036	2,447,813	101,992	3,306,098	125,712	2,791,156	132,912	-23,720	-30,920
20	2037	2,349,901	97,913	3,177,872	128,226	2,658,244	132,912	-30,314	-35,000
21	2038	2,255,905	93,996	3,047,081	130,791	2,525,332	132,912	-36,795	-38,916
22	2039	2,165,668	90,236	2,913,674	133,407	2,392,420	132,912	-43,170	-42,676
23	2040	2,079,042	86,627	2,777,599	136,075	2,259,507	132,912	-49,448	-46,285
24	2041	1,995,880	83,162	2,638,803	138,796	2,126,595	132,912	-55,635	-49,751
25	2042	1,916,045	79,835	2,497,231	141,572	1,993,683	132,912	-61,737	-53,077
26	2043	1,839,403	76,642	2,352,828	144,404	1,860,771	132,912	-67,762	-56,270
27	2044	1,765,827	73,576	2,205,536	147,292	1,727,859	132,912	-73,716	-59,336
28	2045	1,695,194	70,633	2,055,298	150,237	1,594,946	132,912	-79,604	-62,279
29	2046	1,627,386	67,808	1,902,056	153,242	1,462,034	132,912	-85,434	-65,104
30	2047	1,562,291	65,095	1,745,749	156,307	1,329,122	132,912	-91,212	-67,817
31	2048	1,499,799	62,492	1,586,316	159,433	1,196,210	132,912	-96,942	-70,421
32	2049	1,439,807	59,992	1,423,694	162,622	1,063,298	132,912	-102,630	-72,920
33	2050	1,382,215	57,592	1,257,820	165,874	930,385	132,912	-108,282	-75,320
34	2051	1,326,926	55,289	1,088,628	169,192	797,473	132,912	-113,903	-77,624
35	2052	1,273,849	53,077	916,052	172,576	664,561	132,912	-119,499	-79,835
36	2053	1,222,895	50,954	740,025	176,027	531,649	132,912	-125,073	-81,958
37	2054	1,173,979	48,916	560,478	179,548	398,737	132,912	-130,632	-83,996
38	2055	1,127,020	46,959	377,339	183,139	265,824	132,912	-136,179	-85,953
39	2056	1,081,939	45,081	190,537	186,801	132,912	132,912	-141,721	-87,831
40	2057	1,038,662	43,278	0	190,537	0	132,912	-147,260	-89,635
			4,277,826		5,316,488		5,316,488	-1,038,662	-1,038,662

The existing methodology results in the CFR being £1.039m in 40 years' time as MRP is charged on a reducing balance basis. Under the Annuity method this element of the CFR would be fully financed in 40 years' time. This method can be considered to be more prudent than the current methodology as it would fully finance the capital expenditure over the given period of years.

MRP under this method would be £0.125m lower in 2017/18 when compared with that under the CFR Method. In 15 years' time MRP under the Annuity method would broadly match that under the CFR Method. Interestingly the final amount of MRP in 40 years' time would be £0.190m which is £0.022m lower than MRP under the CFR Method estimated for the current year.

Unsupported non-HRA Capital Expenditure:

Details of the Council's unsupported capital expenditure are as follows:

	CFR	MRP	CFR	Estimated	Remaining
	31-Mar-16	2016/17	31-Mar-17	Life	Life
Unsupported Capital Expenditure:	£	£	£	(Years)	(Years)
Rose Hill Car Park: Pay-on-Exit Scheme:					
Electrical & ICT infrastructure, lighting columns, boundary walls	33,753.81	- 1,350.15	32,403.66	30	25
Hard surfacing	58,162.72	- 3,877.51	54,285.21	20	15
Parking control equipment, light fittings, other fixtures, boundary fences	123,566.72	- 12,356.67	111,210.05	15	10
	215,483.25	- 17,584.33	197,898.92		
Market Hall Redevelopment:					
Market Hall Redevelopment (LT)	1,213,333.34	- 43,333.33	1,170,000.01	30	28
Market Hall Redevelopment (Temp)	480,052.16	- 17,144.72	462,907.44	30	28
	1,693,385.50	- 60,478.05	1,632,907.45		
QPSC New Build:					
QPSC New Build (Wall Structure) (50% of spend)	3,023,577.94	- 37,794.72	2,985,783.22	80	80
QPSC New Build (Other Structure) (15% of spend)	907,073.38	- 18,141.47	888,931.91	50	50
QPSC New Build (Building Services) (30% of spend)	1,814,146.76	- 60,471.56	1,753,675.20	30	30
QPSC New Build (Fixtures etc.) (5% of spend)	302,357.79	- 30,235.78	272,122.01	10	10
	6,047,155.88	- 146,643.53	5,900,512.35		
Ex-Fire Station Site	547,844.50	- 11,413.43	536,431.07	50	48
Loan to Chesterfield FC	420,141.77	- 9,548.68	410,593.09	50	44
Total Unsupported Capital Expenditure	8,924,010.90	- 245,668.02	8,678,342.88		

For new capital expenditure under the Prudential system for which no Government support is being given and is therefore self-financed, there are two options included in the Guidance.

Option 3 is to make provision over the estimated life of the asset for which the capital expenditure is undertaken. Within option 3, two methods are identified.

The first of these is the equal instalment method where MRP is charged on a straight line basis over the estimated life of the asset. The Council has adopted this version of Option 3 as its current policy for making MRP in respect of unsupported capital expenditure.

From 2017/18 onwards the Council proposes adopting the alternative method under Option 3 which is the annuity method. This has the advantage of linking MRP to the flow of benefits from an asset where the benefits are expected to increase in later years.

Guidance on the calculation method is given by CIPFA in Chapter 6 of its publication Practitioners' Guide to Capital Finance in Local Government (CIPFA 2008) (ISBN 978 1 84508 175 1).

This document states "The informal commentary on the statutory guidance suggests that the annuity method may be particularly attractive in projects where revenues will increase over time. However, 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."

Consideration has been given to assessing the impact of adopting the Annuity method in respect of its unsupported capital expenditure. CIPFA's Practitioners' Guide to Capital Finance in Local Government supports the use of the Annuity method on the basis that the MRP charge to Revenue takes account of the time value of money. This results in a consistent charge to Revenue for assets that provide a steady flow of benefits over their useful lives.

In using the Annuity method for calculating MRP the Council considers that it would be appropriate to set the annuity rate at estimated inflation. This will result in MRP rising each year at that rate. As the Bank of England's Monetary Policy Committee is charged with the requirement for Consumer Price Inflation (CPI) to be maintained at 2%, the Council proposes to apply an annuity rate of 2% to calculate MRP under the Annuity Method.

The Table below compares the existing straight line approach MRP and the CFR with a 2% Annuity approach. The first 40 years are presented.

Chesterfield Borough Council							
Unsupported Capital Expenditure CFR and MRP							
Year	Year ending 31st March	Equal Instalment MRP	Equal Instalment CFR	2% Inflation Annuity MRP	2% inflation Annuity CFR	MRP Difference	Cumulative Impact
		£	£	£	£	£	£
1	2018	245,668	8,432,675	174,912	8,503,431	70,756	70,756
2	2019	245,668	8,187,007	178,410	8,325,021	67,258	138,014
3	2020	245,668	7,941,339	181,978	8,143,042	63,690	201,703
4	2021	245,668	7,695,671	185,618	7,957,424	60,050	261,753
5	2022	245,668	7,450,003	189,330	7,768,094	56,338	318,091
6	2023	245,668	7,204,335	193,117	7,574,977	52,551	370,642
7	2024	245,668	6,958,667	196,979	7,377,998	48,689	419,331
8	2025	245,668	6,712,999	200,919	7,177,079	44,749	464,080
9	2026	245,668	6,467,331	204,937	6,972,141	40,731	504,810
10	2027	203,076	6,264,255	162,072	6,810,069	41,004	545,814
11	2028	203,076	6,061,179	165,313	6,644,756	37,763	583,577
12	2029	203,076	5,858,103	168,620	6,476,136	34,456	618,033
13	2030	203,076	5,655,027	171,992	6,304,144	31,084	649,117
14	2031	203,076	5,451,951	175,432	6,128,712	27,644	676,761
15	2032	199,198	5,252,753	174,456	5,954,256	24,742	701,503
16	2033	199,198	5,053,555	177,945	5,776,311	21,253	722,756
17	2034	199,198	4,854,357	181,504	5,594,807	17,694	740,450
18	2035	199,198	4,655,159	185,134	5,409,673	14,064	754,514
19	2036	199,198	4,455,961	188,837	5,220,836	10,361	764,875
20	2037	199,198	4,256,763	192,614	5,028,223	6,584	771,460
21	2038	199,198	4,057,565	196,466	4,831,757	2,732	774,192
22	2039	199,198	3,858,367	200,395	4,631,362	-1,197	772,995
23	2040	199,198	3,659,169	204,403	4,426,959	-5,205	767,790
24	2041	199,198	3,459,971	208,491	4,218,468	-9,293	758,497
25	2042	197,848	3,262,123	210,948	4,007,520	-13,100	745,397
26	2043	197,848	3,064,275	215,167	3,792,353	-17,319	728,078
27	2044	197,848	2,866,427	219,470	3,572,882	-21,622	706,455
28	2045	137,370	2,729,057	145,001	3,427,881	-7,631	698,824
29	2046	137,370	2,591,687	147,901	3,279,980	-10,531	688,293
30	2047	76,898	2,514,789	70,579	3,209,401	6,319	694,612
31	2048	76,898	2,437,891	71,991	3,137,411	4,907	699,520
32	2049	76,898	2,360,993	73,430	3,063,980	3,468	702,987
33	2050	76,898	2,284,095	74,899	2,989,081	1,999	704,986
34	2051	76,898	2,207,197	76,397	2,912,684	501	705,487
35	2052	76,898	2,130,299	77,925	2,834,760	-1,027	704,461
36	2053	76,898	2,053,401	79,483	2,755,276	-2,585	701,875
37	2054	76,898	1,976,503	81,073	2,674,203	-4,175	697,700
38	2055	76,898	1,899,605	82,695	2,591,509	-5,797	691,904
39	2056	76,898	1,822,707	84,348	2,507,160	-7,450	684,453
40	2057	76,898	1,745,809	86,035	2,421,125	-9,137	675,316

MRP is lower than the current methodology in the early years but again the differences diminish over the years as the annuity inflates at 2% per annum. The original capital expenditure is fully financed under both MRP methods.