LOCAL AUTHORITY PFI GRANT REFORM
ADDITIONAL MATERIAL, CORRECTIONS & FURTHER EXPLANATION
NUMBER 1: 13 AUGUST 2004

Availability of data in consultation paper

The version of the consultation paper originally posted on the ODPM website was, unfortunately, a pdf file. As such the embedded spreadsheet material was not available. This has been corrected and a Word version in now available.

Uplift

The current method of calculating PFI grant includes a complicated system of increasing the level of PFI credits depending on the period between contract signature and operational start. This 'uplift' applies to projects which were endorsed before 1 April 2002 - and for various schools projects where the PFI credit level was set before that date. It will continue to apply when calculating opening balances under the proposed annuity system.

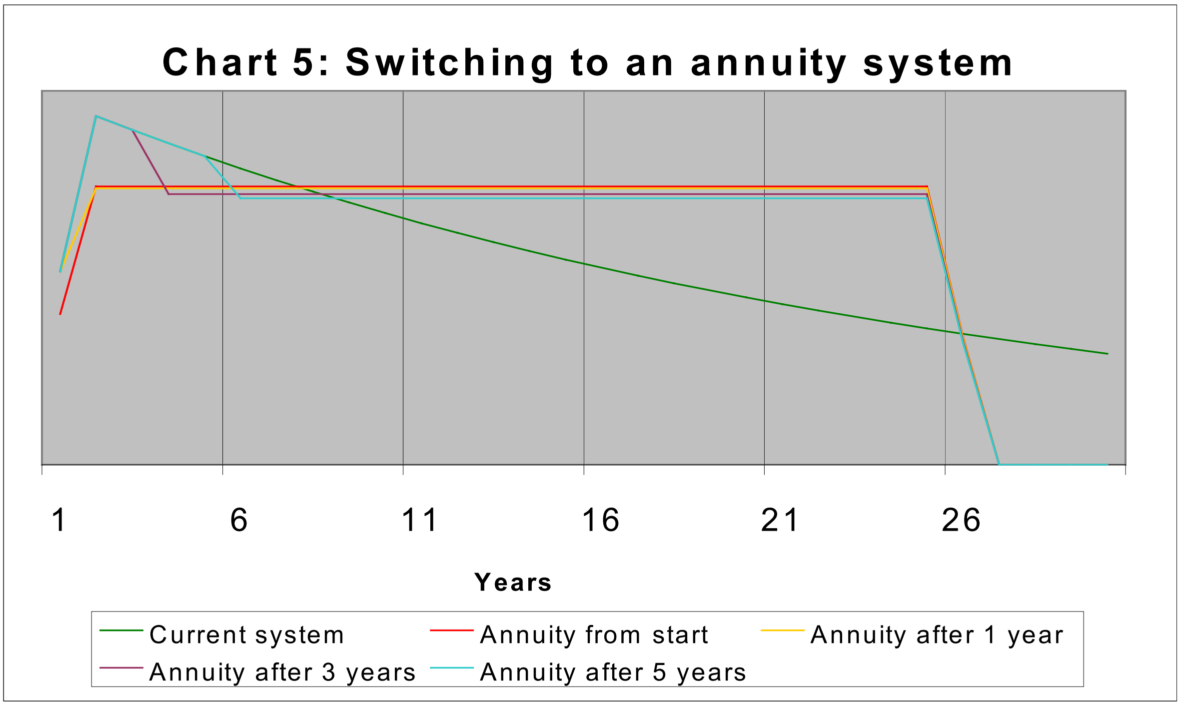
Calculating the annuity payment for projects which switch from the current system

It has been pointed out that the annuity calculations included in chart 4 of the paper do not take into account the period over which grant has already been received. This was an error.

There is also an error in the calculations applied to the final year of payment. The formula used gives the correct figure for projects which receive annuity grant from the start, but not those which switch.

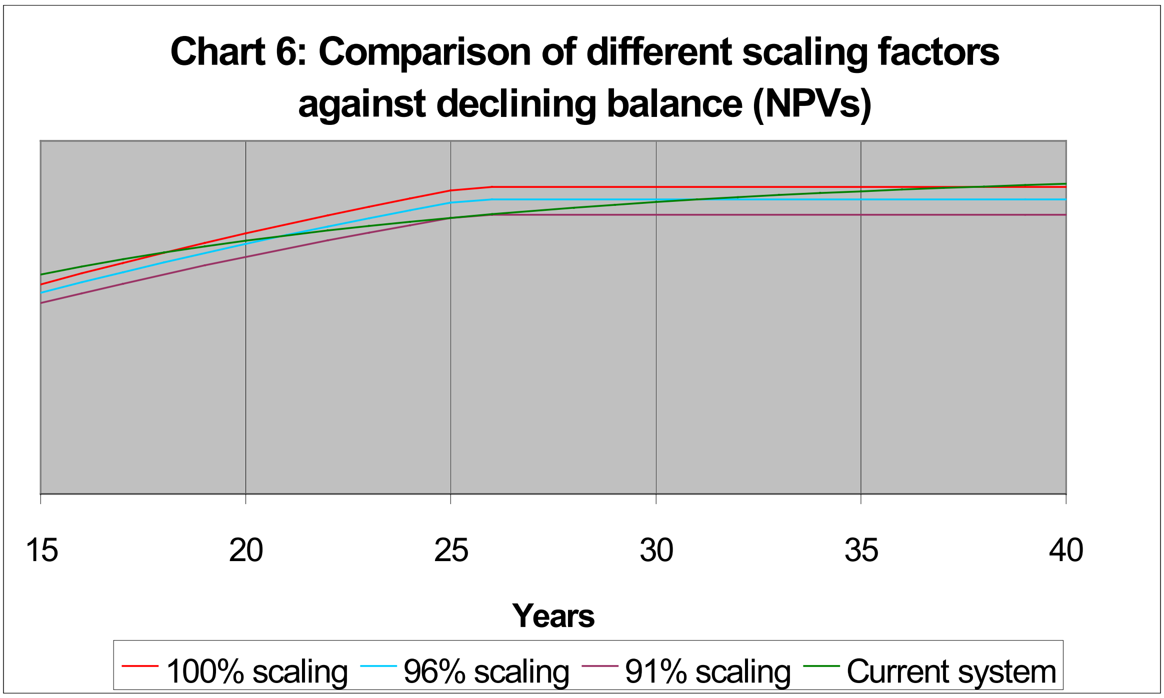
The data embedded in Chart 5 below shows the effects of correcting both of these formulae (you are reminded that advice on accessing embedded material is included in the covering letter sent with the consultation paper). However these figures also show that projects which switch receive a progressively lower level of grant over the 25 year period the longer the period of receiving grant under the current system. This was not the intention. An alternative proposal has therefore been agreed which ensures that projects all receive the same total grant irrespective of when they switch. That is also included in Chart 5 and the graph illustrates the effects of applying this solution.

Your comments are sought on this proposed alternative methodology for calculating the annuity payment for existing projects.



Effects of different scaling factors, compared to existing grant

Chart 3 of the consultation paper compared the effect of applying three different scaling factors and compared these to the level of unitary charge which the grant is intended to support. It is, of course, important to central government that the level of support is appropriate to meet need. However, it has been requested that a chart also be prepared to compare annuity grant at different scaling factors to the level of grant which would be received under the current system. This comparison was included in tabular form in para 24 of the paper, but Chart 6 below shows the same information in graphical form.



Interest earned under the current system

When comparing income under the existing and the proposed systems, the consultation paper takes account of interest earned on early payments under the current system. It does this by looking at the excess of grant received compared to the unitary charge paid out by the local authority.

However it is also possible to consider the interest which could theoretically be earned on the difference between grant received under the existing system and an annuity system. Chart 7 below looks at interest earned in this way. The result is that cumulative payments (in NPV terms) under an annuity system match those under the current system after 25 years when the scaling factor is at 92.4%, rather than 91% as shown in Chart 6. It is suggested that this is unlikely to change opinions on the benefits or otherwise of switching to an annuity system.