REPORT TO	**SCRUTINY COMMITTEE RESOURCES, EXECUTIVE AND COUNCIL**
Date of Meeting:	**Scrutiny Committee Resources - 27 January 2016** **Executive - 9 February 2016** **Council - 23 February 2016**
Report of:	**Assistant Director Finance**
Title:	**The Prudential Code for Capital Finance in Local Authorities (Incorporating the Annual Statement of Minimum Revenue Provision)**

Is this a Key Decision?
Yes

Is this an Executive or Council Function?
Council

1. What is the report about?

To set out the proposed 2016/17 prudential indicators for capital finance for adoption by the Council and set the annual statement of Minimum Revenue Provision (MRP).

2. Recommendations:

It is recommended that Scrutiny Committee – Resources supports and Council approves the adoption of:

i. The Prudential Indicators set out in Appendix A-C
ii. The Annual Statement of Minimum Revenue Provision for the Council

3. Reasons for the recommendation:

With effect from 1 April 2004, the Government abolished the capital finance legislation in Part 4 of the Local Government and Housing Act 1989 and the Local Authorities (Capital Finance) Regulations 1997 (Statutory Instrument 1997/319) and replaced it with a new Prudential system based on self-regulation. This means that Councils are free to borrow for capital investment where the borrowing is affordable.

The Prudential Code was revised slightly during 2012. The “net debt and the capital financing requirement” has been amended to “gross debt and the capital financing requirement” and the proportion of net debt to gross debt indicator introduced last year has been withdrawn as it does not work.

The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 came into force on 31 March 2008. The Regulations require Full Council to approve an Annual Statement of Minimum Revenue Provision which is the amount set aside from revenue for the repayment of debt principal relating to the General Fund only. The Housing Revenue Account remains exempt from making Minimum Revenue Provision although it can make voluntary set asides if it wishes.

The Prudential Indicators / MRP report will be incorporated within the Budget Book for approval at the full Council meeting as per the statutory requirement.

4. What are the resource implications including non financial resources

The financial resources required are set out in the body of this report.

5. **Section 151 Officer comments:**
This report has been prepared on behalf of the Section 151 Officer to set out the Prudential Indicators for 2016/17 and the annual statement of Minimum Revenue Provision.

6. **What are the legal aspects?**
With effect from 1 April 2004, the Government abolished the capital finance legislation in Part 4 of the Local Government and Housing Act 1989 and the Local Authorities (Capital Finance) Regulations 1997 (Statutory Instrument 1997/319) and replaced it with a new Prudential system based on self-regulation.

7. **Monitoring Officer's comments:**
The Monitoring Officer comments have not been obtained.

8. **Report Details:**

8.1 PRUDENTIAL INDICATORS

The proposed prudential indicators for the next three years are shown in Appendix A-C.

8.2 Key issues to consider

Appendix C summarises the prudential code indicators for the Council and of particular importance are

- the Capital Financing Requirement - demonstrates the amount that the Council has an underlying need to borrow, regardless of whether that amount has actually been borrowed;
- the Operational Boundary – this sets the amount of borrowing that the Council intends to keep within over the period covered by the indicators;
- The Authorised Limit – the maximum that the section 151 officer is allowed to borrow to cover the Operational Boundary and day to day Cashflow needs. The Council is not allowed to exceed this amount of borrowing without first authorising an increase to the limit.

9. ANNUAL STATEMENT OF MINIMUM REVENUE PROVISION

The Regulations require that "a local authority shall determine for the current financial year an amount of minimum revenue provision which it considers to be prudent".

Minimum Revenue Provision (MRP) is an amount set aside from revenue to meet the repayment of debt principal. It is in effect a replacement for depreciation that you would normally expect to see within a Company's Accounts. Under the old Regulations this was 4% of principal outstanding for the General Fund and no requirement to set aside MRP in the Housing Revenue Account. In local government accounting depreciation is charged and then reversed out so it does not affect the level of Council Tax, however MRP is charged to the General Fund and therefore does affect levels of Council Tax.

The Secretary of State for Communities and Local Government has issued guidance under section 21(1A) of the Local Government Act 2003. This states that "the broad aim of prudent provision is to ensure that debt is repaid 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 the grant." The guidance notes detail five options which the Secretary of State considers prudent. These are described in section 4 below:

(a) Regulatory Method;
(b) Capital Financing Requirement Method;
(c) Asset Life (Equal Instalment) Method;
(d) Asset Life (Annuity) Method; and
(e) Depreciation Method

Key issue to consider
Section 6 sets out the proposed policy for MRP, which matches the amount set aside against the useful life of the assets. The only exception to this is the writing off of historic debt which is being undertaken over 50 years.

10. MRP OPTIONS

Regulatory Method
MRP is equal to the amount determined in accordance with the former regulations 28 and 29 of the 2003 Regulations as if they had not been revoked. In effect this is 4% of the debt principal outstanding.

Capital Financing Requirement Method
MRP is equal to 4% of the non-housing Capital Financing Requirement, which is a Prudential Indicator.

Asset Life (Equal Instalment) Method
Where capital expenditure on an asset is financed wholly or partly by borrowing then MRP is determined by reference to the life of the asset and an equal amount charged in each year.

Asset Life (Annuity) Method
MRP is the principal element for the year of the annuity required to repay over the asset life the amount of capital expenditure financed by borrowing.

Depreciation Method
MRP is equal to the provision required in accordance with depreciation accounting in respect of the asset, including any amount of impairment chargeable to the Income and Expenditure Account. As standard depreciation rules are used where an asset is part financed by loan, e.g. 50% loan, 50% Capital Receipt, then the full 100% depreciation charge on the asset is required to be charged as MRP. MRP is required to be charged annually until the cumulative amount of the provision is equal to the original expenditure financed by borrowing. Should the asset be disposed of then the charge needs to continue as if the asset had not been disposed of unless the debt is repaid.

11. Minimum Revenue Provision Policy 2016/17

The Council's MRP policy is to match borrowing against specific capital investment and adopt either the Asset Life (Equal Instalment) or the Asset Life (Annuity) method for MRP. In this way the funding for the asset will be paid off over the useful life of that asset. This will ensure that loans are repaid over the asset life thus freeing financial resources for investment in other schemes or in asset renewal. They are also simple to operate and gives certainty in each year as to the level of charge for principal.

The other advantage is that it makes business cases and scheme appraisals easier to compile. As a general rule the Council will seek to borrow over the same period of the asset life up to a maximum of 50 years in line with the Regulations. The total capital financing requirement at the end of 2015/16 is likely to be approximately £97.5m, some of which has financed redundancy payments and other shorter dated expenditure. Therefore MRP for 2016/17 will be calculated based on the capital financing requirement at the end of 2015/16 using the varying periods of repayment. The MRP charge for 2016/17 will be approximately £0.875 million. For the avoidance of doubt, it is proposed to use both options from 2015/16 onwards.

12. How does the decision contribute to the Council's Corporate Plan?
The Capital Programme contributes to all of the key purposes, as set out in the Corporate Plan.

13. What risks are there and how can they be reduced?
Areas of budgetary risk are highlighted to committee as part of the quarterly budget monitoring updates.

14. What is the impact of the decision on equality and diversity; health and wellbeing; safeguarding children, young people and vulnerable adults, community safety and the environment?
No impact

15. Are there any other options?
No

David Hodgson, Assistant Director Finance

Local Government (Access to Information) Act 1972 (as amended)
Background papers used in compiling this report:
1. The Prudential Code for Capital Finance in Local Authorities
2. The Prudential Code Guidance Notes

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