EXPLANATORY MEMORANDUM TO

THE LOCAL AUTHORITIES (CAPITAL FINANCE AND ACCOUNTING) (ENGLAND) (AMENDMENT) REGULATIONS 2024

2024 No. 478

1. Introduction

1.1 This Explanatory Memorandum has been prepared by Department for Levelling Up, Housing and Communities and is laid before Parliament by Command of His Majesty.

2. Declaration

2.1 Minister Simon Hoare, Parliamentary Under Secretary of State for Local Government at the Department for Levelling Up, Housing and Communities confirms that this Explanatory Memorandum meets the required standard.

2.2 Suzanne Clarke, Deputy Director for Local Government Financial Stewardship, at the Department for Levelling Up, Housing and Communities confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Matt Hemsley at the Department for Levelling Up, Housing and Communities Telephone: 0303 444 0472 or email: la.financialcontrolframework@levellingup.gov.uk can be contacted with any queries regarding the instrument.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 These Regulations make amendments to the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (S.I. 2003/3146) ("the 2003 Regulations"). The amendments specify additional requirements that local authorities must comply with when they determine the annual charge known as minimum revenue provision ("MRP"). MRP is an amount of money set aside each year by local authorities to ensure they can repay the principle of their debt. The instrument does not change policy, rather, it seeks to strengthen adherence to existing good practice.

Where does the legislation extend to, and apply?

4.2 The extent of this instrument (that is, the jurisdiction(s) which the instrument forms part of the law of) is England and Wales.

4.3 The territorial application of this instrument (that is, where the instrument produces a practical effect) is England.

5. Policy Context

What is being done and why?

5.1 Since 2004, local authorities borrow and invest under the Prudential Framework ("the Framework"), which comprises the statutory duties that must be adhered to and the

statutory guidance that local authorities must have regard to. The Framework supports local decision-making, but also seeks to limit risk and ensure decisions are prudent, affordable, and sustainable. Under the 2003 Regulations, local authorities must set aside an amount of money, to ensure their debt can be repaid. The charge is referred to as minimum revenue provision ("MRP").

5.2 The 2003 Regulations originally set out a prescriptive calculation to determine the MRP charge with little flexibility for local authorities. This changed in 2008, when the 2003 Regulations with respect to MRP were simplified to the broad requirement that local authorities must determine a "prudent" charge. Legislation does not provide detail on the calculation of the MRP charge but it is supported by statutory guidance ("the MRP Guidance"). The MRP Guidance sets out additional details and four methods for appropriately calculating the MRP charge. Local authorities must always have regard to the MRP Guidance, but having done so, may in some cases consider that a more individually designed MRP approach is justified.

5.3 The duty to make MRP is an important component of the Framework. When it works effectively, it serves to prevent local authorities taking on more debt than they can afford to repay. Some local authorities, however, apply practices that result in the underpayment of MRP. Where a local authority does not make sufficient provision, this can lead to unaffordable levels of debt and contribute to financial failure. Issues with underpayment of MRP were raised in the National Audit Office report *Local authority investments in commercial property*.[1] The subsequent report[2] by the Public Accounts Committee recommended that the government should undertake a review of the MRP guidance and consider whether its statutory basis should be strengthened. In response, the government committed clarifying the MRP regulations and guidance to ensure borrowing is genuinely affordable and can be paid when it is due.[3]

5.4 To address these issues, this statutory instrument introduces amendments to the 2003 Regulations. These amendments explicitly prevent the common practices by which local authorities underpay MRP. These are: using proceeds from asset sales to replace the revenue charge; and, not making MRP on debt associated with investments, in the belief the assets would accumulate or retain value and can be sold to repay debt. The amendments should ensure that there is consistent and robust adherence to the duty to make MRP, and to mitigate the risks associated with failing to make prudent MRP.

5.5 This statutory instrument also includes provisions to reduce the risks of unintended consequences, specifically, where a local authority borrows and lends the money on to a third party as a capital loan.

What was the previous policy, how is this different?

5.6 Since 2008, the 2003 Regulations with respect to MRP only set out the broad requirement that local authorities must determine a "prudent" charge. The MRP Guidance sets out additional detail and interpretation of the legislation to support local authorities' application of the MRP duty.

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[1] Comptroller and Auditor General, Local authority investment in commercial property, Session 2019-20, HC 45, National Audit Office, February 2020. Available at: Local authority investment in commercial property (nao.org.uk) https://www.nao.org.uk/wp-content/uploads/2020/02/Local-authority-investment-in-commercial-property.pdf.

[2] HC Committee of Public Accounts, Local authority investment in commercial property, Eleventh Report of Session 2019-21, HC 213, July 2020. Available at: Local authority commercial investment (parliament.uk).

[3] Treasury Minutes - Government response to the Committee of Public Accounts on the Seventh to the Thirteenth reports from Session 2019-21 (parliament.uk) https://committees.parliament.uk/publications/1845/documents/19224/default/.

5.7 Local authorities must have regard to the MRP Guidance but may depart from it. As the legislation is not prescriptive, there has been a reliance on local governance processes to appropriately follow good practice in a manner that achieves the objectives of MRP: to constrain risk and ensure borrowing is affordable. Some local authorities have departed from the statutory guidance and interpreted the statutory requirements in a way which has led to underpayment of MRP and, in some cases, led to excessive borrowing that has contributed to financial failure.

5.8 This statutory instrument amends the 2003 Regulations to give greater prescription in statute to specifically set out requirements and restrictions on how local authorities must calculate MRP. However, Local authorities that have been appropriately adhering to the MRP Guidance and following good practice should be unaffected.

5.9 Therefore, the amendments are not intended to be a change in policy, but to strengthen adherence to existing good practice. Subject to the new statutory requirements, local authorities still retain the freedom to determine their own MRP policies, provided they are prudent.

6. Legislative and Legal Context

How has the law changed?

6.1 Section 21(1) of the Local Government Act 2003 ("the 2003 Act") provides that the Secretary of State may make provision about the accounting practices to be followed by local authorities. Subsection (1A) further provides that the Secretary of State may issue guidance about the accounting practices and subsection (1B) provides that a local authority must have regard to it.

6.2 Under these powers, regulation 27 of the 2003 Regulations places a duty on local authorities to charge MRP to a revenue account for each financial year and regulation 28 provides that the amount charged must be what the local authority considers to be prudent. Guidance about the amount of MRP to charge is issued by the Secretary of State under section 21(1A) of the 2003 Act.

6.3 This instrument strengthens the duty in regulation 27 and moves some of the guidance into regulation 28 so that it is more prescriptive about the amount of MRP which must be charged. The MRP guidance has also been updated in consequence of these statutory changes.

6.4 The new duty will apply to financial years commencing on or after 1st April 2025. Pursuant to section 16 of the Interpretation Act 1978, the amendments will not affect the MRP duty which applied in previous financial years. A requirement to include credit loss on loans given by a local authority on or after 7th May 2024 in the MRP amount will come into force earlier.

Why was this approach taken to change the law?

6.5 The duty to charge MRP and provision regarding the amount that must be charged already exist in the 2023 Regulations. The most straightforward approach to amend these duties was to amend the 2023 Regulations.

7. Consultation

Summary of consultation outcome and methodology

7.1 The government has consulted on three occasions. The first consultation (November 2021 – February 2022) was on proposed amendments to the 2003 Regulations to

prevent local authorities using the proceeds of asset sales in place of the MRP charge, and not making MRP on debt used to finance investment assets.[4] There were 120 responses. Three roundtables were also organised to invite sector discussion, with 100 attendees. The responses to the consultation and the feedback from the roundtables indicated support for tightening the MRP duty, but highlighted risks of unintended consequences. In response, the government amended the proposed changes to allow MRP exemptions for loans, and additional safeguards to recognise the risks local authorities take as lenders to protect the government's original objectives. This necessitated a much more complex technical solution, which the government tested through a further consultation.

7.2 The second consultation ran from June to July 2022. [5] There were 84 respondents, including 76 local authorities. Responses to the second consultation were mostly positive. However, the increased technical nature of the proposals created confusion for some authorities. The government agreed to revise and then consult on MRP guidance before making changes to the 2003 Regulations.

7.3 The third and final consultation (December 2023 – February 2024), included revised statutory guidance to help local authorities and auditors interpret the regulation changes. [6] There were 75 responses, of which 61 were from local authorities. Four audit firms also responded, as did a regulator, sector representatives and private firms. Overall, there was strong positive sentiment that the revised guidance and amended regulations were clear and meet the government's objectives.

7.4 As a result of the final consultation, one substantive technical change was made regarding how MRP is charged with respect to loans made by local authorities before the amendments to the 2003 Regulations. This was to reduce the risk of significant cost pressures arising for some local authorities due to losses on historic loans.

8. Applicable Guidance

8.1 The relevant guidance is the Statutory Guidance on MRP.[7] The MRP guidance has been updated in consequence of these statutory changes.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A full Impact Assessment has not been prepared for this instrument because this statutory instrument only affects local authorities that have a duty to make MRP. Relevant local authorities are already required to make MRP and do so as part of normal financial management and reporting, and therefore no additional operational burden is expected.

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[4] Consultation on changes to the capital framework: Minimum Revenue Provision - GOV.UK (www.gov.uk) https://www.gov.uk/government/consultations/changes-to-the-capital-framework-minimum-revenue-provision

[5] Consultation on changes to the capital framework: Minimum Revenue Provision - Department for Levelling Up, Housing and Communities - Citizen Space - https://consult.levellingup.gov.uk/local-government-finance/minimum-revenue-provision/

[6] Consultation MRP guidance and reg changes for publication.pdf (levellingup.gov.uk) https://consult.levellingup.gov.uk/local-government-finance/consultation-on-changes-to-statutory-guidance-and/supporting_documents/Consultation%20MRP%20guidance%20and%20reg%20changes%20for%20publication.pdf

[7] Capital finance: guidance on minimum revenue provision (fifth edition) - GOV.UK (https://www.gov.uk/government/consultations/changes-to-the-capital-framework-minimum-revenue-provision.gov.uk)

Impact on businesses, charities and voluntary bodies

9.2 There is no, or no significant, impact on business, charities or voluntary bodies because the changes are specific to local authority accounting practices. The statutory instrument does not apply to activities that are undertaken by small businesses.

9.3 The legislation does not impact small or micro businesses.

9.4 There is no, or no significant, impact on the public sector. It is expected that some local authorities will need to make additional MRP because of these changes, as this is an intended objective. Evidence from the final consultation, however, indicates that the amendments will not substantively affect most authorities.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 The instrument does not include a statutory review clause. The department undertakes continual monitoring of local practices and systemic trends with respect to borrowing and investment to identify risks, and assess whether the Framework remains effective.

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 None.

12. European Convention on Human Rights

12.1 As the instrument is subject to the negative resolution procedure and does not amend primary legislation, no statement is required.

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 (“relevant European Union Acts”).