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Pool Rate Calculation

Summary

1. This paper looks at the distributional impact on authorities' Standard Spending Assessments (SSAs) of the differing values of the Pool Rate brought about by either reversing or not reversing unsupported borrowing out of the calculation.

Views sought

2. Members are asked to note the impact on the distribution of the SSA as a consequence of not reversing unsupported borrowing out of the calculation of the pool rate and to consider the case for a different approach to the treatment of the unsupported borrowing element within the calculation of the pool rate.

Background

3. From 2010-11 onwards the calculation of the pool rate of interest, used to determine the debt financing element of the revenue settlement, has had unsupported borrowing reversed out of total outstanding debt.
4. In order to do this, information on the amount of new unsupported borrowing in each year since prudential borrowing was introduced was required, as well as information on the interest rate and residual maturities for unsupported borrowing for each year.
5. The amount of new unsupported borrowing in each year was readily available, but the information on the interest rate and residual maturities for unsupported borrowing for each year was not available, so had to be proxied.
6. The amounts of all new borrowing by UK local authorities from the PWLB and corresponding interest rates were therefore used to derive notional residual maturities for unsupported borrowing of Welsh Local Authorities. This assumes that Welsh debt financed by unsupported borrowing has the same residual maturity profile as all UK local authority borrowing. The notional amount outstanding at the end of the financial year, and the average rate of interest, were reversed out of the pool rate calculation for use in the revenue settlement.

Analysis

7. Table 1 below shows the interest rate that is built in to the unsupported borrowing calculation and the resultant effect on the PWLB debt interest rate, once the unsupported borrowing is reversed out of the model.

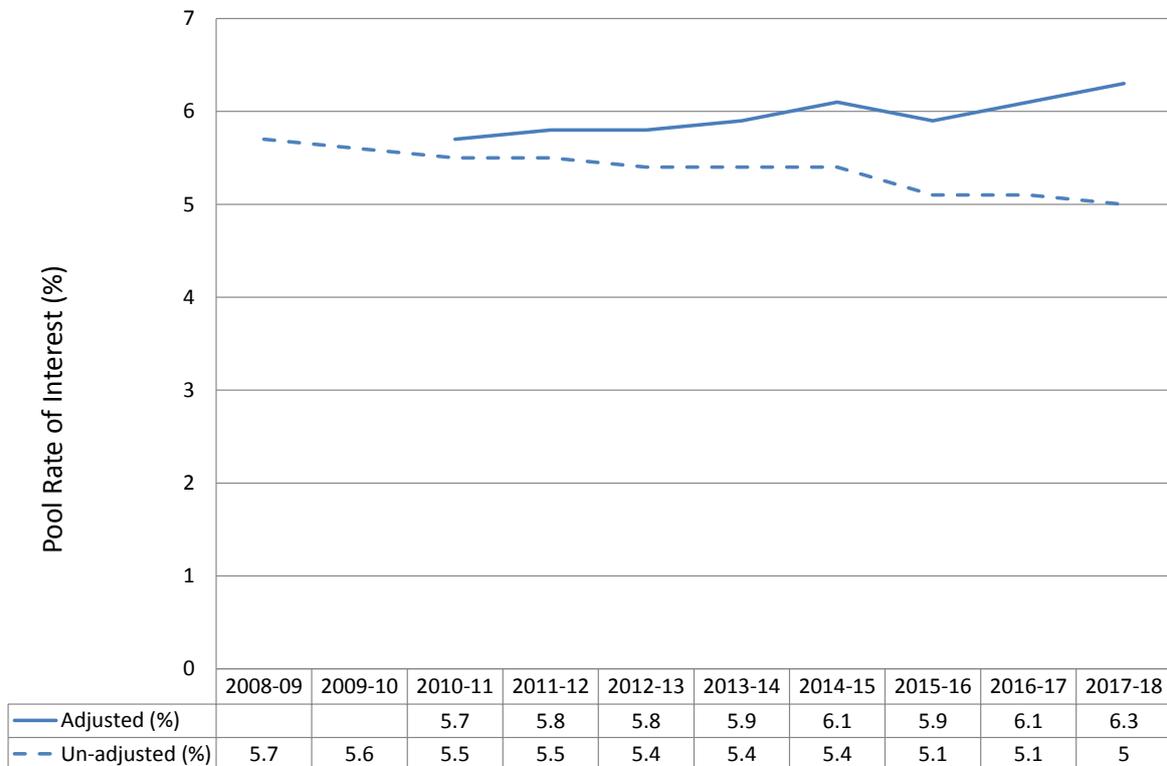
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Table 1: Interest rates used in the calculation of the pool rate of interest

	04-05	05-06	06-07	07-08	08-09	09-10	10-11	11-12	12-13	13-14	14-15	15-16
Average interest rate built in to the model	4.69	4.19	4.29	4.55	3.37	3.25	3.26	3.2	3.07	3.38	3.38	2.49
Resultant average interest rate at which unsupported borrowing is reversed out	4.69	4.35	4.32	4.43	4.15	3.99	3.84	3.72	3.60	3.56	3.54	3.40
PWLB Interest Rate					5.70	5.70	5.65	5.60	5.53	5.52	5.37	5.19
PWLB Interest rate with unsupported borrowing reversed out					5.99	6.13	6.26	6.44	6.64	7.03	7.18	7.47

8. The table shows that the relatively low interest rate built into the model in the first instance (row 1) results in a relatively low assumed interest rate for the unsupported borrowing (row 2). Once this is reversed out of the PWLB interest rate (row 3) this results in the remaining PWLB debt assuming a higher rate of interest (row 4).
9. Chart 1 below shows the divergence of the pool rate of interest when reversing and not reversing out the unsupported borrowing. This illustrates that, when leaving the unsupported borrowing in the model, the pool rate gradually reduces. However, when reversing the unsupported borrowing out of the model at the lower interest rate (as illustrated by table 1) the pool rate gradually increases.

Chart 1: Pool Rate of Interest With and Without Reversing Out Unsupported Borrowing



10. As the pool rate of interest has continued to increase when general interest rates have remained stable or have decreased, this brings into question the methodology behind the reversal out of the unsupported borrowing.

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11. Table 2 below shows the estimated distributional impact on SSA of removing the reversal out of unsupported borrowing from the model for 2017-18.

Table 2: Estimated¹ Distributional Impact of removing reversal out of unsupported borrowing

Unitary Authority	Total SSA (6.3% Pool Rate ²)	Estimated total SSA (5% Pool Rate ³)	Difference		Rank of percentage change
			£'000	Percentage	
Isle of Anglesey	127,453	127,392	-61	0.0%	18
Gwynedd	226,413	226,272	-141	-0.1%	19
Conwy	207,919	207,896	-24	0.0%	12
Denbighshire	185,620	185,565	-55	0.0%	17
Flintshire	257,526	257,577	51	0.0%	7
Wrexham	230,510	230,670	160	0.1%	3
Powys	239,309	238,965	-344	-0.1%	20
Ceredigion	134,235	134,031	-203	-0.2%	22
Pembrokeshire	219,607	219,548	-59	0.0%	15
Carmarthenshire	335,323	335,289	-34	0.0%	11
Swansea	414,595	414,582	-13	0.0%	10
Neath Port Talbot	262,581	262,587	6	0.0%	9
Bridgend	248,593	248,689	95	0.0%	6
The Vale Of Glamorgan	216,807	216,982	174	0.1%	1
Rhondda Cynon Taf	442,518	442,428	-90	0.0%	13
Merthyr Tydfil	109,683	109,655	-28	0.0%	14
Caerphilly	333,301	333,528	227	0.1%	4
Blaenau Gwent	133,102	132,903	-199	-0.1%	21
Torfaen	166,924	166,879	-45	0.0%	16
Monmouthshire	143,880	143,886	6	0.0%	8
Newport	274,653	274,761	108	0.0%	5
Cardiff	592,630	593,100	469	0.1%	2
Total Unitary Authorities	5,503,184	5,503,184	0	0.0%	

1 Impact estimated by running the debt financing SSA on updated Pool Rate, then re-distributing this on the non-actual sector SSAs

2 Actual Pool Rate used for 2017-18 settlement calculation (unsupported borrowing reversed out)

3 Pool Rate adjusted to leave the unsupported borrowing in the calculation

12. Reverting back to the old method of calculation of the Pool Rate for 2017-18 reduces the Debt Financing SSA by £38 million, to £269 million.

13. The overall re-distributional effect for 2017-18 of reverting back to the old method of calculation of the Pool Rate (without reversing out the unsupported borrowing) is £1.3 million. The Vale of Glamorgan would see the largest percentage increase in their total SSA (0.1%) with Ceredigion seeing the largest decrease (0.2%).

Conclusion

14. In light of this information, members are asked to consider the case for a different approach to the treatment of the unsupported borrowing element within the calculation of the pool rate.