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Pool Rate for 2022-23 onwards

Summary

1. This paper provides a brief background on the calculation and use of the pool rate of interest, the potential issue surrounding the current methodology and an update of the work of the pool rate working group.

Views sought

2. Members are asked to note the background and methodological issues with the current pool rate model and to consider how best to take this work forwards.

Background

3. The Partnership Council introduced a pool rate of interest for Welsh local authorities for the 2000-01 Settlement.
4. The pool rate is used to determine the debt financing element of the revenue settlement. In the past, the pool rate has also been used as the interest rate for calculating PFI revenue support.
5. The Debt Financing model calculates the estimated average outstanding debt for the settlement year and applies the Pool Rate to estimate the interest charged on this debt.
6. From 2010-11 onwards, 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.
7. In May 2015, the DSG agreed that the basket of loans taken out through PWLB totalling £919 million to fund the buyout from the HRA subsidy scheme would be excluded from the pool rate calculations for the 2017-18 Settlement onwards.
8. 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, by settlement year (%)

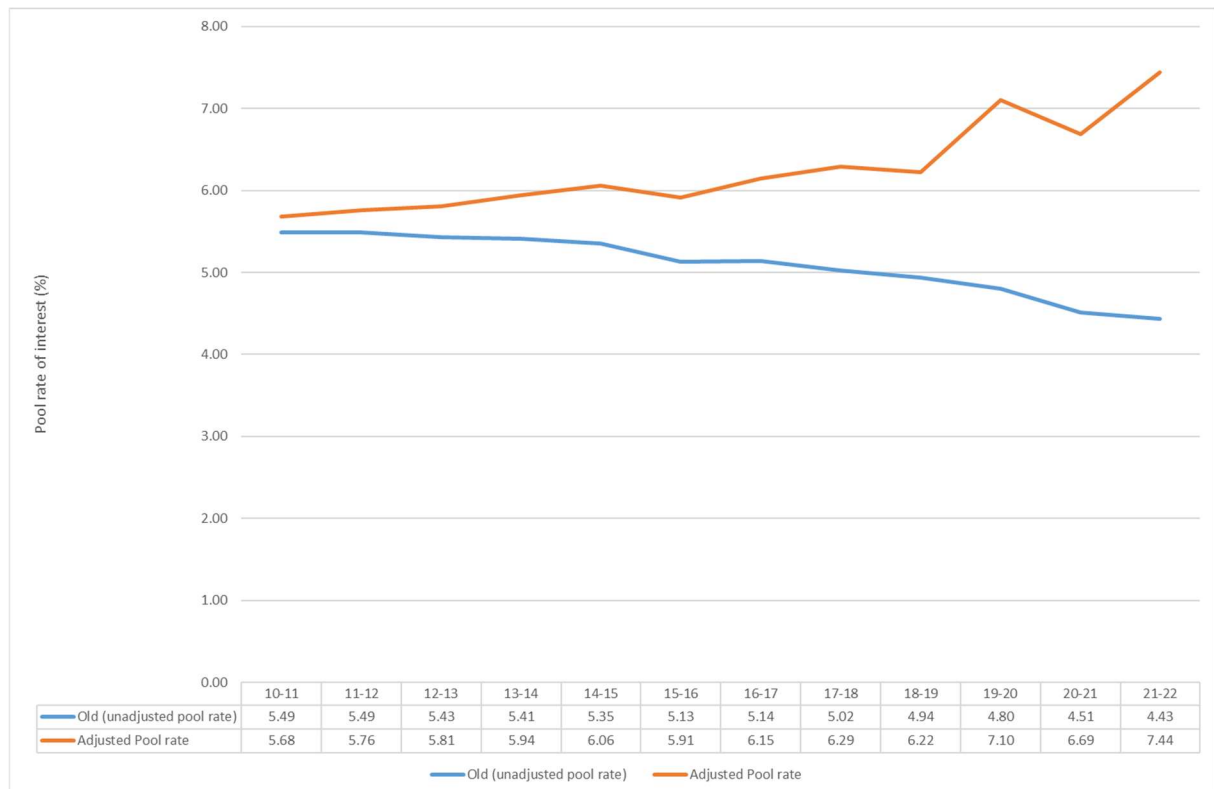
Year of pool rate model	10-11	11-12	12-13	13-14	14-15	15-16	16-17	17-18	18-19	19-20	20-21	21-22
Average interest rate built into the model ¹	3.37	3.25	3.26	3.20	3.07	3.38	3.38	2.49	2.18	2.40	2.23	2.23
Resultant average interest rate at which unsupported borrowing is reversed out	4.15	3.99	3.84	3.72	3.60	3.56	3.54	3.40	3.28	3.11	3.00	2.91
PWLB interest rate	5.70	5.71	5.66	5.61	5.53	5.52	5.37	5.19	5.07	4.92	4.54	4.54
PWLB interest rate with unsupported borrowing reversed out	5.99	6.13	6.26	6.44	6.64	7.03	7.18	7.47	7.26	9.70	8.49	11.61

1. Rate for 2021-22 rolled forward from 2020-21, as the PWLB were unable to provide the required breakdown

9. 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).

10. 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 the pool rate gradually increases.

Chart 1: Pool Rate with and without reversing out unsupported borrowing



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11. 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.

Pool Rate Working Group

12. The Pool Rate Working Group was formed in 2018 to look, specifically, at the issue of the pool rate increasing as a result of reversing out the unsupported borrowing, when general interest rates have not seen the same increases.

13. The group felt that it was important to consider how the pool rate is used in the debt financing model before coming to any conclusions on any alternative methodology.

14. After analysis of the debt financing model, the group proposed an alternative methodology for calculating the debt financing element of the settlement by utilising existing verifiable data on supported borrowing outstanding.

15. This model assumes that an existing average pool rate is used, unless there was an appetite to go back and revise previous years. For future years, the proposal was then to apply an estimate of average interest rates on PWLB for the preceding year.

16. Whilst detailed analysis has not been carried out on the financial implications of this methodology, the debt financing element of SSA reduced by around £25m under the new methodology (calculated in 2019) so has the potential for a significant financial impact.

Conclusion

17. Members' views are sought on whether they would like Welsh Government officials to present this methodology, and options for the forward-looking interest rate, at the next meeting, in September, or whether this work should be picked up through a refreshed Pool Rate Working Group.