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.