Recommendations to the Council

(a) Treasury Management, Annual Investment and Minimum Revenue Provision Strategies 2018/19

1. The management of the County Council's cash flows and borrowing have a significant impact on the budget.

The Cabinet, at their meeting on 17 January 2018, approved the proposed strategies for the 2018/19 financial year.

Adoption of the Annual Investment Strategy (AIS) and the adoption of the Minimum Revenue Provision (MRP) policy are however matters that are reserved for the Full Council to determine.

2. **Recommend** – That, in accordance with the regulations:

(a) The Annual Investment Strategy (AIS) 2018/19 as described in paragraphs 38 to 89 and as detailed in Appendices 2 and 4 of the report considered by the Cabinet (attached) be adopted.

(b) That the Minimum Revenue Provision (MRP) policy 2018/19 as summarised in paragraphs 128 to 130 and as set out in full at Appendix 8 to the report considered by the Cabinet (attached), be adopted.

(b) Members' Allowances Scheme - Independent Remuneration Panel Report

3. The County Council is required to establish and maintain an Independent Remuneration Panel to provide advice and recommendations to the Council on its Members' Allowances Scheme. Any decision on the nature and level of allowances are a matter for the full Council, but the Council must have regard to any recommendations submitted by the Independent Remuneration Panel before establishing or amending the Members' Allowances Scheme. The Panel meets each year to consider the recommendations to be made to the Council in respect of the level and nature of the forthcoming year's allowances.

The Independent Remuneration Panel's report of March 2018, including recommendations on the Members' Allowances Scheme for 2018/19, is attached.

As part of their deliberations and in response to feedback from Members of the Council, in addition to the Special Responsibility Allowance (SRA) for the Opposition Leader, the Panel have proposed a change to the County Council's Constitution to include three new roles of Opposition Select Committee Vice-Chairmen created from the single Shadow Cabinet Member Special Responsibility Allowance (SRA). The Independent Remuneration Panel proposes that the Opposition Deputy Leader will hold a vice-chairmanship on the Corporate Review Select Committee and the three Opposition Select Committee posts will hold a vice-chairmanship on the Healthy Staffordshire Select Committee, Prosperous Staffordshire Select Committee and the Safe and Strong Communities Select Committee.

In the report, the Panel have also proposed to the Council that the Chairman of the County Council, in consultation with the relevant group leader, be given delegated authority to increase the allowance paid to the Vice-Chairmen of a Committee to the level of the corresponding Chairman's allowance if they are required to take on the responsibilities of the Chairman for a sustained period. The Special Responsibility Allowance paid to the Chairman of the Committee will be suspended during this period.

Recommend – (a) That the Council's views on the recommendations of the Independent Remuneration Panel are requested.

(b) That, if the Council are minded to support the recommendations of the Panel:

(i) The Council's Constitution be amended to include the provision of an Opposition Select Committee Vice-Chairman on each of the Council's Select Committees.

(ii) The Council's Constitution be amended to give delegated authority to the Chairman of the County Council, following consultation with the relevant group leader, to increase the allowance paid to the Vice-Chairmen of a Committee to the level of the corresponding Chair's allowance if they are required to take on the responsibilities of the Chair for a sustained period; and that when this power is utilised, the Chairmen's allowance be suspended during this period.

Annual Investment Strategy (AIS) 2018/19

Annual Investment Strategy (AIS) 2018/19

38. Following the introduction of the second Markets in Financial Instruments Directive (MiFID II) regulations from January 2018, local authorities will automatically be treated as retail clients by financial services firms, unless they ‘opt up’ to be professional clients. As a retail client, the County Council would receive enhanced protections but this would also mean it may face increased costs and restricted access to certain products including money market funds, pooled funds, treasury bills and treasury advice.

39. At their meeting on 15 November 2017, Cabinet agreed to opt up the County Council to be treated as a professional client by regulated financial services firms.

40. The County Council manages a significant investment portfolio that can peak at over £130m at certain points in the year. Since the financial crisis in 2008, the County Council has taken a low risk approach to investment and the AIS for 2018/19 continues in this vein.

<u>Investment options</u>

41. The main characteristics which determine an investment strategy are related to:
    - the credit risk of the counterparties that you invest with;
    - the length of the investment; and
    - the type of financial instrument that is used.

42. These issues have to be considered in the light of the existing regulatory framework provided by the Government.

43. Key parts of this framework are the existing Government Guidance on Local Government Investments and the existing CIPFA Code of Practice for Treasury Management in the Public Services. These state that the two prime risk issues are:
    - the security of capital; and
    - the liquidity of investments.

44. As stated from **paragraph 16**, CIPFA and DCLG guidance for investments and treasury management are due to be revised for 2018/19 but the County Council will continue using the existing guidance until the new reporting requirements are published.

45. The existing Government Guidance on Local Government Investments specify the type of financial instruments that authorities can invest in and divide them into ‘specified’ investments and ‘non-specified’ investments.

Specified Investments

46. Specified Investments are investments made in sterling for a period of less than a year that are not counted as capital expenditure and are invested with:
- the UK Government;
- a UK local authority, parish council or community council; and
- a body or investment scheme, that has **'high credit quality.'**

47. The first two named counterparties will be used by the County Council by virtue of their inclusion within the guidance (referred to as regulation investments subsequently in this report). The assessment of the third aspect of high credit quality is dealt with in the paragraphs that follow.

48. Whilst it is difficult to precisely define 'high credit quality', credit ratings are published by credit rating agencies (for example, Fitch, Standard and Poors, Moodys); this detailed information is provided by the County Council's treasury management adviser, Arlingclose, where available.

Money Market Funds (MMFs)

49. Money Market Funds are pooled investment vehicles consisting of money market deposits and similar instruments. Arlingclose recommend the use of MMF's by their local authority clients, and these have been used for some time by the County Council.

50. New EU regulations for MMFs were approved and published in July 2017 meaning existing funds will need to be compliant by January 2019. It is expected that most short term MMFs will convert from a Constant Net Asset Value (CNAV) to a Low Volatility Net Asset Value (LVNAV) structure.

51. The assets of LVNAV MMFs are marked to market, meaning the dealing NAV (unit price) may fluctuate. However the new regulations confirm they will be allowed to maintain a constant dealing NAV provided they meet strict new criteria and minimum liquidity requirements. Public debt CNAV MMFs will still be available where 99.5% of assets are invested in government debt instruments.

52. The County Council's treasury advisor, Arlingclose, will monitor how individual MMFs react to the new regulations and update the County Council with any developments. The County Council will continue to consider MMFs for investment. MMFs that meet the criteria listed below will be considered to have sufficient high credit quality and be included on the County Council's Approved Lending List.
- Recommended to clients by the County Council's treasury adviser, Arlingclose.
- Diversified – MMFs are diversified across many different investments, far more than the County Council could hope to achieve on its own account.
- Same day liquidity – this means that cash can be accessed on a daily basis.
- Ring-fenced assets – the investments are owned by the investors and not the fund management company.
- Custodian – the investments are also managed by an independent bank known as a custodian, who operates at arms-length from the fund management company.

53. All treasury activity carries an element of risk and MMFs are no different. In the event of another financial crisis, the failure of one or more of an MMFs investments could lead to a run on the MMF as investors rush to redeem their investment. This could then spread to other MMFs as investors take flight from this asset class. The new MMF regulations look to limit some of these risks.

54. The very low interest rate environment could threaten the ongoing continuity of MMFs. Each MMF charges a fee and this could mean that interest earned becomes negative after its deduction. If this problem arises then it would be a matter of moving funds to an alternative category of investment. However this threat has receded with the recent rise in Bank Rate.

55. All of these issues point towards the fundamental need for diversification across MMFs and also investment categories where possible. This issue is dealt with later in this report (**paragraph 72** onwards).

<u>The Credit Management Strategy for 2018/19</u>

56. Existing government guidance requires an explanation of how credit quality is monitored, what happens when it changes and what additional sources of information are used to assess credit quality. The assessment of what 'high credit quality' is for banks or building societies is set out in this section of the report.

57. Arlingclose are the County Council's treasury advisor and an important aspect of their service is credit advice. This is where the treasury advisor provides information about suitable investments in the context of the current economic risk environment and incorporates the views of credit rating agencies. However it is important to understand that the County Council maintains the responsibility for the decisions it takes with its investments.

58. Credit ratings provided by the three main credit rating agencies form an important, but not the only, aspect of how creditworthiness is assessed by Arlingclose. For 2018/19 minimum credit-rating thresholds are set at a long-term rating of 'A-' where available. Counterparties that are rated below this level are excluded.

59. In addition the following are also considered.
- Potential government support.
- Credit Default Swap prices (CDS) (i.e. the cost of insuring against counterparty default).
- Share prices and bond yields.
- Balance sheet structure.
- Macro-economic factors.
- A subjective overlay, i.e. a judgement being made about whether the counterparty should be recommended or not.

60. In practical terms all of this information is considered by Arlingclose when they determine their recommended Lending List. Any change in these criteria can result in a counterparty being removed from their Lending List, not solely a change in credit rating.

61. In the recent past, the economic environment has been very volatile, so the advice provided by Arlingclose results in counterparties with high quality credit characteristics that are intended to insulate the County Council against further volatility. Of course, the future cannot be foreseen and in some situations

changes may need to be made quickly, but this is considered a cautious approach.

62. The County Council remains responsible for its investment decisions. The Treasury Management Panel, chaired by the Director of Finance and Resources, meets monthly and a review of the County Council's Lending List and any changes recommended by Arlingclose will take place at these meetings. In between meetings, the Treasury team will implement any recommendations made by Arlingclose. On the rare occasion that Arlingclose do not make a firm recommendation then this will be referred to the Panel for their review.

63. Under stressed market conditions, additional Panel meetings may take place at very short notice after which the Panel may decide to adjust the County Council's investment risk profile. The end result may involve moving investments to lower risk counterparties or instruments.

64. In conclusion, the proposed AIS will be based on the following definition of high credit quality:
    - Regulation investments as set out (**paragraph 46**).
    - Diversified sterling Money Market Funds meeting the criteria set out (**Paragraph 52**).
    - A bank or building society that is recommended by Arlingclose for inclusion on the County Council's Lending List.

<u>Monitoring</u>

65. Rating changes and significant changes in risk indicators will be communicated by Arlingclose for the Treasury team to action, together with any revisions to their recommendations. Changes by Arlingclose will be notified by e-mail, and in urgent situations, followed up by a phone call.

<u>The County Council's banker</u>

66. The County Council's banking provider is Lloyds Bank. Cash is retained with Lloyds Bank each night earning interest at a market rate; the amount retained will be set in line with the diversification policy set out at **paragraph 72** onwards.

67. With consideration to the Bank ring-fencing legislation referred to in **paragraph 34**, Lloyds Bank has a relatively small investment banking operation meaning that 97% of the bank's assets are expected to remain within the ring-fence. It has been confirmed that the County Council's business with Lloyds Bank will take place within the ring-fence and not form part of their investment banking operations.

68. As the different credit risks of 'retail' and 'investment' banks will not be known for certain until the banks' new structures are finally determined and published, Arlingclose recommended in May 2017, that the County Council amend its Lending List for unsecured investments in Lloyds Bank from 13 months to 6 months. The County Council will continue to monitor Arlingclose's advice on bank credit risk and amend the Lending List accordingly.

69. Should the Lloyds credit rating fall below the minimum specified in this report, then small balances may be retained with the bank for operational efficiency.

This will be determined by the Treasury Management Panel chaired by the Director of Finance and Resources.

Investment duration for Specified Investments

70. In considering the financial instruments that meet the definition of a Specified Investment, there is the scope to consider the length of the investment period.

71. One of the important lessons of the 2008 banking crisis has been to exercise caution in the duration of investments with banks and building societies. This recognises that the factors that led to the investment being considered secure can change adversely over time. As such it is judged reasonable to limit unsecured fixed-term deposits with banks or building societies to a maximum duration of 12 months, even if Arlingclose recommend a longer duration.

Investment diversification

72. Having determined the County Council's Lending List of highly rated counterparties and the duration of investments, the last piece of the process is to overlay the methodology for ensuring diversification. This is achieved by setting a maximum amount to be invested with each counterparty to limit risk and to ensure a spread of investments.

73. Ensuring diversification is fundamentally important; it protects the security of the investments by limiting the County Council's loss in the event of a counterparty default. However, diversification does not protect the County Council from a systemic failure of the banking sector, although the risk of this has diminished as a result of bail-in banking regulations.

74. Investment balances rise and fall during the year, so diversification needs to take account of this. The limits shown are based upon percentages of investments and the Treasury team will review and reset these limits at least once a month with reference to forecast future balances. The interval between each review is very much a matter of balance between ensuring diversification and efficient processing as investment balances cannot practically be moved each day to accommodate shifting limits. It is judged that a monthly review strikes this balance. This action will be notified to the Treasury Panel at their next monthly meeting.

75. Investment diversification is proposed at two levels; firstly at investment category level:

Investment category	**Maximum % of total investments**
Regulation Investments*	100%
Money Market Funds (MMF)	50%
Banks and Building Societies	50%

**no limit is proposed as in certain circumstances these may be utilised for all of the County Council's investments.*

76. Secondly, diversification will also take place at investment counterparty level:

Banks and Building Societies Lower of:	
£m	Maximum investment as a proportion of total forecast cash balances
30	5% (unsecured) 10% (secured)

Individual MMF Lower of:	
Maximum investment as a share of the total size of the MMF	Maximum investment as a proportion of total forecast cash balances
0.50%	10%

77. There is an exception to these rules, that where cash balances are low, then the amount invested in MMFs may be as high as 100%. This recognises the fact that there may simply be no other available investment for small amounts where liquidity is needed.

78. As a result of bail-in regulations, Arlingclose recommend a limit of 10% of cash balances if investments are secured (e.g. covered bonds) and a limit of 5% if investments are unsecured (e.g. fixed term deposits).

79. It is proposed that the application of the investment diversification policy is delegated to the Treasury Management Panel chaired by the Director of Finance and Resources.

<u>Non-Specified Investments</u>

80. Existing government regulations define Non-Specified Investments as all other types of investment that do not meet the definition of Specified Investments. In contrast to Specified Investments, existing government guidance indicates that the AIS should:

- set out procedures for determining which categories of Non-Specified Investments should be prudently used;
- identify such investments;
- state an upper limit for each category of Non-Specified Investment; and
- state upper limits for the total amount to be held in such investments.

81. The Non-Specified Investments proposed for use within the AIS are listed below. None of these present any additional security risk to the investments within Specified Investments.

- <u>Covered Bonds</u> are issued by banks and building societies against mortgage assets they hold, and they are guaranteed by a separate group of companies. Covered bonds are exempt from bail-in as their structure enables investors to have effective security over the mortgage assets, by being sold if needed. Covered bonds can be classified as a Specified Investment if their maturity is under 12 months and is with a bank or building society recommended by Arlingclose.

- Repos (Repurchase Agreements) comprise the purchase of securities with the agreement to sell them back at a higher price in the future. Investments are exchanged for assets such as government bonds, which can be sold in the case of a loss.
- Certificates of Deposit (CD's) are identical to a fixed term deposit and are not exempt from bail-in. A certificate is issued for a specified length of time and rate of interest and can be sold in the secondary market if needed. CD's can be classified as a Specified Investment if their maturity is under 12 months and is with a bank or building society recommended by Arlingclose.
- UK Government Gilts are similar to the Debt Management Account Deposit Facility (DMADF) account and Treasury Bills but are a longer term investment that can be sold in the secondary market.
- Multilateral Development Bank Bonds are "AAA" rated bonds created by institutions and backed by a group of countries. They can be sold in the secondary market if needed.
- Collective Schemes range from enhanced MMFs (which have 3-5 day liquidity notice as they invest further along the yield curve) to property and equity funds. These all have varying risk and return profiles. The Treasury Management Panel approved a decision to use this category of investment in 2016/17 by committing to an enhanced 'cash plus' MMF with a 3 day liquidity notice period.

82. Where investments are subject to market risk (this is the risk that the value of the investment can go down as well as up), the inclusion of these investment instruments is proposed only on the basis that if purchased, they would be held until maturity under normal circumstances. At maturity the investment and accrued interest would be paid in full. Certificates of Deposit would only be sold early if there were concerns over the borrower defaulting.

83. The decision to invest in the categories of investments above will only be taken after due consideration by the Treasury Management Panel chaired by the Director of Finance and Resources.

84. For the purpose of setting investment amounts and duration limits, Non-Specified Investments are split into two groups (see **Appendix 2**).
    - Long-term local authority loans and UK Government Gilts. These have a combined investment limit of £45m (up to 40 years duration) due to their similar high credit quality. The County Council has held £30m of long term local authority investments since 2013.
    - Other Non-Specified Investments. These have an individual investment cap amount per asset class at £20m (up to 5 years duration) with an overall cap of £50m for this group.

    This means a total of £95m can be invested in Non-Specified Investments in 2018/19 and is reflected in **Appendix 5,** Prudential Indicator point 5.

85. **Appendix 2** sets out the investment categories authorised for use in 2018/19 and **Appendix 4** lists the County Council's Lending List at the time of writing this report.

Non-treasury investments

86. Although not currently classed as treasury management activities and therefore not covered by the existing CIPFA Code or the DCLG Guidance, the County Council may purchase property for investment purposes and may also make loans and investments for service purposes.

87. It is anticipated that the new CIPFA Code and DCLG Guidance will require non-treasury investments, such as property investments, to be reported for their objectives, governance and risk management. The County Council currently has one non-treasury investment, valued at around £24m as at 31 March 2017; this is a 49% share in the company Entrust which provides education support services to schools.

Risk assessment

88. Although the current guidance sets out security and liquidity as being the main treasury risks, they are not the only investment risks faced by the County Council. **Appendix 3** sets out a high-level risk assessment for six of the key risks which are summarised in the following table:

Risk	**Assessment**
Security	Low
Liquidity	Low
Interest rate	Low to Medium
Market	Low
Refinancing	Low to Medium
Regulatory and Legal	Low

89. The proposed AIS has been assessed against these risks and the judgement is that the most significant risks have been reduced as far as possible. This is not to say that all risk has been eliminated, which is never possible in treasury terms.

MRP Strategy 2018/19

128. The County Council is legally obliged to have regard to government guidance issued in February 2008 concerning the MRP policy. MRP is where the County Council must make an annual revenue provision for the repayment of debt (also referred to as the Capital Financing Requirement or CFR). The MRP policy must be submitted to the full Council for approval prior to the start of the financial year to which the provision will relate. The policy for 2018/19 is summarised below and shown in full at **Appendix 8**.

129. It is proposed to continue the agreed MRP policy as follows:
- The major proportion of the MRP for 2018/19 will relate to the more historic debt liability that will continue to be charged at the rate of 4%, in accordance with the recommendations and intent of Option 1 of the guidance.
- Further amounts of new capital expenditure may continue to be charged at the rate of 4%, and added to the above mentioned base CFR amount, up to an amount equivalent to the County Council's annual Supported Capital Expenditure (Revenue) allocation.
- Certain expenditures reflected within the debt liability at 31 March 2018 will under delegated powers be subject to MRP under Option 3.
- With regards to potential loans granted by the County Council, no MRP will be charged on them. The MRP will be equated to the principal repayment of the individual loans.

130. In practical terms, this approach means that capital expenditure funded from Supported Borrowing (that is, supported by government grant) will be repaid at

4%. However, expenditure funded from Unsupported Borrowing will be repaid at a rate which matches the useful lives of those assets funded. This will result in a saving for the authority as the debt can be spread over a longer period of time, for example 60 years where a building has been funded from Unsupported Borrowing (that is, supported by the County Council).

Appendix 2

Cabinet – 17 January 2018 - Investment categories authorised for use 2018/19

Investment	Specified*	Non-Specified	Comments
UK Government - Debt Management Account Deposit Facility (DMADF) (regulation investment)	**unlimited**	**n/a**	6 months maximum available
UK Government - Treasury Bills (T-Bills) (regulation investment)	**unlimited**	**n/a**	6 months maximum available
UK local authorities term deposits (regulation investment)	**unlimited**	**£45m across these categories**	Up to 40 years in duration (non-specified)
UK Government – Gilts	**unlimited**		
Money Market Funds	✓	**n/a**	50% of total investments in this category. Individual MMF - Lower of 0.50% of individual MMF size or 10% of total forecast cash balances per MMF
Term deposits with banks and building societies	✓	✗	50% of total investments in this category. Lower of 5% (unsecured) or 10% (secured) of total forecast cash balances or £30m per counterparty
Certificates of deposit (banks / building societies)	✓	**Maximum £20m per investment category and £50m in total across all categories**	Up to 5 years in duration (non-specified)
Bonds issued by Multilateral Development Banks	✓		
Collective Investment Schemes e.g. Enhanced MMF’s	✗		
Covered Bonds	✓		
Repos (repurchase agreement)	✗		

** Up to 12 months*

Appendix 4

Cabinet - 17 January 2018

County Council Lending List – December 2017	
	Maximum Time Limit
Regulation investments	
DMADF account	6 months
UK Government T-Bills	6 months
UK local authority	12 months
Banks and building societies	
Barclays	100 days
HSBC	6 months
Lloyds	6 months
Nationwide	6 months
Santander	6 months
MMF	
Black Rock	same day
Insight	same day
Federated	same day
Standard Life	same day
State Street (SSGA)	same day
Enhanced MMF	
Royal London Cash Plus	3 day notice

Appendix 8

Cabinet – 17 January 2018

Minimum Revenue Provision (MRP) Policy Statement

Introduction

Capital expenditure is expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. It would be impractical to charge the entirety of such expenditure to revenue in the year in which it was incurred therefore such expenditure is spread over several years in order to try to match the years over which such assets benefit the local community through their useful life.

The manner of spreading these costs is through an annual Minimum Revenue Provision (MRP), which was previously determined under Regulation, and will in future be determined under Guidance.

The Government issued guidance which came into force on 31 March 2008 which requires that a Statement on the County Council's policy for its annual MRP should be submitted to the full Council for approval before the start of the financial year to which the provision will relate.

The guidance offers four main options under which MRP could be made (for information these are detailed over the page), with an overriding recommendation that the County Council should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits.

MRP Policy Statement 2018/19

The County Council implemented the new MRP guidance in 2009/10, and will assess their MRP for 2018/19 in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

The major proportion of the MRP for 2018/19 will relate to the more historic debt liability that will continue to be charged at the rate of 4%, in accordance with the recommendations and intent of Option 1 of the Guidance.

Further amounts of new capital expenditure may continue to be charged at the rate of 4%, and added to the above mentioned base Capital Financing Requirement (CFR) amount, up to an amount equivalent to the County Council's annual Supported Capital Expenditure (Revenue) allocation.

Certain expenditures reflected within the debt liability at 31 March 2018 will under delegated powers be subject to MRP under Option 3.

Estimated life periods will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the County Council. However, the County Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

Asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure.

With regards to loans granted by the County Council no MRP will be charged on them. The MRP will be equated to the principal repayment of the individual loans.

Option 1: Regulatory Method

Under the previous MRP regulations, MRP was set at a uniform rate of 4% of the adjusted CFR (i.e. adjusted for "Adjustment A") on a reducing balance method (which in effect meant that MRP charges would stretch into infinity). This historic approach must continue for all capital expenditure incurred in years before the start of this new approach. It may also be used for new capital expenditure up to the amount which is deemed to be supported through the SCE annual allocation.

Option 2: Capital Financing Requirement Method

This is a variation on Option 1 which is based upon a charge of 4% of the aggregate CFR without any adjustment for Adjustment A, or certain other factors which were brought into account under the previous statutory MRP calculation. The CFR is the measure of an authority's outstanding debt liability as depicted by their balance sheet.

Option 3: Asset Life Method.

This method may be applied to most new capital expenditure, including where desired that which may alternatively continue to be treated under Options 1 or 2.

Under this option, it is intended that MRP should be spread over the estimated useful life of either an asset created, or other purpose of the expenditure. There are two useful advantages of this option.

- Longer life assets e.g. freehold land can be charged over a longer period than would arise under Options 1 and 2.
- No MRP charges need to be made until the financial year after that in which an item of capital expenditure is fully incurred and, in the case of a new asset, comes into service use (this is often referred to as being an 'MRP holiday'). This is not available under Options 1 and 2.

There are two methods of calculating charges under Option 3:

a. equal instalment method – equal annual instalments; or

b. annuity method – annual payments gradually increase during the life of the asset.

Option 4: Depreciation Method

Under this option, MRP charges are to be linked to the useful life of each type of asset using the standard accounting rules for depreciation (but with some exceptions) i.e. this is a more complex approach than Option 3.

The same conditions apply regarding the date of completion of the new expenditure as apply under Option 3.