Capital Finance

Guidance on Minimum Revenue Provision

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Department for Communities and Local Government

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Department for Communities and Local Government

GUIDANCE ON MINIMUM REVENUE PROVISION

NOTE ON THE REVIEW OF THE GUIDANCE

[This note is not part of the guidance]

BACKGROUND

Regulations 27 and 28 in the **Local Authorities (Capital Finance and Accounting) (England) Regulations 2003** [SI 3146, as amended] require local authorities to make a prudent amount of minimum revenue provision (MRP). The Secretary of State has issued statutory guidance on determining the "prudent" level of MRP, to which authorities are required to have regard.

The guidance was first published on 28 February 2008 and a second edition was issued on 11 March 2010. The guidance has been further revised and the third edition is below. The previous editions are superseded.

APPLICATION

The new guidance is operative from 1 April 2012.

CHANGES

The revisions in this third edition of the guidance are as follows. In Part 1, a new paragraph 39A is inserted after paragraph 39; in Part 2, a new paragraph (c) is inserted at the end of paragraph 19. Both relate to the **HRA reform exercise** on 1 April 2012 and are to ensure that the authorities taking on new debt do not face any inappropriate increase in their MRP liability.

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GUIDANCE ON MINIMUM REVENUE PROVISION

[Third edition]

Part 1
Informal commentary

INTRODUCTION

1. **Part 2** of this document contains statutory guidance on Minimum Revenue Provision issued by the Secretary of State. **Part 1** provides an informal commentary on that statutory guidance. Both parts have been revised and apply with effect from 1 April 2012. The previous editions of the MRP guidance are superseded.

2. Local authorities are normally required each year to set aside some of their revenues as provision for debt. More precisely, the provision is in respect of capital expenditure financed by borrowing or credit arrangements but, both in this commentary and in the statutory guidance, it has generally proved more convenient to use the term "debt" as shorthand for that technically more accurate form of expression.

3. The scheme of Minimum Revenue Provision ("MRP") was set out in former regulations 27, 28 and 29 of the *Local Authorities (Capital Finance and Accounting) (England) Regulations 2003* [SI 2003/3146, as amended] ("the 2003 Regulations"). This system has now been radically revised by the *Local Authorities (Capital Finance and Accounting) (England)* ***)*** *(Amendment) Regulations 2008* [SI 2008/414], ("the 2008 Regulations") in conjunction with the publication by DCLG of this MRP guidance.
http://www.legislation.gov.uk/uksi/2008/414/contents/made

4. As well as simplifying the system, this shift in emphasis from regulations to guidance will, for example, help to promote development schemes which would have been hindered by the inflexibility of the former regulatory regime.

MRP CALCULATION – AMENDMENT REGULATION

5. Amendment regulation 4(1) of the 2008 Regulations revised the former regulation 28. In the new regulation 28, the detailed rules are replaced with a simple duty for an

authority each year to make an amount of MRP which it considers to be “prudent”. The regulation does not itself define “prudent provision”. However, the MRP guidance makes recommendations to authorities on the interpretation of that term. The operative date of the change is 31 March 2008, which means that it applies to the financial year 2007-08 and to subsequent years.

POWER TO ISSUE GUIDANCE

6. The issue of statutory MRP guidance was made possible by section 238(2) of the *Local Government and Public Involvement in Health Act 2007*, which amends section 21 of the *Local Government Act 2003*. Section 21 already allowed *regulations* to be made on accounting practices and is the power under which the existing MRP regulations were made. The amendment inserts a new section 21(1A) into the 2003 Act, enabling the Secretary of State also to issue *guidance* on accounting practices and thus on MRP.

7. Authorities are obliged by new section 21(1B) to “have regard” to such guidance – which is exactly the same duty as applies to other pieces of statutory guidance including, for example, the CIPFA Prudential Code, the CIPFA Treasury Management Code and the DCLG Guidance on Investments.

8. The statutory MRP guidance itself is in Part 2 of the present document. Part 1 of this document is simply an informal commentary, explaining the policy intention in more detail and including other information to help practitioners; it has no statutory force.

9. Specific recommendations of the statutory guidance are considered in more detail below.

ANNUAL MRP STATEMENT [paragraph 3 of the guidance]

10. Authorities are asked to prepare an annual statement of their policy on making MRP for submission to their full council (for authorities without a full council, approval of the statement should be at the closest equivalent level). This mirrors the existing requirements to report to the council on the Prudential borrowing limit and investment policy. The aim is to give elected Members the opportunity to scrutinise the proposed use of the additional freedoms conferred under the new arrangements. On the timing of the issue of this statement, please see paragraph 34 below. If it is ever proposed to vary the terms of the original statement during the year, a revised statement should be put to the council at that time. It is for each council to consider with its officers the preferred format of the statement and DCLG will not being issuing any advice on the matter.

11. To underpin this recommendation, it was necessary to amend the *Local Authorities (Functions and Responsibilities) (England) Regulations 2000 [SI 2000/2853].* Regulation 4(1)(b) specifies functions which are not to be the sole responsibility of an authority’s executive and includes the authority's borrowing, investments, capital expenditure and now also the making of MRP.

MEANING OF “PRUDENT PROVISION” [paragraphs 4 to 6]

12. The main part of the guidance is concerned with recommendations on the interpretation of the term “prudent provision” as used in the amended regulation 28. The guidance includes specific examples of options for making “prudent provision”.

13. It explains (paragraph 5) that provision for 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. In the case of borrowing supported by the Government through the Revenue Support Grant system, however, it will be reasonable to link the period of making provision broadly with that implicit in the determination of the grant; and options 1 and 2 (below) are based on that principle.

OPTIONS FOR PRUDENT PROVISION

14. Four ready-made options are included in the guidance (and there are two alternatives under Option 3). The options are those likely to be most relevant for the majority of authorities but other approaches are not meant to be ruled out, provided that they are fully consistent with the statutory duty to make prudent revenue provision. Authorities must always have regard to the guidance, but having done so, may in some cases consider that a more individually designed MRP approach is justified. That could involve taking account of detailed local circumstances, including specific project timetables and revenue-earning profiles. Authorities may wish to consult their legal advisers and external auditors about their approach to MRP if it involves a significant departure from the guidance or relates to any large, complex or novel schemes. However, the decision on what is prudent is for the authority and it is not for DCLG to say in particular cases whether any proposed arrangement is consistent with the statutory duty.

Option 1: Regulatory Method [paragraph 7]

15. For debt which is supported by the Government through the RSG system, authorities may continue to use the formulae in the current regulations, since the RSG is calculated on that basis. Although the existing regulation 28 is revoked by regulation 4(1) of the 2008 Regulations, authorities will be able to calculate MRP as if it were still in force. Solely as a transitional measure, this option will also be available for all capital expenditure incurred prior to 1 April 2008 – see paragraph 34 below. The earlier regulations relevant to MRP are available online at:

http://www.legislation.gov.uk/uksi/2003/3146/contents/made
http://www.legislation.gov.uk/uksi/2004/3055/contents/made
http://www.legislation.gov.uk/uksi/2006/521/contents/made
http://www.legislation.gov.uk/uksi/2007/573/contents/made

16. Normally, under this option, the former regulations should be followed exactly as if they had not been revoked. That includes taking advantage, if desired, of the **commutation adjustment** in the former regulation 29.

17. When introducing the new MRP regime in 2004, as part of the Prudential system framework, the Government’s policy aim was that the move from the former MRP scheme should not itself increase any authority’s MRP liability. Safeguards to

achieve that result were built in from the outset (or added later as anomalies came to light).

18. The main device for achieving the neutrality between old and new MRP systems was “Adjustment A” in the original regulation 28. This was an amount to be calculated at the start of the new system in 2004 and not subsequently varied. For the purposes of Option 1, Adjustment A should therefore continue to be given the value attributed to it in the financial year 2004-05, even if that value reflected erroneous calculations under the former capital finance system which reduce MRP liability under the present system. If, however, Adjustment A reflects an error which increases the current MRP liability, the authority would be justified in recalculating it and hence reducing MRP to its proper level.

19. Similarly, if an authority considers that, in its particular circumstances, strict compliance with any other aspect of the former regulations would produce an anomalous and disadvantageous result, it may consider modifying the rules to achieve the intended neutrality. Again, such a step should be discussed in advance with external auditors.

Option 2: CFR Method [paragraph 8]

20. This is a technically much simpler alternative to Option 1 which may 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 old regulation 28 (though for most authorities it will probably result in a higher level of provision than Option 1). It does however still rely on definitions in regulation 28(11), which are as follows:

> *“Non-housing CFR” means that part of the capital financing requirement which is not housing CFR. “Housing CFR” means that part, if any, of the capital financing requirement which is in respect of borrowing or credit arrangements used to finance capital expenditure on housing assets. “Housing assets” means any land, houses or other property to which subsection (1) of section 74 of the Local Government and Housing Act 1989 (duty to keep Housing Revenue Account) for the time being applies.*

Option 3: Asset Life Method [paragraphs 9 to 13]

21. For new borrowing 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.

22. Option 3 is to make provision 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. Within option 3, two methods are identified

23. The first of these, the **equal instalment method**, allows the use of the simple formula in paragraph 9 of the guidance. This will normally generate a series of equal annual amounts over the estimated life of the asset. The original amount of expenditure (“A” in the formula) remains constant. The cumulative total of the MRP made to date (“B” in the formula) will increase each year.

24. The outstanding period of the **estimated life** of the asset (“C” in the formula) reduces by 1 each year. For example, if the life of the asset is originally estimated at 25 years, then in the initial year when MRP is made, C will be equal to 25. In the second year, C will be equal to 24, and so on. The original estimate of the life is determined at the outset and should not be varied thereafter, even if in reality the condition of the asset has changed significantly (paragraph 11).

25. The formula allows an authority to make **voluntary extra provision** in any year. This will be reflected by an increase in amount B and will automatically ensure that in future years the amount of provision determined by the formula is reduced.

26. The alternative is the **annuity method**, which has the advantage of linking MRP to the flow of benefits from an asset where the benefits are expected to increase in later years. It may be particularly attractive in connection with projects promoting regeneration or administrative efficiencies or schemes where revenues will increase over time. 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)*.

27. **Freehold land** (paragraph 12) cannot properly have a life attributed to it, so for the purposes of Option 3 it should be treated as equal to a maximum of 50 years. But if there is a structure on the land which the authority considers to have a life longer than 50 years, that same life estimate may be used for the land.

28. Provision for debt under Option 3 will normally commence in the financial year following the one in which the expenditure is incurred [paragraph 10]. But paragraph 13 of the guidance highlights an important exception to this rule. In the case of the provision of a new asset, MRP would not have to be charged until the asset came into service (paragraph 13) and would begin in the financial year following the one in which the asset became operational. This “**MRP holiday**” would be perhaps 2 or 3 years in the case of major projects, or possibly longer for some complex infrastructure schemes, 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 [paragraphs 14 to 15]

29. 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.

30. A step in this direction was made in the last set of amendments to the MRP rules [SI 2007/573]. However, the move to reliance on guidance rather than regulations will make this approach more viable in future.

31. Authorities will normally need to follow the standard procedures for calculating depreciation provision. But the guidance identifies some necessary exceptions (paragraph 15):

> (a) MRP continues until the total provision made is equal to the original amount of the debt and may then cease.

(b) The capital receipt from the disposal of the asset may not be used for revenue spending, since that would run counter to the Government's "golden rule". Capital receipts may be used only as specified in regulation 23 of the 2003 regulations.
(c) If only part of the expenditure on the asset was financed by debt, the depreciation provision is proportionately reduced.

CONDITIONS FOR USING THE OPTIONS [paragraphs 16 to 18]

32. The intention is that Options 1 and 2 should normally be available only for **Government-supported borrowing**. Options 3 and 4 are meant to be used in future for all **self-financed borrowing**.

33. Purely as a transitional measure, however, the guidance allows Options 1 and 2 to be used initially for both supported and self-financed borrowing. But authorities are free to move fully to the new arrangements immediately if they wish.

34. With regard to the transition to the new arrangements and the preparation of the annual MRP statement, the intention is that the following schedule should be followed.

MRP in 2007-08. This is to be determined on or before 31 March 2008 and takes account of new capital expenditure incurred in 2006-07. Methods of making prudent provision include the four options exemplified in the guidance, each of which may be used for supported expenditure or self-financed expenditure or both. The MRP statement may be combined with that prepared in 2008-09 (see below).

MRP in 2008-09. This is to be determined on or before 31 March 2009 and takes account of new capital expenditure incurred in 2007-08. Methods of making prudent provision include the four options exemplified in the guidance, each of which may be used for supported expenditure or self-financed expenditure or both. The MRP statement (combined with that for 2007-08 if the latter has not been prepared earlier) should be submitted to the council as soon as practicable during the 2008-09 financial year.

MRP in 2009-10. This is to be determined on or before 31 March 2010 and takes account of new capital expenditure incurred in 2008-09. Options 1 or 2 may be used only for supported expenditure. Methods of making prudent provision for self-financed expenditure include Options 3 or 4 (which may also be used for supported expenditure if the authority so chooses). The MRP statement should be submitted to the council before the start of the 2009-10 financial year.

MRP in subsequent financial years. Options 1 or 2 may be used only for supported expenditure. Methods of making prudent provision for self-financed expenditure include Options 3 or 4 (which may also be used for supported expenditure if the authority so chooses). The MRP statement should be submitted to the council before the start of the financial year.

If it is ever proposed to vary the terms of the original MRP statement during the year, a revised statement should be put to the council at that time.

CAPITAL FINANCING REQUIREMENT

CFR Adjustment [paragraph 19]

35. The aim of this part of the guidance is to protect authorities from double-counting. Where an authority undertakes self-financed borrowing to acquire an asset and makes MRP under Options 3 or 4, there will still be a rise in the Capital Financing Requirement [CFR], which is the basis of the calculation under Options 1 and 2. That potentially increases the MRP liability under Options 1 and 2, so the authority would end up making double provision.

36. The guidance therefore provides that, for the purposes of Options 1 and 2, an adjusted version of the CFR is used. This excludes any expenditure funded by self-financed borrowing for which MRP is made under Options 3 and 4.

37. This adjustment mechanism also ensures that the making of MRP under Options 3 and 4, which in reality reduces the CFR, does not thereby lead to an unjustified decrease in MRP liability under Options 1 and 2.

38. However, this adjustment to the CFR is only for the purposes of the MRP regime. When deciding on the affordability of borrowing in accordance with the Prudential Code, the CFR should continue to be determined exactly as specified in that document, without the adjustments mentioned in the MRP guidance.

Negative CFR

39. Where the CFR (as calculated for the normal purposes of the Prudential Code and not the adjusted CFR mentioned above) is nil or negative on the last day of a financial year, this indicates that the authority's provision for debt is equal to or greater than the debt incurred. There is accordingly no need to make MRP in the following financial year under any of the specified options, or in any other way.

HRA Reform Exercise

39A. This initiative, on 1 April 2012, entails new debt being incurred by certain authorities, some with a previously negative HRA CFR. The ensuing increase in their overall CFR would potentially raise their MRP liability - in some cases from nil to a significant level. The Secretary of State considers that, given the special circumstances of the exercise, such a consequence should not be imposed upon authorities. He therefore makes the formal recommendation (Part 2, paragraph 19(c) below) that, for the purposes of determining MRP, this increase in the CFR may be ignored, and so avoiding any impact on the revenue budget.

FINANCE LEASES AND PFI [paragraph 20]

40. The move to International Financial Reporting Standards (IFRS) in local government is expected to bring more PFI schemes on balance sheet and to result in some leases (or parts of leases) being reclassified as finance leases instead of operating leases. The relevant accounting provisions are in Chapter 4 (*Non-current*

assets) of CIPFA's *Code of Practice on Local Authority Accounting in the United Kingdom,* applying with effect from 1 April 2010. These contracts would become subject to the requirement to provide MRP. IFRS requires these changes to be accounted for retrospectively, with the result that an element of the rental or service charge payable in previous years (and previously charged to revenue accounts) will be taken to the balance sheet to reduce the liability. On its own, this change in the accounting arrangements would result in a one-off increase to the capital financing requirement and an equal increase in revenue account balances. This is not seen as a prudent course of action and the guidance aims to ensure authorities are in the same position as if the change had not occurred. It does this by recommending the inclusion in the annual MRP charge of an amount equal to the amount that has been taken to the balance sheet to reduce the liability, including the retrospective element in the first year. (This approach will produce an MRP charge comparable to that under Option 3, in that it will run over the life of the lease or PFI scheme and will have a profile similar to what the annuity method gives). DCLG recognises the complexity of the accounting in this area and acknowledges that the recommendations in paragraph 20 of the formal guidance and in this commentary may not be entirely appropriate in all cases. It will be open to authorities to consider a different approach to the calculation, subject to compliance with the overriding statutory requirement to make a prudent level of MRP.

HOUSING ASSETS [paragraph 21]

41. As was the case under regulation 28 of the 2003 Regulations prior to its amendment by the 2008 Regulations, the duty to make MRP does not extend to cover borrowing or credit arrangements used to finance capital expenditure on housing assets (as defined in paragraph 20 above). Options 1 and 2 above already automatically achieve this; and when using options 3 or 4 (or any other method) the authority should not take account of capital expenditure on housing assets.

TRANSFERRED DEBT [paragraph 22]

42. The intention here is not to disrupt the well-established arrangements for managing and making provision for debt following the various local government reorganisation exercises which have taken place. It is intended that these arrangements should continue under the new MRP system. Authorities also sometimes agree to transfer debt from former reorganisations between themselves to improve the efficiency of its management. As part of such agreements, they will need to ensure that prudent provision continues to be made by one or other of the authorities. It is likely that the authority relinquishing the debt will normally cease making MRP in respect of it and the authority taking on the debt will accept a corresponding increase in MRP liability. However, this is for the authorities to decide.

CAPITALISED EXPENDITURE [paragraphs 23 and 24]

43. Authorities may borrow to meet expenditure which is treated as capital expenditure by virtue of either a capitalisation direction (section 16(2)(b) of the 2003 Act) or regulation 25(1) of the 2003 Regulations. The guidance recommends that MRP in such cases is determined under Option 3. However, since the expenditure does not relate (directly at least) to an asset for which a life can be estimated, guidance is given on how to determine the value of the variable "C" in the formula in paragraph 9 of the guidance.

44. The table in paragraph 24 of the guidance gives the value of “C” for each of the categories listed in regulation 25(1). The basic principle is that, where the capitalised expenditure can be indirectly linked to an asset, the estimated life of that asset should be used.

45. In other cases, 25 years is proposed as a reasonable default. But for the acquisition of **share or loan capital** (regulation 25(1)(d)), the slightly shorter period of 20 years is specified, because the aim of that regulation is to discourage the use of those particular forms of investment.

46. Similarly, 20 years is specified in the case of expenditure **capitalised by direction**, since the Government again does not wish to encourage reliance upon that practice.

47. It should be noted that the value of “C” given in each case applies only in the *initial* year of making MRP. Subsequently, the value will decrease by 1 in each successive year (see paragraph 24 above in this commentary).

48. These arrangements will apply only to expenditure incurred on or after 1 April 2008.

Department for Communities and Local Government

Department for Communities and Local Government

GUIDANCE ON MINIMUM REVENUE PROVISION

[Third edition]

Part 2

Guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003

DEFINITIONS

1. In this guidance:

2003 Act means the *Local Government Act 2003*.
2007 Act means the *Local Government and Public Involvement in Health Act 2007*.
2003 Regulations means the *Local Authorities (Capital Finance and Accounting) (England) Regulations 2003* [SI 2003/3146, as amended].
2007 Regulations *means the Local Authorities (Capital Finance and Accounting) (Amendment) (England) Regulations 2007 [SI 2007/573].*
2008 Regulations *means the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 [SI 2008/414].*
Local authority has the meaning given in section 23 of the 2003 Act. (This guidance does not apply to parish councils and charter trustees).
MRP means Minimum Revenue Provision.
Prudential Code means the code of practice referred to in regulation 2 of the 2003 Regulations.
CFR means the Capital Financing Requirement, as defined in the Prudential Code.
Non-housing CFR has the meaning given in regulation 28(11) of the 2003 Regulations before this was amended by the 2008 regulations.
Credit arrangement has the meaning given in section 7 of the 2003 Act.
Supported Capital Expenditure means the total amount of capital expenditure which a local authority has been notified by one or more Government departments is to be taken into account in the calculation of the revenue grant due to the authority in respect of its use of borrowing and credit. It excludes any expenditure which is supported by capital grant.

Housing assets means any land, houses or other property to which subsection (1) of section 74 of the Local Government and Housing Act 1989 (duty to keep Housing Revenue Account) applies. (Section 74 was amended by section 222 of, and paragraph 24(2) of Schedule 18 to, the Housing Act 1996).

INTRODUCTION

2. Under regulation 27 of the 2003 Regulations, local authorities are required to charge to their revenue account for each financial year MRP to account for the cost of their debt in that financial year. Prior to its amendment by the 2008 Regulations, regulation 28 (as amended by regulation 3(1), and read with regulation 3(2) and (3), of the 2007 Regulations) set out the method authorities were required to follow in calculating MRP. For the financial year 2007/08 and subsequent financial years, the detailed calculation has been replaced with a requirement that local authorities calculate an amount of MRP which they consider to be prudent. This guidance is issued under section 21(1A) of the 2003 Act (as inserted by section 238(2) of the 2007 Act) and addresses this new requirement in regulation 28. In accordance with section 21(1B) of the 2003 Act, local authorities must have regard to this guidance. This revised edition of the guidance applies with effect from 31 March 2010 and supersedes that issued on 28 February 2008.

ANNUAL MRP STATEMENT

3. 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. For authorities without a full council, approval of the statement should be at the closest equivalent level. The statement in respect of the years 2007-08 and 2008-09 should be made as soon as practicable during the financial year 2008-09. The statement should indicate how it is proposed to discharge the duty to make prudent MRP in the financial year. If it is ever proposed to vary the terms of the original statement during the year, a revised statement should be put to the council at that time.

MEANING OF “PRUDENT PROVISION”

4. Regulation 28 of the 2003 Regulations (as amended by regulation 4 of the 2008 Regulations) requires a local authority to calculate for the current financial year an amount of MRP which it considers to be prudent. The Secretary of State recommends that, for the purposes of regulation 28, the prudent amount of provision should normally be determined in accordance with paragraphs 5 and 6 below.

5. 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 that grant.

6. The Secretary of State considers that the methods of making prudent provision include the options set out in paragraphs 7 to 15, subject to the conditions in paragraphs 16 to 18. Approaches differing from those exemplified are not ruled out.

OPTIONS FOR PRUDENT PROVISION

Option 1: Regulatory Method

7. 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 by the 2008 Regulations. For the purposes of that calculation, the adjustment A should normally continue to have the value attributed to it by the authority in the financial year 2004-05. However, it would be reasonable for authorities to correct any perceived errors in Adjustment A, if the correction would be in their favour.

Option 2: CFR Method

8. MRP is equal to 4% of the non-housing CFR at the end of the preceding financial year.

Option 3: Asset Life Method

9. Where capital expenditure on an asset is financed wholly or partly by borrowing or credit arrangements, MRP is to be determined by reference to the life of the asset. There are two main methods by which this can be achieved, as described below. Under both variations, authorities may in any year make additional voluntary revenue provision, in which case they may make an appropriate reduction in later years' levels of MRP.

(a) Equal instalment method

MRP is the amount given by the following formula:

$$\frac{A - B}{C}$$

where-

A is the amount of the capital expenditure in respect of the asset financed by borrowing or credit arrangements
B is the total provision made before the current financial year in respect of that expenditure
C is the inclusive number of financial years from the current year to that in which the estimated life of the asset expires.

(b) 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 or credit arrangements. The authority should use an appropriate interest rate to calculate the amount. Adjustments to the calculation to take account of repayment by other methods during the repayment period (eg by the application of capital receipts) should be made as necessary.

10. **Commencement of provision**. Subject to paragraph 13 below, MRP should normally commence in the financial year following the one in which the expenditure was incurred.

11. **Asset life**. The estimated life of the asset should be determined in the year that MRP commences and not subsequently be revised.

12. **Freehold land**. If no life can reasonably be attributed to an asset, such as freehold land, the life should be taken to be a maximum of 50 years. However, in the case of freehold land on which a building or other structure is constructed, the life of the land may be treated as equal to that of the structure, where this would exceed 50 years.

13. **MRP commencement**. When borrowing to provide an asset, the authority may treat the asset life as commencing in the year in which the asset first becomes operational. It may postpone beginning to make MRP until the financial year following the one in which the asset becomes operational. "Operational" here has its standard accounting definition. Investment properties should be regarded as becoming operational when they begin to generate revenues.

Option 4: Depreciation Method

14. MRP is to be equal to the provision required in accordance with depreciation accounting in respect of the asset on which expenditure has been financed by borrowing or credit arrangements. This should include any amount for impairment chargeable to the Income and Expenditure Account.

15. For this purpose standard depreciation accounting procedures should be followed, except in the following respects.

(a) MRP should continue to be made annually until the cumulative amount of such provision is equal to the expenditure originally financed by borrowing or credit arrangements. Thereafter the authority may cease to make MRP.
(b) On disposal of the asset, the charge should continue in accordance with the depreciation schedule as if the disposal had not taken place. But this does not affect the ability to apply capital receipts or other funding sources at any time to repay all or part of the outstanding debt.
(c) Where the percentage of the expenditure on the asset financed by borrowing or credit arrangements is less than 100%, MRP should be equal to the same percentage of the provision required under depreciation accounting.

CONDITIONS FOR USING THE OPTIONS

16. Options 1 and 2 may only be used in relation to:

(a) capital expenditure incurred before 1 April 2008; and
(b) capital expenditure incurred on or after that date which the authority is satisfied forms part of its Supported Capital Expenditure.

17. For expenditure incurred on or after 1 April 2008 which does *not* form part of the authority's Supported Capital Expenditure, prudent approaches include Options 3

and 4 (which may also be used at the authority's discretion in relation to all capital expenditure, whether or not supported and whenever incurred).

18. For all capitalised expenditure incurred on or after 1 April 2008, authorities should use Option 3, adapted in accordance with paragraphs 23 and 24 below.

CAPITAL FINANCING REQUIREMENT

19. There are the following points to note with regard to the CFR:

(a) **CFR Adjustment**. Where the authority has used Options 3 or 4, the CFR for the purposes of Options 1 and 2 should be treated as not being increased by the amount of the expenditure on the asset. In addition, the CFR should not be treated as being decreased by the amount of the MRP made under Options 3 and 4. However, for the purposes of determining the affordability of borrowing in accordance with the Prudential Code, the CFR should continue to be calculated as specified in that document.

(b) **Negative CFR**. Where the CFR was nil or negative on the last day of the preceding financial year, the authority need not make any MRP in the current financial year.

(c) **HRA Reform Exercise**. Any increase in the CFR arising from the HRA reform exercise undertaken on 1 April 2012 may be ignored for the purposes of determining MRP.

FINANCE LEASES AND PFI

20. In the case of finance leases and on balance-sheet PFI contracts, the MRP requirement would be regarded as met by a charge equal to the element of the rent/charge that goes to write down the balance sheet liability. Where a lease (or part of a lease) or PFI contract is brought onto the balance sheet, having previously been accounted for off-balance sheet, the MRP requirement would be regarded as having been met by the inclusion in the charge, for the year in which the restatement occurs, of an amount equal to the write-down for that year plus retrospective writing down of the balance sheet liability that arises from the restatement.

HOUSING ASSETS

21. The duty to make MRP does not extend to cover borrowing or credit arrangements used to finance capital expenditure on housing assets (as defined in paragraph 1 above).

TRANSFERRED DEBT

22. Where debt is transferred between authorities, the authorities concerned should agree on arrangements for the continued making of MRP. Normally, the authority relinquishing the debt should cease to make MRP in respect of it and the authority taking it over should begin to make MRP as if undertaking new borrowing.

CAPITALISED EXPENDITURE

23. Where on or after 1 April 2008 an authority incurs expenditure which is:

(a) financed by borrowing or credit arrangements; and
(b) treated as capital expenditure by virtue of either a direction under section 16(2)(b) of the 2003 Act or regulation 25(1) of the 2003 Regulations

the authority should make MRP in accordance with Option 3.

24. For the purpose of the formula in paragraph 9 above, in the initial year of making MRP the variable "C" should be given the maximum values as set out in the following table:

Expenditure type	Maximum value of "C" in initial year
Expenditure capitalised by virtue of a **direction** under s16(2)(b)	"C" equals 20 years
Regulation 25(1)(a) Expenditure on computer programs	"C" equals the value it would have for computer hardware
Regulation 25(1)(b) Loans and grants towards capital expenditure by third parties	"C" equals the estimated life of the assets in relation to which the third party expenditure is incurred
Regulation 25(1)(c) Repayment of grants and loans for capital expenditure	"C" equals 25 years, or the period of the loan, if longer
Regulation 25(1)(d) Acquisition of share or loan capital	"C" equals 20 years
Regulation 25(1)(e) Expenditure on works to assets not owned by the authority	"C" equals the estimated life of the assets
Regulation 25(1)(ea) Expenditure on assets for use by others	"C" equals the estimated life of the assets
Regulation 25(1)(f) Payment of levy on Large Scale Voluntary Transfers (LSVTs) of dwellings	"C" equals 25 years

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Department for Communities and Local Government
