APPENDIX 9

CAPITAL STRATEGY REPORT 2020/21

Introduction

The capital strategy report gives a high-level overview of how capital expenditure, capital financing and treasury management activities contribute to the provision of local public services at the Council. In addition it also gives an overview of how the associated risks are managed and the implications for future financial sustainability.

The report is a requirement of the 2017 Code of Practice on Treasury Management, issued by the Chartered Institute of Public Finance & Accountancy, and has been produced in an accessible way to enhance members' understanding of these sometimes technical areas. It is a replacement for the prudential indicator and treasury management report included within previous budget setting reports prior to 2019/20, but gives a wider context on the capital financing processes used.

Capital Expenditure and Financing

Capital expenditure is where the Council spends money on assets, such as property, IT and vehicles that will be used for more than one financial year. In local government this also includes spending on assets owned by other bodies, finance leases and loans and grants to other bodies enabling them to buy assets. The Council has some limited discretion on what counts as capital expenditure, for example assets costing below £10,000 are generally not capitalised.

- For details of the Council's policy on the capitalisation of assets, see the accounting policies section of the annual statement of accounts on the Council's website (www.middlesbrough.gov.uk).

In the 2020/21 financial year, the Council is planning a total capital expenditure of £65.831m as summarised below:

Table 1: Prudential Indicator: Estimates of Capital Expenditure in £ millions

	2018/19 £000 Actual	**2019/20 £000 Estimate**	**2020/21 £000 Estimate**	**2021/22 £000 Estimate**	**2022/23 £000 Estimate**
Total Capital Expenditure – Investment Strategy	31.507	50.996	62.331	37.174	8.273
Total Capital Expenditure – Finance Leases	0.000	20.835	3.500	30.500	0.500
Total Capital Expenditure	**31.507**	**71.831**	**65.831**	**67.674**	**8.773**

The main capital projects expected to be undertaken in 2020/21 include the acquisition of town centre properties £12.35m, the new BOHO schemes 8 & 10 - £10.4m, Middlesbrough Development Company projects - £6.9m, Affordable Housing & Housing Growth schemes - £3.3m, Town Centre Accommodation Strategy £3.0m, Disabled Facilities Grant schemes £2.9m, ICT related projects £2.8m, A66 Throughabout - £1.8m and East Middlesbrough Community Hub £1.1m.

Governance: Service managers generally bid during the previous financial year to include projects in the Council's forward capital programme. Bids are collated by the Council's finance team who calculate the financing costs of each project (which can be nil if the project is fully externally financed). The Council's Management Team (CMT) appraises all bids based on a comparison of service priorities against financing costs and then makes recommendations to Members for which schemes progress against the capital resources available. The final capital programme to support the Medium Term Financial Plan is then presented to Executive during February and to Council in March each year for approval.

All capital expenditure must be financed, either from external sources (government grants and other contributions), the Council's own resources (revenue, reserves and capital receipts) or debt (borrowing, leasing and Private Finance Initiative). The planned financing of the above expenditure is as follows:

Table 2: Capital financing in £ millions

	2018/19 actual	**2019/20 forecast**	**2020/21 budget**	**2021/22 budget**	**2022/23 budget**
External sources	14.020	20.368	23.849	19.466	0.000
Own resources	4.420	3.038	18.625	17.623	8.273
Debt	13.067	48.425	23.357	30.585	0.500
TOTAL	**31.507**	**71.831**	**65.831**	**67.674**	**8.773**

Any external debt (loans and leases) must be repaid over time by other sources of finance. This normally comes from the revenue budget in the form of Minimum Revenue Provision (MRP). Alternatively, proceeds from selling capital assets (known as capital receipts) may be used to replace/repay debt finance. The Council generally capital receipts to finance new capital expenditure rather than to redeem debt. The total cost of MRP included in the Council's revenue budget is as follows:

Table 3: Minimum Revenue Provision in £ millions

	2018/19 actual	**2019/20 forecast**	**2020/21 budget**	**2021/22 budget**	**2022/23 budget**
Cost to Revenue Budget	3.004	3.440	4.403	5.145	5.367

- The Council's full minimum revenue provision statement for 2020/21 is available towards the end of this Appendix.

The Council's cumulative amount of debt finance still outstanding is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure each year and then reduces with Minimum Revenue Provision and capital receipts used to redeem debt.

The CFR is expected to increase by £18.9m or 7.9% during the 2020/21 financial year. This increase is due to the new capital expenditure funded by external debt of £23.3m less the MRP set aside of £4.4m.

Based on the above figures for expenditure and financing, the Council's estimated CFR for the period of the Medium Term Financial Plan is as follows:

Table 4: Prudential Indicator: Estimates of Capital Financing Requirement in £ millions

	31.3.2019 actual	31.3.2020 forecast	31.3.2021 budget	31.3.2022 budget	31.3.2023 budget
TOTAL CFR	**195.235**	**240.220**	**259.174**	**284.614**	**279.747**

Asset disposals: When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or be used to repay debt. The Council is currently also permitted to spend capital receipts on service transformation projects until 2021/22. Repayments of capital grants, loans and investments also generate capital receipts.

The Council plans to receive £18.6m of capital receipts in the coming financial year as follows:

Table 5: Capital receipts in £ millions

	2018/19 actual	2019/20 forecast	2020/21 budget	2021/22 budget	2022/23 budget
TOTAL	**4.469**	**1.711**	**18.631**	**21.512**	**5.962**

- The level of capital receipts for each year is monitored between Finance, Regeneration and Valuation & Estates teams, on a monthly basis. The total receipts generated each financial year may differ from those used to finance the programme in table 2 (own resources) due to timing issues and all receipts not being needed immediately for funding purposes.
- The Council has not adopted the Flexible Use of Capital Receipts Policy where these proceeds may be used for funding service transformation costs that would otherwise be classed as revenue expenditure.

Treasury Management

Treasury Management is concerned with keeping sufficient but not excessive cash resources, available to meet the Council's spending needs, while managing the risks involved in these investments. Surplus cash is invested until required, whilst a shortage of cash will be financed by borrowing, to avoid excessive credit balances or overdrafts in the bank current account.

The Council is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are therefore offset against capital cash shortfalls to reduce the overall borrowing amount required, as part of an integrated strategy on Treasury Management.

The Council at the end of January 2020 has £223.4m of borrowing at an average interest rate of 3.9% and £13m of treasury investments at an average rate of around 0.9%.

Borrowing strategy: The Council's main objectives when borrowing are to achieve a low but certain cost of finance for long term capital projects whilst retaining flexibility should plans change in future. These objectives are often conflicting, and the Council therefore seeks to strike a balance between using cheap short-term loans (currently available at variable rates between 0.75% & 1.0%) and long-term fixed rate loans where the future cost is known but interest costs are higher (currently between 2.5% to 3.5%).

Projected levels of the Council's total outstanding debt (which comprises borrowing and relevant finance leases) are shown below, compared with the capital financing requirement.

Table 6: Prudential Indicator: Gross Debt and the Capital Financing Requirement in £ millions

	31.3.2019 actual	**31.3.2020 forecast**	**31.3.2021 budget**	**31.3.2022 budget**	**31.3.2023 budget**
External Debt	160.111	223.414	**243.409**	270.544	267.503
Capital Financing Requirement	195.235	240.220	**259.174**	284.614	279.747

Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term where the benefits of short term borrowing may be taken. As can be seen from table 6, the Council expects to comply with this in the medium term with debt being lower than the capital financing requirement in all relevant financial years.

Affordable borrowing limit: The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt levels start to approach the legal limit and is a more realistic rather than worst case view of what will happen during the financial year. Any need to change these during the 2020/21 financial year from the original budget assumptions will be reported by the Strategic Director of Finance, Governance & Support to the Executive at the earliest opportunity.

Table 7: Prudential Indicators: Authorised limit and operational boundary for external debt in £m

	2019/20 limit	2020/21 limit	2021/22 limit	2022/23 limit
Authorised Limit (OB + £20m)	273.000	**300.000**	325.000	320.000
Operational Boundary (CFR + £20m)	253.000	**280.000**	305.000	300.000

Investment strategy: Treasury investments arise from receiving cash before it is paid out again. Investments made for service reasons or for pure financial gain are not generally considered to be part of treasury management.

The Council's policy on treasury investments is to prioritise security and liquidity over yield, which focuses on minimising risk rather than maximising returns. Cash that is likely to be spent in the short term is invested securely, for example with the government, other local authorities or selected high-quality banks, to minimise the risk of loss.

Table 8: Treasury management investments in £millions

	31.3.2019 actual	31.3.2020 forecast	31.3.2021 budget	31.3.2022 budget	31.3.2023 budget
Short-term investments	3.450	5.000	5.000	5.000	5.000
Longer-term investments	10.000	10.000	10.000	10.000	10.000
TOTAL	**13.450**	**15.000**	**15.000**	**15.000**	**15.000**

Governance: Decisions on treasury management investment and borrowing are made daily and are therefore delegated by the Strategic Director of Finance, Governance and Support to the Head of Financial Governance & Revenues and staff within the finance team, who must act in line with the treasury management strategy approved by Council. Quarterly updates on treasury management activity are presented to Executive as part of the budget monitoring process.

Revenue Budget Implications

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue, offset by any investment income receivable. The net annual charge is known as capital financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, business rates and general government grants. This is an important indicator around the affordability of the Council's capital plans going forwards.

Table 9: Prudential Indicator: Proportion of financing costs to net revenue stream

	2018/19 actual	**2019/20 forecast**	**2020/21 budget**	**2021/22 budget**	**2022/23 budget**
Financing costs (£m)	7.377	9.561	9.168	9.900	10.432
Net Revenue Budget (£m)	111.285	111.926	116.397	117.739	119.645
Proportion of net revenue stream	6.6%	8.5%	7.9%	8.5%	8.7%

Sustainability: Due to the very long-term nature of capital expenditure and its financing, the revenue budget implications of this investment incurred in the next few years could extend for up to some 50 years into the future.

The % figures in table above also remain stable at a time when debt levels for the Council are increasing significantly. Members need to be aware that this is as a result of investments in commercial property made by the Council during 2019/20 and to be made in 2020/21. This results in around £1.5m of income per year to the capital financing budget by the end of the 2022/23 financial year. It is a key budget risk that these rental levels are maintained going forwards. This will be considered as part of future budget monitoring and performance reports each quarter to Executive.

The figures on financing costs above are also lower than those currently being reported in the medium term financial plan. This relates to changes in the funding position for the Investment Strategy and the assumptions that underpin this at Quarter 3 for 2019/20 and after the revenue budget for 2020/21 has been finalised. These changes will be incorporated in the next update of the MTFP.

The Strategic Director of Finance, Governance & Support is satisfied that the proposed capital programme being proposed is prudent, affordable and sustainable because appropriate resources have been allocated from the Council's medium term financial plan, any finance leases have been appropriately vetted and any borrowing plans have been fully costed.

Table 10 – Total Borrowing required for each year of the MTFP

	2018/19 £000 Estimate	**2019/20 £000 Estimate**	**2020/21 £000 Estimate**	**2021/22 £000 Estimate**	**2022/23 £000 Estimate**
Investment Strategy	13.067	27.590	19.857	0.085	0
Finance Leases	0	20.835	3.500	30.500	0.500
Debt Restructuring	0	0	0	0	0
Total	13.067	48.425	23.357	30.585	0.500

This takes into account any debt needed to either finance the capital programme, in respect of leasing arrangements or to finance any debt restructuring required. The restructuring amount is a general provision for any loans that it may be beneficial to repay early. Current interest rates at present suggest that this is prohibitive for the next three financial years and therefore no amounts have been factored into the borrowing plans of the Council for this.

All the Prudential Indicators & limits set out in the earlier parts of this report, are consistent with the authority's current commitments, existing plans and the proposals in the budget report for capital expenditure and financing, and with its approved treasury management policy statement and practices.

The Strategic Director of Finance, Governance and Support confirms that they are based on the estimate of most likely, prudent but not worst case scenario, with in addition sufficient headroom over and above this to allow for operational management, for example unusual cash movements or unbudgeted expenditure. Risk analysis and risk management strategies have been taken into account; as have plans for capital expenditure, estimates of the capital financing requirement and estimates of cash flow requirements for all purposes.

Prudence – Treasury Management Indicators

It is recommended that the Council sets an upper limit on its fixed interest rate exposures for 2020/21, 2021/22 and 2022/23 of 100% of its estimated total borrowing undertaken.

It is further recommended that the Council sets an upper limit on its variable interest rate exposures for 2020/21, 2021/22 and 2022/23 of 25% of its estimated total borrowing undertaken.

This means that the Strategic Director of Finance, Governance and Support will manage fixed interest rate exposures on total debt within the range 75% to 100% and variable interest rate exposures on total debt within the range 0% to 25%.

It is also recommended that the Council sets upper and lower limits for the maturity structure (when the debt needs to be repaid) of its total borrowing as follows.

<u>Amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate at the start of the period:</u>

	Upper limit	**Lower limit**
under 12 months	50%	0%
12 months and within 24 months	30%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and above	90%	20%

Currently investments are limited to a maximum of 3 years, with the deals being arranged so that the maturity will be no more than 3 years and one month after the date the deal is arranged.

The maximum % of the total of all investments that have an outstanding period of one year or longer, at the time the investment is made, is 10%.

Knowledge and Skills

The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, both the Head of Financial Governance & Revenues and the Chief Accountant have in excess of 15 years' experience in local government treasury management. There is similar experience with the finance teams in relation to budgeting & accounting for capital expenditure and financing. The Council pays for junior staff to study towards relevant professional qualifications including CIPFA, CIMA, ACCA, AAT and other relevant vocational studies.

Where Council staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The Council currently employs Arlingclose Limited as treasury management advisers. This approach is more cost effective than employing such staff directly, and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.

- Further details on staff training and the policy on the use of external advisers can be seen with reference to its Treasury Management Practices document which is on the Council's website.

Treasury Management Practices

Further details of how the treasury management function operates, the procedures used to manage banking, treasury and capital market transactions, how risk is managed by the in-house team and how this fits with the CIPFA Code of Practice is included in the Council's set of Treasury Management Practices.

This document is available to Members for further information on request.

ANNUAL INVESTMENT STRATEGY & TREASURY MANAGEMENT POLICY STATEMENT 2020/21

1. In accordance with revised guidance from the Ministry of Housing, Communities and Local Government (MHCLG) a local authority must prepare and publish an Annual Investment Strategy which must be approved by full Council before the start of the financial year to which it relates.

2. The MHCLG guidance offers authorities greater freedom in the way in which it invests monies, providing that prior approval is received from Members by approving the Annual Investment Strategy. The guidance also considers the wider implications of investments made for non-financial returns and how these can be evaluated.

3. The Local Government Act 2003, which also introduced the Prudential Code, requires that a local authority must have regard to such guidance as the Secretary of State issues relating to prudent investment practice.

4. In addition the Chartered Institute of Public Finance & Accountancy (CIPFA) has published a revised Code of Practice for Treasury Management in the Public Services in December 2017. This replaces the 2011 Code which had been adopted in full by Middlesbrough Council. The revised Code requires the Council to clearly state, in the Annual Investment Strategy document, its policy on effective control, and monitoring of its treasury management function. These controls are set out in Treasury Management Practices (TMP's) which have been approved as part of acceptance of the previous Code.

5. The revised Strategy, showing where the Guidance has determined Council policy, can be set out as:

ANNUAL INVESTMENT STRATEGY 2020/21

6. Middlesbrough Council will create and maintain as the cornerstones for effective treasury management:

   - a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities;

   - suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

7. The content of the policy statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the Code's key principles.

8. Middlesbrough Council will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy in advance of the year, a mid-year review which will include an annual report on the previous year, in the form prescribed in its TMP's. Revised Strategies can be presented to the Council for approval at any other time during the year if the Strategic Director of Finance, Governance and Support felt that significant changes to the risk assessment of significant parts of the authority's investments had occurred.

9. Middlesbrough Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Strategic Director of Finance, Governance and Support, and for the execution and administration of treasury management decisions to the Head of Financial Governance and Revenues, who will act in accordance with the organisation's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's *Standard of Professional Practice on Treasury Management.*

10. Middlesbrough Council nominates the Executive to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

11. The Council has, for some time, been very circumspect in its use of credit rating agencies. The section on Specified Investments sets out the current policy. Ratings are monitored on a monthly basis, or more frequently if information is received from the treasury management consultant or other recognised source. Decisions regarding inclusion on the Approved List are made on the basis of market intelligence drawn from a number of sources.

12. All staff involved in treasury management, will, under the supervision of the Head of Financial Governance and Revenues, act in accordance with the treasury management practices and procedures, as defined by the Council. Such staff will undertake relevant training, identified during the Council's induction process and, on an on-going basis, the Council's appraisal policy.

13. The general policy objective contained in the guidance is that local authorities should invest prudently the short-term cash surpluses held on behalf of their communities. The guidance emphasises that priority should be given to security and liquidity rather than yield. Within that framework the authority must determine a category of borrowers, who must be of "high credit quality" classified as **Specified Investments**, with whom it can invest surplus cash with minimal procedural formalities and further identify a category of borrowers classified as **Non-Specified Investments**, with whom it can also invest but subject to prescribed limits.

14. Although the guidance definition of Non-Specified Investments is "one not meeting the definition of a Specified Investment", the authority is required to identify which categories of investments are identified as prudent to use and the limits on any such investment either individually or in total. It is because some organisations do not subscribe to credit rating agencies that they have to be included as Non-Specified Investments, rather than any concern over their creditworthiness.

15. The guidance defines investment in such a way as to exclude pension fund and trust fund investments. In practice Middlesbrough Council, in its role as Administering Authority for the Teesside Pension Fund, follows similar procedures as approved by Members as part of compliance with the CIPFA Code of Practice, albeit with different limits.

LIMITS & DEFINITION OF SPECIFIED INVESTMENTS

16. The following are currently determined as meeting the criteria for Specified Investments:

17. The investment is made with the UK Government, or a local authority (as defined in the Local Government Act 2003), or a police authority, or fire, or a UK Nationalised Industry, or UK Bank, or UK Building Society.

18. The investment is made with a Money Market Fund which, at the time the investment is made, has a rating of AAA.

19. The investment is made with one of the bodies listed in section 4 of Schedule 1E of the current version of the Treasury Management Practices document. which, at the time the investment is made, has a short-term "investment grade" rating with either Standard & Poors, Moody's Investors Search Ltd or Fitch Ratings Ltd (or in the case of a subsidiary the parent has such a rating). Where ratings awarded differ between the rating agencies any one award below investment grade will prevent the investment being categorised as a Specified Investment. The rating of all listed bodies must be monitored on a monthly basis. Where officers become aware of a downward revision of rating, that moves the body out of the "investment grade" category, between such monthly checks, the body should be removed from the list of Specified Investments and, if considered appropriate, the investment should be recalled.

20. All Specified Investments must be denominated in sterling and must be one where the authority may require it to be repaid or redeemed within 12 months of the date on which the investment is made and must be considered of high credit quality. This is defined as having met the criteria set out above. The investment must not constitute the acquisition of share capital or loan capital in any body corporate.

- The minimum % of the total of all investments which must be Specified Investments, at the time the investment is made, is 70%
- The maximum investment with any one counterparty is £15 million, except for the Debt Management Office which is limitless.
- The maximum investment in any one group (i.e. a bank and its wholly-owned subsidiaries) is £15m.

LIMITS & DEFINITION OF NON-SPECIFIED INVESTMENTS

21. These categories of investment currently meet the criteria for Non-Specified investments:

22. The investment is made with a UK bank, or UK building society, or a UK subsidiary of an overseas bank.

23. The investment is made with one of the bodies listed in section 4 of Schedule 1E of the current version of the Treasury Management Practices document, which is not a Specified Investment.

24. The investment is for a period of one year or longer.

25. All Non-Specified Investments must be denominated in sterling. The investment must not constitute the acquisition of share capital or loan capital in any body corporate.

- The maximum % of the total of all investments which can be Non-Specified Investments, at the time the investment is made, is 30%.
- The maximum investment with any one counterparty is £15 million
- The maximum investment in any one group (i.e. a bank and its wholly-owned subsidiaries) is £15m.
- The maximum % of the total of all investments that have an outstanding period of one year or longer, at the time the investment is made, is 10%.

26. The maximum period for which an investment can be made is 3 years, with the maturity date no more than 3 years and 1 month from the time the deal is agreed.

27. As referred to earlier in the report, borrowing should be kept at, or below, the expected capital financing requirement over the medium term to reduce the risk of exposure to interest rate fluctuations. The balance of ‘net borrowing’ (loans less investments) should also be monitored to, where prudent, minimise interest rate differences.

28. The Council considers that it is empowered by Section 12 of the Local Government Act 2003 for the temporary investment of funds borrowed for the purpose of expenditure in the reasonably near future. While not “borrowing to invest” it is prudent to invest monies raised in advance of expenditure. As required by the Guidance such investment is permitted providing the anticipated expenditure is within this or the next financial year or within a period of eighteen months, whichever is the greater.

TREASURY MANAGEMENT POLICY STATEMENT

29. Middlesbrough Council defines its treasury management activities as:
'The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.'

30. The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation and any financial instruments entered into to manage those risks.

31. The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

32. The high level policies and monitoring arrangements adopted by the Council for Borrowing and Investments are as follows:

<u>Borrowing</u>

- Any borrowing decisions will aim to strike an appropriate risk balance between securing low interest rates and achieving cost certainty over the periods for which funds are required. Economic forecasts available from our treasury management advisers and any other available sources will be used to form a view on the target borrowing rates and overall borrowing strategy;
- Any decisions should also look to maintain the stability and flexibility of the longer term debt portfolio, given the current low interest rate environment where short term borrowing or borrowing from internal resources offer revenue budget savings;
- The main sources of funding for external borrowing for the Council are the Public Works Loan Board, Other Local Authorities and private sector financial institutions;

<u>Investments</u>

- The CIPFA and MHCLG guidance require the Council to invest its funds prudently and to have regard to security, liquidity and yield when making these decisions;
- Security being the arrangements in place to protect principal sums invested by a local authority;

- Liquidity being to ensure that enough cash resources are available on a day to day basis for transactional needs;
- Yield being the interest rate and total financial return applicable to the investment being made;
- With these strategic issues in mind, the management of credit risk (or security) is key to the Council’s investment strategy and any subsequent investment activity. The Council uses the external advisers’ credit worthiness matrix to determine limits with individual counterparties.

MINIMUM REVENUE PROVISION POLICY 2020/21

INTRODUCTION

33. Local authorities are required each year to set aside some of their revenues as provision for debt repayment. There is a simple duty for an authority each year to make an amount of revenue provision which it considers to be “prudent”. (Minimum Revenue Provision) MRP Guidance makes recommendations to authorities on the interpretation of that term.

34. Authorities are legally obliged to “have regard” to any such guidance – which is exactly the same duty as applies to other statutory guidance including, for example, the CIPFA Prudential Code, the CIPFA Treasury Management Code and the CLG Guidance on Investments.

35. Authorities are asked to prepare an annual statement of their policy on making MRP.

MEANING OF “PRUDENT PROVISION”

36. The main part to the guidance is concerned with the interpretation of the term “prudent provision”. The guidance proposes a number of options. It explains that provision for repayment of the borrowing which financed the acquisition of an asset should be made over a period bearing some relation to that over which the asset continues to provide a service. It should also cover the gap between the Capital Financing Requirement and the various sources of capital income available to the Authority to finance its capital programme, such as capital receipts, capital grants, contributions and direct revenue financing.

OPTIONS FOR PRUDENT PROVISION

Option 1: Regulatory Method

37. For debt which is supported by (Revenue Support Grant) RSG, authorities will be able to continue to use the formulae in regulations, since the RSG is calculated on that basis.

Option 2: CFR Method

38. This is a technically simpler alternative to Option 1 and may also be used in relation to supported debt. While still based on the concept of the Capital Financing Requirement (CFR), which is easily derived from the balance sheet, it avoids the complexities of the formulae in the regulations.

Option 3: Asset Life Method

39. For new borrowing under the Prudential system for which no Government support is being given, there will be two options. Option 3 is to make provision in **equal annual instalments** over the estimated life of the asset for which the borrowing is undertaken. This is a possibly simpler alternative to the use of depreciation accounting (Option 4), though it has some similarities to that approach.

40. The formula allows an authority to make **voluntary extra provision** in any year.

41. In the case of the construction of a new building or infrastructure, MRP would not have to be charged until the new asset came into service. This "**MRP holiday**" would be perhaps 2 or 3 years in the case of major projects and could make them more affordable. There would be a similar effect in the case of Option 4 under normal depreciation rules.

Option 4: Depreciation Method

42. Alternatively, for new borrowing under the Prudential System for which no Government support is being given, Option 4 may be used. This means making MRP in accordance with the standard rules for depreciation accounting.

43. Authorities will normally need to follow the standard procedures for calculating deprecation provision with some exceptions.

Option 5: 2% Annuity Method

44. This method recognises the time value of money and the useful life of the assets funded from borrowing and is seen as a fairer way of charging MRP. It is supported by the Council's treasury management advisers (Arlingclose) and is being adopted by many local authorities nationally as the way of accounting from pre 2008 debt.

2020/2021 MINIMUM REVENUE PROVISION STATEMENT FOR MIDDLESBROUGH COUNCIL

45. The Secretary of State recommends that before the start of each financial year a local authority prepares a statement of its policy on making MRP in respect of that financial year and submits it to the full council. The statement should indicate which of the options listed above are to be followed in the financial year.

46. For supported capital expenditure Middlesbrough Council intends to move from option 2 to option 5, a 2% annuity basis with effect from 2016/2017 financial year.

47. For unsupported capital expenditure Middlesbrough Council intends to use option 3, the asset life method.