Consultation on changes to statutory guidance and regulations: Minimum Revenue Provision

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Department for Levelling Up, Housing and Communities

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Executive summary

1. Since 2004, local authorities in England borrow and invest under the Prudential Framework ("the Framework"). It provides wide freedoms for authorities to borrow and invest without seeking the government's consent, allowing authorities to determine their own capital strategies and deliver the investment that is needed locally, provided that the plans are prudent and affordable. These powers are set out in the Local Government Act 2003 ("the 2003 Act"), the Local Authority (Capital Finance and Accounting) Regulations 2003 ("the Regulations") and supported through four statutory codes and guidance issued by CIPFA and the government. The objectives of the Framework are to drive sound investment and borrowing decisions in a way that is compliant with a local authority's statutory duties, reduces risk, and represents best value.

2. The duty to make Minimum Revenue Provision (MRP) is an important component of the Framework. Where local authorities finance capital expenditure from debt, they must set aside an amount of money each year to ensure their debt liabilities can be repaid. In practice, the application is more complex, but when it operates effectively it should ensure that local authorities do not borrow more than they can afford. This is because MRP is a cost that must be met from an authority's budget which must be balanced each year. Therefore, in deciding whether any revised debt is affordable, an authority must consider whether it can afford the cost of the associated MRP from its budget. The amount of MRP should be calculated using the authority's total level of capital indebtedness, known as the capital financing requirement (CFR). This is the total amount of capital expenditure for which the authority needs to borrow or finance through credit arrangements: it represents the authority's underlying need to borrow for a capital purpose.

3. In recent years, the government is aware that some local authorities employ practices which result in the underpayment of MRP. The two main issues that have been identified are: excluding a proportion of debt from the MRP determination, whereby some authorities are intentionally excluding debt associated with certain kinds of assets, typically investment assets; and, some local authorities use capital receipts in place of making the charge to the revenue account. Although local authorities can apply capital receipts to reduce debt, some local authorities interpreted the Regulations to mean that capital receipts may *replace* some or all of the prudent MRP charge by using the capital receipt to reduce debt, then reducing the MRP charge by an *equivalent amount*. The effect is the same as treating a capital receipt as revenue and using it to fund the MRP charge. In some cases, such an approach has led to local authorities making only a nominal MRP charge to their revenue account. The government is clear that these practices are not compliant with the duty to make a prudent charge to revenue and result in an underpayment of MRP.

4. To address these known issues, the government consulted from November 2021 to February 2022 on proposals the strengthen the duty to make MRP. The consultation

proposed adding additional text to the Regulations to make explicit that that capital receipts may not be used in place of the revenue charge and prudent MRP must be determined with respect to the authority's *total* capital financing requirement. The consultation responses highlighted concerns raised by a number of authorities that the changes, as revised, could have unintended consequences that could adversely affect the delivery of priorities such as housing where councils were providing capital loans to finance delivery. In response to sector concerns, the proposals were amended to offer more flexibility regarding capital loans, balancing the need for MRP with the risk of non-repayment. The consultation on these changes ran from June to July 2022.

5. Generally, the sector sentiment was positive to the new proposals and recognised that the government had taken action to address concerns. However, it was also clear that the additional complexity raised a number of questions as to how the new provisions would work in practice. For this reason, the government undertook to revise its Statutory Guidance on Minimum Revenue Provision ("the Guidance") before putting in place the changes to the Regulations, and notified the sector that no changes would be put in into effect before April 2024.
6. The purpose of this consultation is to seek views on the revised Guidance and final proposed amendments to the Regulations. The proposed changes to the Regulations remain substantively the same as previously consulted on in the June-July 2022 consultation, with some minor changes to reflect responses. The Guidance provides detailed interpretation and outlines the government's expectations of how the Regulation requirements should work in practice. Respondents should consider the Guidance (including the informal commentary in its annex) and Regulation changes together.
7. The government will work with the sector and relevant stakeholders through this consultation to ensure that the objectives are met while avoiding unintended consequences.

Background

8. The Department for Levelling Up, Housing and Communities (DLUHC) has policy responsibility for the Framework, which sets the powers, duties and best practice by which local authorities borrow and invest. The powers provided by legislation give local authorities considerable freedoms to make borrowing and investment decisions without prior government consent. In making these decisions, however, authorities are required to “have regard” to four statutory codes that set out best practice, and which the government expects authorities to appropriately comply with to ensure capital plans are prudent, affordable and sustainable.
9. Of the four codes, DLUHC produces the *Guidance on Local Authority Investments* and the *Guidance on Minimum Revenue Provision* (referred to herein as “the Guidance” and the subject of this consultation). CIPFA publishes the *Prudential Code for Capital Finance in Local Authorities* (“the Prudential Code”), which provides a framework for determining that borrowing is affordable, and *Treasury Management in the Public Services,* which provides guidance on treasury management activities.
10. The duty to make an MRP charge is set out in the Regulations. Regulation 27 requires local authorities to make a charge to the revenue account each year with respect to “the financing of capital expenditure incurred by the local authority in that year or in any financial year prior to that year”. The underlying principle of MRP is that where an authority has financed capital expenditure from debt (meaning borrowing or credit arrangements), it must set aside an amount from its revenue resources each financial year to ensure that its debt can be repaid. This duty is an essential component of the Framework to support sound decision making and limit risk from borrowing.
11. The duty to make MRP should ensure that authorities do not borrow more than they can afford. This is because MRP is a charge to an authority’s revenue account and is therefore a cost that the authority must take account of in determining council tax and setting an annual balanced budget. As a consequence, when making capital expenditure decisions an authority will have to consider whether it can afford the MRP charge if it intends to finance some or all of the cost with debt.
12. As originally drafted, the Regulations (regulation 28) set out a prescriptive set of calculations for determining the amount of the MRP charge. The regulation was amended in 2008, such that regulation 28 as currently drafted only sets out the requirement that the amount of the charge is ‘prudent’. Further detail is contained within the Guidance on how a prudent amount should be determined.
13. The Guidance was last updated for April 2019 onwards, and sets out a definition of a prudent charge and good practice which authorities are expected to follow. It includes four methodologies for calculating MRP, but allows authorities to apply alternative methods if they are more appropriate. The Guidance sets out that the appropriate measure of “debt” on which MRP should be calculated is the CFR, calculated in accordance with the Prudential Code. In terms of governance, the Guidance requires

authorities to set out their MRP policy to Full Council or equivalent at the start of each year, which should outline how the council will meet its statutory duty.

Issues identified with current practices

14. The improper charging of MRP creates risk to the authority and therefore both local and national tax payers. Under-provision can result in an authority being unable to repay a proportion of its debt in the future or leaves the burden of paying for the assets with future taxpayers. If a prudent charge is not made, then this can also result in the authority taking on greater levels of debt than are affordable. Reducing or excluding elements of MRP makes debt cheaper, if authorities only have to afford the interest payments. This can potentially lead to disproportionate levels of debt being accumulated. Since the current Guidance was issued, there have been notable instances of severe financial failure in some councils due to certain capital practices, and in several cases the failure to make appropriate MRP has contributed to the financial issues.

15. The government is aware that some local authorities employ practices which result in the underpayment of MRP. The two main issues that have been identified are:

    - **Excluding a proportion of debt from the MRP determination.** Some authorities are intentionally excluding debt associated with certain kinds of assets, typically investment assets, when calculating MRP. The rationale put forward is that where assets retain their capital value, the asset can be sold to meet any loan liability in future. In other cases, the authority's strategy is to make MRP only to the extent to which the asset value falls below the original cost financed by debt.

      It is the government's view that this is not prudent. Paragraph 45 of the current Guidance explicitly states that authorities should make provision for debt taken on to fund acquisition of investment properties, and this can reasonably be considered to apply to any form of investment that increases the CFR. Full compliance with CIPFA's *Code of Practice on Local Authority Accounting in the United Kingdom* ("the Accounting Code") and the Prudential Code mean that all capital expenditure is included in the calculation of CFR and therefore should be reflected in MRP. The government's concern is that where MRP is not made with respect to the financing of investment assets, this potentially creates a risk of capital losses or income shortfalls in the future.

    - **Some local authorities use capital receipts in place of the charge to the revenue account.** Local authorities may apply capital receipts to reduce borrowing under regulation 23 of the 2003 Regulations. Some local authorities, however, have interpreted the Regulations to mean that capital receipts may *replace* some or all of the prudent MRP charge by using the capital receipt to reduce debt, then reducing the MRP charge by an *equivalent amount*. The effect is the same as treating a capital receipt as revenue and using it to fund the MRP charge. In some cases, such an approach has led to local authorities making only a nominal MRP charge to their revenue account. The government is clear that this is not a permitted practice.

The only acceptable means by which this may be used to reduce the MRP charge is to use the capital receipts to reduce the overall CFR that forms the basis of the calculation for the MRP charge. The charge to revenue would then be made with respect to the residual outstanding CFR.

Revised changes to strengthen the MRP duty

16. To address these known issues, the government consulted from November 2021 to February 2022 on proposals the strengthen the duty to make MRP. The consultation proposed adding additional text to the 2003 Regulations to make explicit:

- that capital receipts may not be used in place of the revenue charge; and,
- prudent MRP must be determined with respect to the authority's total capital financing requirement.

17. These changes were intended to prevent the two common practices, detailed above, by which some authorities underpay MRP.

18. The consultation highlighted concerns raised by a number of authorities that the changes could have unintended consequences where authorities have made *capital loans* to council companies. Specifically, that the amendments as proposed in this first consultation would require authorities to make MRP where they have made a capital loan which is financed by debt. Under the regulation 25(1) of the Regulations, capital loans are classed as capital expenditure by local authorities, and therefore increase the CFR of an authority where they finance such lending from debt.

19. Where authorities are not currently making MRP with respect to debt used to make capital loans, this would increase the cost and potentially make some schemes unaffordable; housing delivery was a commonly raised example of activity that would be affected. Although the intent remains to ensure adequate MRP is made each year, the government has also been clear that any changes should avoid hindering prudent investment or causing unnecessary financial stress. Therefore, in response to sector concerns, the proposals were amended to offer more flexibility regarding capital loans, balancing the need for MRP with the risk of non-repayment. Further detail can be found in the consultation, which ran from June to July 2022, and the proposed legislative changes.

20. The amended proposals were inherently more complex. In summary, the additional changes with respect to capital loans were:

   i. **Authorities can choose to exclude capital loans from MRP requirement.** Provided the loan is not a commercial loan (defined as a loan for capital expenditure primarily intended to generate a financial return), aligning with both the Prudential Code and HMT's definitions set out in the lending terms to the Public Works Loan Board, and consistent with the government's view that authorities should not be investing in assets where the primary purpose is for profit. There were also provisions included whereby an annual (or otherwise) repayment of a loan to an authority could be used to directly offset the MRP charge if used to reduce debt. That is, if an authority has made a loan and this is being repaid regularly, and the repayments are then used to reduce the authority's debt, then

any MRP that would otherwise be made with respect to that loan can be reduced by an equivalent amount.

ii. **Authorities are required to make an MRP charge at least equal to the expected credit loss or actual loss.** Under accounting standard *International Financial Reporting Standard 9* (IFRS 9), as implemented in accordance with the Accounting Code, authorities must already account for expected or actual credit losses on loans. Under accounting practices, where an investment or a debtor balance (which is a financial instrument) meets the definition of capital expenditure, impairment losses are not proper charges to the General Fund. Although Option 4 in the MRP guidance requires impairments to be recognised as MRP when they occur, there is not a statutory requirement to do so. This new statutory requirement ensures that sufficient funds are set aside for debt repayment by requiring any loss on a capital loan to be fully covered by MRP *in the year the loss is recognised*, with no option to spread the cost over future years. If MRP was charged before a loss occurs, the charge can be reduced by any historic MRP made for that loan (other than MRP that was previously made with respect to an earlier loss on that loan). It is intended to make authorities consider very carefully the decision to make a capital loan and to then opt not to make any MRP, in the context of the credit risk.

21. The overall effect of the combination of these provisions allows authorities to not make MRP on capital loans provided the loans are being or will be repaid. The aim is to allow local authorities to use capital loans to deliver important investment in housing and services, while making sure that any deficits created by these investments can be covered from revenue by ensuring that the outstanding CFR in respect of a capital loan will be no higher than the outstanding principal less the cumulative expected credit losses or actual losses on that loan.

22. The results of the June to July 2022 consultation are summarised in **Annex A**. Generally, the sector sentiment was positive towards the new proposals and recognised that the government had taken a pragmatic approach to address concerns. However, it was also clear that the additional complexity raised a number of questions as to how the new provisions would work in practice. For this reason, the government undertook to revise the MRP guidance (on the basis of the proposed regulation changes) and notified the sector that no changes would be put in place before April 2024.

Current position and matters for consultation

23. The responses to the second consultation were very informative. The government's response to the consultation can be broadly considered to be: changes required to the Regulation proposals; and, matters to be addressed through the Guidance.

24. This consultation asks for views on both the revised regulation changes (**Annex B**) and the revised Guidance (**Annex C**). The Guidance has been revised insofar as required to provide additional detail on the practical implementation of the changes to the Regulations, however, the opportunity has been taken to add further clarity and detail to the Guidance more generally.

25. The purpose of this consultation is not to revisit the substance of the proposed changes to the Regulations, as these have been consulted on in detail (see initial MRP consultation and consultation on amended MRP proposals). Respondents are asked to comment on the further amendments to the revised Regulations and provide a view as to whether the Regulations will now achieve the government's objectives.

26. With respect to the revised Guidance, the purpose of this consultation is to collect views on all amendments to understand:

- whether the revised Guidance and informal commentary provides sufficient and clear detail on the government's expectations of how the Regulations are to be implemented;
- whether the Guidance and informal commentary provide in totality sufficient and clear detail with respect to an authority's MRP duties, including how to determine a prudent charge; and,
- whether there are any elements of the revised Guidance and informal commentary that could give rise to unintended consequences or risks to the sector.

27. It is also the purpose of this consultation to collect further data on the potential financial impact of the revised Regulations and revised Guidance on the sector.

28. The changes to the Regulations (with respect to the last consultation) and amendments to the Guidance and informal commentary are set out in detail in the next section.

Changes to the regulation proposals.

29. As stated, there are no substantive changes to the policy intent of the Regulations that were consulted on in June-July 2022 (revised legislative changes). However, the consultation identified some necessary amendments. These changes have been amended in the new draft Regulations (revised Statutory Instrument ("the SI") included at **Annex B**):

    a. **Amended regulation 1(3A) to specifically exclude Mayoral development corporations from the duty to charge MRP.** Section 23(1)(e) of the Local Government Act 2003 brings into scope of the MRP duty certain Mayoral development corporations that are functional bodies of the Greater London Authority. This is not consistently applied to other Mayoral development corporations. The amendment removes all Mayoral development corporations from the scope of the MRP duty.

    b. **Amended regulation 27(3), such that an authority can delay the MRP charge to revenue to the year *after* the asset becomes operational.** This is not a change in policy. As per the existing guidance (options 3 and 4), where an authority uses a method of determining MRP over the life of an asset, the requirement to make MRP can be deferred to the financial year after the asset is operational. This is similar to how depreciation functions. It was not the intent of the Regulations to change this, so it has been amended.

c. **Amended regulation 27(4) and 28(2), to align the language used in IFRS 9.** Changed to “expected credit loss” to match the language used in the Accounting Code, in which credit loss has a specific definition.

d. **Amended regulation 27(5), to extend the definition of a commercial loan.** The Regulation changes, as revised in the second consultation, defines a “commercial loan” based on the expenditure the money is ultimately used for. Some respondents highlighted that the loans themselves can also be investments to generate financial return. The definition has been widened to recognise that a capital loan can be an investment primarily for profit in itself.

e. **Amended regulation 28(3) to recognise that the expected/actual credit loss MRP charge may be less the amount recognised under IFRS 9.** IFRS 9 requires an expected credit loss or actual credit loss to be recognised against the amount in the balance sheet. Due to the way that authorities can attribute CFR to assets, and then reduce that CFR by setting aside MRP, applying capital receipts or other available resources *but not actually pay off the loan*, it is possible for the CFR associated with the financing of any given capital loan to be less than the amount of the loan asset in the balance sheet. The wording of the regulation has been extended to recognise that authorities may use capital receipts and potentially other resources) as well as MRP), to have reduced the CFR with respect to any given capital loan. Therefore, the MRP charge made with respect to an expected credit loss or actual loss may be less than the amount recognised under proper practices.

f. **Amended regulation 28(5), to make clear that any capital receipt used under that provision must be used to pay down debt.** Repayments of capital loans to an authority are classed as capital receipts. Capital receipts may be used to pay down debt but can also be used to fund new capital expenditure. The Regulation changes, as revised in the second consultation, allow authorities to specifically reduce what would otherwise be the MRP charge by (up to) the value of the capital receipt received that is a loan repayment on the relevant loan. The amendment makes clear that authorities can *only* do this if they use the capital receipt to reduce debt. In practice, the capital receipt must be applied to the Capital Adjustment Account (thus reducing the CFR) and the cash ultimately used to repay borrowing.

g. **Amended regulation 28(6) for clarity.** Some respondents were confused by the language in 6(a)(III) where it stated “a local authority has charged minimum revenue provision…”. The confusion arises because the purpose of this provision is to allow authorities to use the repayment of loans (capital receipts) in place of an MRP charge (provided the capital receipt is used to reduce debt). This would not be applicable if an authority had, under regulation 27(4), determined not to charge MRP on that loan in the first place. Therefore, the Regulation was worded to ensure that the option to use

capital receipts in this way can only apply where there is otherwise a policy to charge MRP on capital loans. The wording has been adjusted to be clearer.

Q1: Do the revised Regulations meet government's objectives as set out in this consultation? Please provide details to support your answer.

Q2: In your view, do the most recent amendments to the Regulations as set out in this consultation document give rise to any unintended consequences or new risks? Please provide details to support your answer.

Changes to the statutory guidance

30. This section details all substantive revisions made to the current Guidance to produce the revised Guidance and informal commentary, provided in **Annex C,** and invites responses on the amendments. It does not list all changes – the main focus is to set out clearly the amendments that support the revised regulations and other substantive changes. Where necessary, this document provides the rationale for why the changes have been made. Where respondents are asked to consider the Guidance, the informal commentary should be considered concurrently as this provides additional information to help interpret the Guidance.

Introduction to the Guidance

31. The revised Guidance includes more detailed information on the rationale for the MRP duty to give further clarity on its purpose and objectives and provide context for the implementation of the Guidance. This is not intended as a change to policy but to support the understanding of users of the Guidance, including a broader range of stakeholders.

Annual MRP Statement

32. The revised Guidance sets out more detail on what an authority's statement of its policy on making MRP ("MRP Statement") should contain. The requirement to produce an MRP Statement and for this to be approved by full Council remain unchanged from the current Guidance, but the revised Guidance now contains additional detail as to what would be expected to be within the MRP Statement to ensure transparency and accountability. This is not intended to be prescriptive, but provides users of the Guidance and other stakeholders an understanding of what an MRP Statement should provide as minimum information.

33. The revised Guidance also now makes clear that changing the MRP methodology should not be for the primary purpose of reducing the revenue charge. Authorities may change methodologies where they determine this will provide a more prudent charge, and it may be the case that the MRP charge is reduced as a consequence, but seeking to reduce MRP as the primary objective of changing methodologies is unlikely to result in a more prudent charge.

Q3: Do you agree with the additional guidance on what should be included in the MRP Statement? Please provide details to support your answer.

Meaning of Prudent Provision

34. The revised Guidance provides further detail and rationale that CFR is the appropriate measure of indebtedness that should be used to determine the MRP charge. This is not a change from the current Guidance, but it is more explicit and provides the definition of CFR as set out in the Prudential Code to benefit users of the document who may not have access to the Prudential Code.

35. Paragraph 37 of the revised Guidance explains that **regulation 27(a)** requires the MRP charge to be determined with respect to the total CFR of an authority. The change to regulations is intended to prevent authorities purposefully omitting portions of their CFR that relate to the financing by debt of investment assets (as described in this document as one of the issues government is seeking to address). There are statutory exceptions that allow authorities to not include within the MRP determination CFR relating to assets purchased in year, assets not yet in use or where the capital expenditure relates to capital loans. The approach to CFR associated with a Housing Revenue Account (where applicable) in determining the MRP charge is addressed later in the Guidance and is not addressed here.

Q4: Is the guidance sufficiently clear that MRP must be determined with respect to total CFR, less only those elements of CFR permitted by statute? Please provide details to support your answer.

Q5: Is it clear that authorities must not exclude any portion of CFR from the determination of the MRP charge on the basis that the CFR is associated with an investment asset? Please provide details to support your answer.

Meaning of a charge to the revenue account

36. Paragraph 43 of the revised Guidance now contains a statement that an authority cannot determine a prudent MRP charge and then not charge that amount to revenue. Although this may seem obvious, the purpose is to clarify that capital receipts cannot be used in place of a revenue charge. MRP must be a charge to revenue. This is not a change in policy, but has been added to the revised Guidance to provide users a more complete understanding of the MRP duty.

37. Paragraph 45 sets out additional detail on where an MRP charge may be £nil. The intent is to provide a comprehensive list of the only circumstances where an MRP charge could be £nil while still being compliant with the statutory provisions and revised Guidance.

Q6: Is the list of circumstances where the MRP charge may be determined to be £nil sufficiently clear and complete? Please provide details to support your answer.

Local authorities in government financial support

38. Paragraph 46 is new to the revised Guidance. Since the current version of the Guidance was drafted, there have been a small but significant number of local authorities that have experienced severe financial failure, requiring government intervention and/or ongoing financial support. These are differentiated from authorities requiring one-off government support by the scale and challenge of their financial issues, and necessity for government support over a longer timescale. It is important that the Guidance recognises the existence of such circumstances. The intent is that this is only applicable in very exceptional circumstances where the scale of financial failure is such that the government has been required to take actions to intervene and where there is a need for ongoing government support. The Guidance does not specify how this may impact the determination of the MRP charge nor does it propose any limitations, as individual circumstances will vary greatly and approaches will need to be tailored accordingly. It sets out that where government support is factored into the determination of MRP, the government must agree. The government does not consider this to be a change in policy as it is intended to be consistent with existing duties and guidance, however, the addition to the Guidance provides additional clarity for local authorities, auditors and other relevant stakeholders

Conditions for using the options

39. Paragraphs 59 and 60 of the revised Guidance make it clearer that it is expected Options 1 and 2 are used for supported capital expenditure. The Guidance allows that local authorities are free to determine other methods of calculating MRP, but should set out in their MRP Statement why using another methodology other than that provided in the Guidance provides a more prudent charge. Options 1 and 2 have historically only been available for supported borrowing – the calculation results in the MRP charge being highest in the early years of capital expenditure, aligning the charges with the specific revenue grant support provided to the authority and, as is likely in most cases, the period over which the benefits of the asset manifest. If an authority uses another method with respect to supported capital expenditure, it should explain why it is more prudent.

Housing revenue account

40. Concerns were expressed in the previous consultations that the changes to the 2003 Regulations would mean MRP would be required to be charged for HRA capital expenditure where it had not been before. This is addressed by paragraph 65 of the revised Guidance, which includes additional detail as to why it may be appropriate to not make any further MRP charge to revenue with respect to the CFR associated with the HRA. Since 2008, when the 2003 Regulations were amended, there is no statutory provision for not making MRP with respect to the HRA. However, as there is already a charge to revenue with respect to HRA capital expenditure through the charging of depreciation and requirement to hold a Major Repairs Reserve, an authority may

determine that no further revenue charge is required as prudent provision has already been made. This is not a change in policy.

Q9: Is the revised Guidance clear on how HRA CFR should be treated with respect to determining an MRP charge? Please provide details to support your answer.

Q8:Does the revised Guidance address concerns that changes to the Regulations might require additional MRP for the HRA CFR? Please provide details to support your answer.

Use of capital receipts

41. The revised Guidance includes new material to provide an explanation of the new provisions with respect capital receipts in paragraphs 67 and 68.

42. Responses to previous consultation surfaced some confusion as to how the provisions under the 2003 Regulations, regulation 23 interacted with the emphasis that capital receipts cannot be used to directly reduce the MRP charge. Regulation 23 allows that capital receipts may be used to "repay the principal of any amount borrowed". The government does not consider that the revised provisions are in any way contradictory to this. Regulation 23 allows that capital receipts can be used to reduce CFR by either being set aside for that purpose or used to repay borrowing. The requirement for MRP is with respect to CFR but *must be a revenue charge*. This means that:

    - **An authority can use capital receipts to reduce the overall CFR**. When MRP is then calculated with respect to CFR, then it will be reduced to some extent because the debt is reduced. If CFR is reduced to zero through the use of capital receipts, then MRP may also be zero.
    - **An authority cannot determine the MRP and then use a capital receipt as a direct replacement to this charge**. It is the government's view that this has never been a permissible practice, and it is the intent of the revised provisions to put this beyond doubt. The statute is, and has always been, clear that MRP must be a charge to revenue.

43. This is reflected in the revised **regulations 28(4)** (**Annex B**), which states that "a local authority must not reduce its determination of what would otherwise be a prudent amount by the value of any capital receipts used or to be used by the authority in accordance with regulation 23 in the financial year to which the determination relates.". This does not, and it is not the government's intention that it should, prevent a local authority from using capital receipts to reduce the level of debt with respect to a capital loan (or any other capital expenditure financed by debt) and thereby reduce the level of debt on which MRP is calculated.

Q9: Is the revised Guidance clear on how capital receipts may be used to reduce the CFR, and therefore the MRP charge?

Q10: Is the revised Guidance clear that capital receipts cannot be used to replace, in whole or part, the charge that is required to be made to revenue?

Provisions with respect to loans

44. The guidance includes an explanation of the new regulations with respect to capital loans in paragraphs 69 to 74.

Q11. Is the revised Guidance clear that:

- **(a) MRP need not be made with respect to capital loans provided they are not commercial capital loans?**
- **(b) MRP must be made with respect to commercial capital loans?**

Q12. Taking into account both the draft amendments to the Regulations and the revised Guidance, is it clear what constitutes a commercial loan?

Q13. Does the revised Guidance sufficiently explain how repayments of a capital loan, which are capital receipts, may be used to directly offset the relevant MRP charge (as a statutory exception to the general rule that capital receipts *cannot* be used to offset MRP)?

45. Paragraphs 72 and 73 set out how to interpret the new requirements in regulations to make an MRP charge equal to expected credit loss or actual credit loss. From the previous consultations.

46. Paragraph 73 specifically explains the new **regulation 28(3)** that the amount of MRP charged with respect to an expected credit loss or actual loss may be less than the loss recognised in the statement of accounts because the amount of CFR attributable to the loan is less than the value of the loan asset recorded in the balance sheet.

Q14. Does the revised Guidance sufficiently explain:

- **(a) the requirement to include in the MRP charge an amount for any expected credit loss or actual loss with respect to a capital loan?**
- **(b) the circumstances where the MRP charge may be lower than the recognised loss?**

47. Some respondents to the previous consultations asked if any expected credit loss taken as MRP could be reversed if the expected credit loss was reversed under IFRS 9. Paragraph 73 of the revised Guidance is clear that the MRP charge cannot be reversed, that is there cannot be a corresponding negative MRP charge, however, this may be treated as a prior year overpayment and future MRP payments reduced, as would be the case if a voluntary overpayment had been made.

Retrospective application

48. Some respondents questioned whether the new regulations should only apply to decisions taken after the changes to Regulations come into force. This is not the government's intent. Authorities should not be using practices to reduce MRP below a prudent amount and the intent of these changes is to prevent this. Where authorities were already following the MRP duty appropriately, there should be no changes necessary. Revisions have been made with respect to capital loans to ensure that the

impact to delivery for priorities such as housing are not adversely affected. The amended Regulations and revised Guidance will apply from April 2024 to both existing and new borrowing and credit arrangements. Paragraph 23 of the Guidance states this.

49. It is, however, not the government's intent that prior period adjustments be required as a consequence of these changes. That is, where changes are required to practices as a consequence of the amendments to regulations and Guidance, they should be applied prospectively over the residual asset lives.

Q15: Please provide any further comments you have on the revised Guidance or amendments to the Regulations.

Other matters arising

50. The issue was raised in prior consultation as to whether authorities that receive capital grant can apply this in place of MRP. This is applicable where combined authorities receive general capital grant (sometimes referred to as 'gain share'). Where a combined authority wishes to borrow to invest, this capital income can be used to reduce debt over time. However, the duty to make MRP is specifically a revenue charge and capital grant cannot be transferred to revenue.

51. It is not the government's intent that the revised regulation changes would affect any current practices in this respect. Under the current duty, the requirement to make MRP is a charge to revenue. The revised changes to regulations prohibit the use of *capital receipts* to be used as a direct, one-for-one replacement of MRP. It will be for individual authorities to ensure that they are making a prudent charge.

Implementation timetable

52. The government plans to introduce the changes to the Regulations and the revised Guidance to apply from the financial year beginning 1st April 2024 onward.

Financial impact of the revised changes

53. It is important to understand any financial or other consequences of the changes to the Regulations and the Guidance. This section asks respondents to consider the impact on their local authority or local authorities they represent.

Q16. Consider the changes to the Regulations and the Guidance. Will these result in a change to your MRP charges in future years?

Q17. Where possible, please provide an estimate as to the increase or decrease in your authority's MRP charge. Assume the revised changes come into effect from April 2024. Please provide an absolute value and percentage.

Q18. Will the changes result in an adverse impact on your authority's financial sustainability or ability to deliver services? Please provide details.

Annex A – summary of consultation responses

1. This part sets out a high-level summary of the government's engagement through the consultation *Minimum Revenue Provision post-consultation proposal* and should be considered alongside that consultation to ensure a full understanding.
2. The purpose of the consultation was to seek views from the sector and relevant stakeholders on the government's proposals to strengthen the duty to make Minimum Revenue Provision (MRP) through changes to regulations, and other changes made with respect to capital loans intended to address potential unintended consequences.
3. The consultation ran from June to July 2022. Within that period, there were 84 respondents, including 76 local authorities. Responses were also received from an audit firm, CIPFA, the Local Government Association and local government advisors.
4. The following sections set out a summary of the responses for each question. Questions are collated by theme with the government's response then provided.

Exemption of capital loans

Q1: Do you agree with the proposal that capital loans may be exempt from the need to charge MRP?

5. Of the 84 responses, the vast majority agreed, with only 1 disagreeing and 3 responding as unsure.
6. Of those that responded no or unsure, concerns were expressed about the distinction between commercial and non-commercial loans, and whether misclassification could lead to inadequate MRP provisions and increased financial risk. There was a general request for further guidance.

Q2: Does the proposed wording in Annex A sufficiently represent the policy intent as described?

7. Of the 84 responses, 32 respondents agreed, with 20 disagreeing and 31 responding as unsure (note that Annex A in context refers to the amended Regulations).
8. Of those that said no or unsure, there were concerns about the potential financial impact on local authorities, particularly those that have already made borrowing decisions based on the existing policy, and that historical loans will be affected by the new proposal, leading to additional revenue costs. Some respondents argued that the requirement to make MRP on all capital expenditure is overly prescriptive, and emphasised the critical role of the Section 151 Officer in making appropriate judgments about what is proper and prudent.

Government response to Q1-2

9. The government has been clear that there is a need to strengthen the duty to make MRP, however, the changes are not intended as a change in policy and authorities that were already sufficiently compliant with the duty should not be affected. Where

authorities have not been making sufficient MRP, it is an intended outcome of these proposals that MRP charges may need to increase.

10. With respect to the risk associated with excluding capital loans from the requirement to make MRP, this must be balanced with the need to avoid unintended consequences that could affect priorities such as housing delivery. The requirement for MRP to include an amount for credit loss is intended to mitigate risk. Further, the changes to regulations and MRP guidance will be supported by new powers provided by the Levelling Up and Regeneration Act, which will allow the government to take actions where there is indication of excessive risk from capital practices. Provision for debt repayment (i.e. MRP) is a metric that will be used to determine risk.

Expected credit loss

Q3: Do you agree that authorities should make MRP equal to any loss recognised with respect to a capital loan?

11. Of the 84 responses, 50 respondents agreed, with 12 disagreeing and 21 responding as unsure.
12. Of those that said no or unsure, there were concerns over the potential financial difficulties that immediate recognition of the full expected credit loss could cause. It was also suggested that for capital loans secured against collateral, any loss that will be a charge to revenue should take into account the value in assets secured if that loss was realised. Views were also expressed that over the distinction between expected credit loss and actual credit loss, with the argument that MRP should only be charged for any *actual* credit loss. There were also concerns about the potential volatility and ambiguity of the proposed policy, especially if the expected credit loss fluctuates significantly from year to year.

Q4: Do you agree that using IFRS 9 as the basis for measuring the expected credit loss or impairment that must be charged as MRP is appropriate?

13. Of the 84 responses, 47 respondents agreed, with 11 disagreeing and 25 responding as unsure. Issues were raised with respect to the complexity and subjectivity of IFRS 9 and the large number of “parameters” that require judgement. There were also concerns about the subjective judgements involved in applying IFRS 9, especially for capital loans for service purposes and about the role of external auditors in checking the assumptions of the IFRS 9 model that could lead to debates between auditors and council finance officers.

Q5: Does the proposed wording in Annex A sufficiently represent the policy intent as described?

14. Of the 84 responses, 41 respondents agreed, with 11 disagreeing and 31 responding as unsure. Some respondents suggested a flexibility in reducing the MRP charge if an expected credit loss is recognised in one year and then reversed in a later year. There were also suggestions that the regulations should clearly state what authorities should do if credit losses are reversed. Views were expressed that the regulations should also refer to capital investments, not just capital loans,

due to potential high risks associated with losses on capital investments and that not all investments where losses need to be recognised may fall within the scope of IFRS 9.

15. A further concern was raised that the statutory provision that permits authorities to reduce the amount of any MRP made with respect to a loss recognised under IFRS 9 by an amount of MRP made historically, might be misinterpreted to include MRP charges made with respect to previous losses. That is, an authority might include in its MRP charge for a financial year an amount of £1m with respect to an expected credit loss. If the next year another loss on the loan of £1m is recognised, the authority might then not make a £1m charge to its MRP on the basis that a previous charge of £1m had been made.

Government response to Q3-5

16. The government recognises that the requirement to make MRP to include an amount with respect to any expected credit loss or actual loss recognised could mean that MRP is significantly higher in particular financial years.
17. Authorities do, however, have the option of making MRP to offset any such charges, and the intent is to encourage authorities to carefully consider the risk of any decisions to make capital loans given the potential impact to revenue. It is noted that some authorities may misinterpret the allowance to subtract prior year MRP charges from any charge with respect to credit loss, to include those MRP charges made with respect to prior year losses. The statutory guidance has a section that explains the intent of the provisions is that at any time a local authority will have fully provided for any amount of a capital loan that will not (or is not expected to) be repaid insofar as that capital loan was financed by debt. Moreover, it is clearly not consistent with the duty to make prudent provision to ignore accumulated losses such that a proportion of debt is never provided for.
18. With respect to recognising expected credit losses under IFRS 9 as adopted by the Accounting Code, authorities should already be complying with proper accounting practices, and the rationale of drawing on the understood and established method set out in IFRS 9 for considering credit loss is intended to provide a consistent basis for MRP to include any losses on loans. Provisions in regulations have been made specific to capital loans, as opposed to any other type of investment, as a corresponding risk mitigation for the agreed flexibility to exclude certain capital loans financed by debt from the requirement to make MRP.
19. Under proper accounting practices, it is already permitted to take into account collateral when determining the expected credit loss.

Treatment of capital receipts that are loan repayments

Q6: Do you agree that authorities should be able to use capital receipts that are loan repayments (including the capital receipt element of a lease payment) to directly reduce the prudent charge to revenue?

20. Of the 84 responses, 75 respondents agreed, with 3 disagreeing and 6 responding as unsure. Only a small number of respondents disagreed with this, which is

unsurprising as this provision was introduced following widespread requests in the original consultation.

21. There were, however, some concerns raised that this may be misused authorities using borrowing to lend to companies, which were then used to fund capital repayments back to the authority, thereby self-funding their own capital receipts on loans. A small number of respondents disagreed entirely with treating capital loans differently from other capital expenditure.

Q7: Does the proposed wording in Annex A sufficiently represent the policy intent as described?

22. Of the 84 responses, 49 respondents agreed, with 14 disagreeing and 21 responding as ‘unsure’. There were concerns that the wording allows MRP to be reduced by the value of capital receipts received, but it should be by the value of capital receipts received and applied to reduce debt (noting that capital receipts could be used to fund capital spend). There were also requests for clarity on the use of future anticipated capital receipts to reduce the annual MRP charge, particularly where the repayments are deferred or are a maturity loan.

Government response to Q6-7

23. Authorities should not try to circumvent the objectives of the MRP duty, which have been clearly laid out. The changes to regulations and MRP guidance will be supported by new powers provided by the Levelling Up and Regeneration Act, which allow the government to take actions where there is indication of excessive risk from capital practices. Provision for debt repayment (i.e. MRP) is a metric that will be used to determine risk.

24. Capital receipts that are loan repayments should only be used to offset the MRP charge where the receipts are used to reduce debt. The proposed changes to the Regulations have been amended to make this clear.

Risks and unintended consequences

Q8: If you identified risks to service delivery, including the delivery of housing or other local priorities, as a result of the original proposal, does this amended proposal sufficiently mitigate or remove those risks?

25. Of the 84 responses, 38 respondents agreed, 28 partially agreed with 10 disagreeing. Issues raised included that the changes could potentially halt local investment that may have a degree of commercial risk at the expense of regeneration and place making if they are classed as commercial. One respondent also raised a concern that the proposal does not address the impact of housing development within a council’s General Fund and that the proposed changes could lead to significant pressures being added to budgets.

26. A number of respondents also highlighted that the current MRP guidance includes an exemption for CFR associated with the Housing Revenue Account (HRA), and they felt that the draft regulations will override the Guidance and require MRP to be made with respect to HRA CFR.

Q9: If you identified financial pressures as a result of the original proposal, does this amended proposal sufficiently mitigate or remove those risks?

27. Of the 84 responses, 33 respondents agreed, 26 partially agreed with 15 disagreeing. No respondents indicated they were unsure. Generally, respondents agreed that the proposal is a step towards mitigating financial risks associated with legitimate investments, but that the proposal would still increase financial pressures on authorities that have commercial loans for which authorities are not making MRP charges. Some views also reiterated that they thought the Regulations (as proposed) were too prescriptive and didn't allow authorities sufficient judgement. It was also highlighted that the revised requirement to make an MRP provision in the year an asset becomes operational is a change from the current guidance, which allows authorities to make MRP in the year *following* operation, and this could increase costs for some councils.

Government response to Q8-9

28. The government notes most respondents agreed or partially agreed, and notes the concerns raised. As set out, it is the government's view that MRP should be made with respect to all capital expenditure, acknowledging that exceptions are made for *capital loans* where this may otherwise disrupt essential local investment such as in housing provision. The proposed statutory changes also allow that where authorities are making capital loans for regeneration and place making, they may elect to not make MRP. It is only capital loans, that is where the objective of the loan itself or the ultimate capital spend is primarily for profit, that MRP *must* be made with respect to any associated debt financing. Authorities should not borrow to invest primarily for financial return, and the government expects that some authorities will have to make a larger MRP charge once the proposed regulation changes are enacted, if they had not been making MRP with respect to investment assets before.
29. The proposed changes should not affect the charging of MRP on debt used to finance housing that authorities are undertaking themselves and does not involve the provision of capital loans. The government has been clear that authorities should not be excluding debt from the determination of MRP because of the type of asset financed by debt.
30. The proposed changes to the regulations have been amended such that MRP is chargeable on assets financed by debt the financial year *after* they come into operation. Lastly, the proposed Guidance has been revised to make clear the circumstances and rationale as to why MRP may not be charged with respect to CFR associated with HRA assets. That is, while there is no statutory basis to exempt the HRA from the MRP duty and the Guidance cannot override statute, there is a rationale for not making a *further* revenue charge to the HRA as depreciation is already charged and transferred to the Major Repairs Reserve.