
EDUCATION VILLAGE – CHANGE IN FUNDING MECHANISM

**Responsible Cabinet Member(s) – Councillor Don Bristow
Resource Management Portfolio
Responsible Director(s) – Paul Wildsmith Director of Corporate Services**

Purpose of Report

1. To advise Members of a change in the method of Government support for Private Finance Initiative (PFI) schemes.

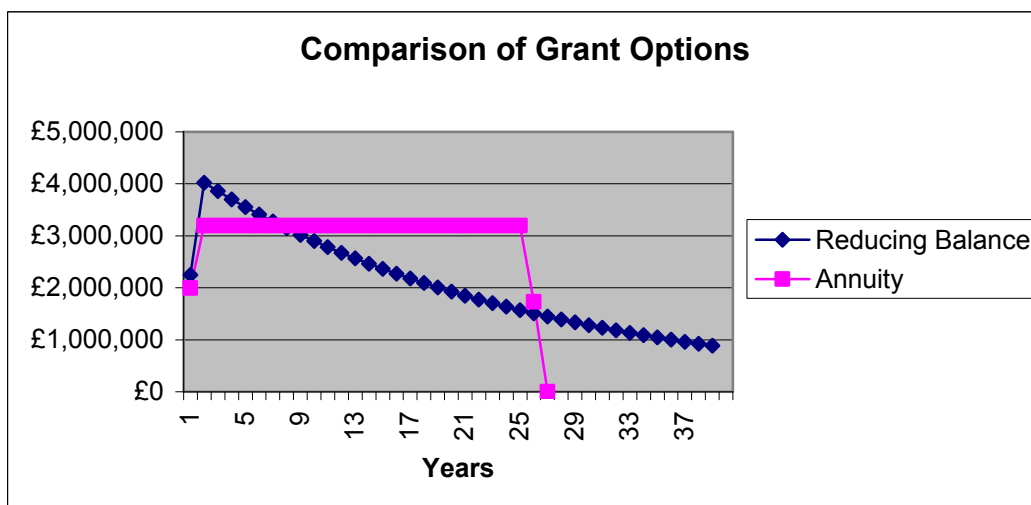
Background

2. At the Council meeting on the 23rd February 2004, Members approved the Final Business Case for the Education Village. In doing so they also agreed the amount the Council would contribute annually to cover the gap between Government Grant plus internal resources and the amount paid to the contractor. The PFI deal was signed on 31 March 2004.

Information and Analysis

The New PFI Grant System

3. On 29 July 2004 the Office of the Deputy Prime Minister (ODPM) issued a consultation paper on PFI Grant Reform with a closing date of 15 October 2005. The essence of the paper was to propose a move to an annuity based grant system from a reducing balance one. This would mean that the grant would all be paid in equal instalments over the life of the contract, in contrast to the reducing balance method whereby the grant starts higher but diminishes and also continues almost infinitely until the grant is exhausted. This is best demonstrated by the graph below:



4. The Rt. Hon. Nick Raynsford, Minister for Local Government and the Regions, then announced the outcome of the consultation exercise on 28 January 2005. Below is a summary of the main reforms to the PFI grant system:
 - All schemes endorsed after 1 April 2005 will receive grant at a constant level over the life of the contract, calculated on an annuity basis.
 - Schemes already receiving grant will be given the option before the start of financial year 2005/06 of either switching to an annuity system or continuing to receive grant under the previous declining balance grant regime.
 - A scaling factor, with a maximum of 1.0, will be set and remain constant for a particular scheme whilst it receives support. Schemes already receiving support will have a scaling factor of 1.0 (ie there will be no impact).
 - ODPM will be contacting the Chief Financial Officer of each authority currently receiving PFI grant paid by the ODPM separately, to formally establish whether it wishes to switch to the annuity system or continue receiving grant under the declining balance regime.
5. Since 28 January 2005 further information has become available including a financial model to allow comparisons between the two methods. This model was only received on 1 March 2005.
6. Included with the financial model on 1 March 2005 ODPM stated ‘Our assumption is that you will want to receive grant based on the annuity method and unless we hear to the contrary by Friday 18 March, these arrangements will be put in place. It will not be possible to change them after 1 April 2005.’ Consequently, there has been a very compressed timescale in which to assess the best option for this Council.

Implications for Darlington

7. The two charts attached at Appendix A and B contrast the two options available to the Council.
8. **Reducing Balance - Appendix A** shows the effect of the Reducing Balance grant distribution method. Members will note how the grant in column (a) steadily reduces after the first full year (2006/07). The other column worthy of note is column (i) the affordability gap, which is the amount the Council has had to factor into the Revenue Medium Term Financial Plan to help pay for the scheme. A summary of the financing over the full term is:

	Years 1- 25	Years 26-38
Resources	£	£
Government Grant (a)	66,506,658	14,022,977
DBC Resources (c)	28,589,783	
Interest (g)	759,888	
Affordability Gap (i)	12,490,234	
Payment to Contractor (b)	108,346,563	0

9. Also shown for comparative purposes is the additional grant from years 26-38, which would be when grant received under this method would be equivalent to grant received under the annuity method.
10. **Annuity – Appendix B** shows the effect of the Annuity grant distribution method. Members will note how the grant in column (a) remains static after the first full year (2006/07). Due to the grant under this method being lower initially, this necessitates creating a negative grant fund initially column (h) which has an interest cost column (g).

	£
Resources	
Government Grant (a)	80,441,557
DBC Resources (c)	28,589,783
Affordability Gap (i)	198,044
	109,229,384
Payments	
Payment to Contractor (b)	108,346,563
Interest (g)	882,821
	109,229,384

11. **Comparison of Options** – over the 25 years the grant income is almost £15m higher under the Annuity method. After allowing for interest costs rather than interest receipts this reduces the affordability gap from almost £12.5m to under £0.200m. Furthermore, it would take until financial year 2042/43 (a further 12 years) to achieve a similar level of grant income under the Reducing Balance Grant system. The Annuity method also has the advantage that from financial years 2020/21 to 2030/31 there would be a positive contribution from resources currently programmed to support the Education Village therefore freeing up resources for other services.
12. The only down side of the Annuity option is that the Government Grant Fund reaches an overdrawn figure slightly in excess of £2.1m by 31 March 2013. Although not permanently reducing resource levels (as it is all repaid by 31 March 2020) it could have the potential of reducing available resources by this amount for this period. However, as it is mainly a cash flow issue, there may be options open when renewing the Revenue MTFP to use financing opportunities to limit or totally negate any impact. In any event there will be no adverse impact on 2005/06 budget and a re-assessment would need to be undertaken annually when the new Revenue MTFP is developed.

Conclusion

13. By opting for the Annuity option the Council can reduce the affordability gap over the concession period of 25 years from almost £12.5m to under £0.200m – a saving to the Council of over £12m. The only down side is in the first half of the concession when a negative reserve will be created which will need to be managed to best effect to minimise any short term impact on revenue resources. This means the risk of overall balances being reduced by up to £2.1m by 31st March 2013. However, officers believe this can be

managed by utilising flexibility within the Council's finances and the Prudential Code, so that the current MTFP balances would remain virtually intact.

Outcome of Consultation

14. There has been no external consultation on this report.

Legal Implications

15. This report has been considered by the Borough Solicitor for legal implications in accordance with the Council's approved procedures. There are no issues which the Borough Solicitor considers need to be brought to the specific attention of Members, other than those highlighted in the report.

Section 17 of the Crime and Disorder Act 1998

16. The contents of this report have been considered in the context of the requirements placed on the Council by Section 17 of the Crime and Disorder Act 1998, namely, the duty on the Council to exercise its functions with due regard to the likely effect of the exercise of those functions on, and the need to do all that it reasonably can to prevent, crime and disorder in its area. It is not considered that the contents of this report have any such effect.

Council Policy Framework

17. The issues contained in this report do not require consideration by Council.

Decision Deadline

18. For the purpose of the 'call-in' procedure this does represent an urgent matter. A decision on the method of payment of PFI Grant for the Education Village needs to be with the ODPM by Friday 18th March 2005.

Key Decisions

19. This is a key decision and has been included in the Forward Plan in accordance with the Special Urgency Rule as contained within this Council's Constitution.

Recommendation

20. It is recommended that :-

(a) Cabinet agree to the Annuity Grant distribution for the Education Village.

Reason

21. It is the most cost effective option.

Paul Wildsmith
Director of Corporate Services

Background Papers

Correspondence from ODPM

Brian Boggon 2305

REDUCING BALANCE METHOD

Financial Year Ending	Government Grant - Declining Balance	Payment to Contractor	Original DBC Resources	DBC Resources + MTFP Plan for Affordability Gap	Original Total Resources Available	+/- to Fund	Interest	Government Grant Fund	Reducing Balance Affordability Gap
	a	b	c	d	e	f	g	h	I
31-Mar-06	£2,247,724	£2,151,852	£385,791	£426,372	£2,674,096	£522,245	£9,139	£531,384	£40,581
31-Mar-07	£4,018,674	£4,752,257	£852,000	£941,622	£4,960,296	£208,039	£22,239	£761,663	£89,622
31-Mar-08	£3,857,927	£4,676,702	£873,300	£984,466	£4,842,393	£165,691	£29,558	£956,911	£111,166
31-Mar-09	£3,703,610	£4,607,033	£895,133	£1,029,259	£4,732,869	£125,836	£35,694	£1,118,441	£134,126
31-Mar-10	£3,555,466	£4,543,086	£917,511	£1,076,090	£4,631,556	£88,470	£40,694	£1,247,605	£158,579
31-Mar-11	£3,413,247	£4,484,705	£940,449	£1,125,052	£4,538,299	£53,595	£44,604	£1,345,804	£184,603
31-Mar-12	£3,276,717	£4,431,742	£963,960	£1,176,242	£4,452,959	£21,217	£47,474	£1,414,496	£212,282
31-Mar-13	£3,145,649	£4,384,059	£988,059	£1,229,761	£4,375,410	-£8,649	£49,356	£1,455,202	£241,702
31-Mar-14	£3,019,823	£4,341,523	£1,012,760	£1,285,715	£4,305,538	-£35,985	£50,302	£1,469,520	£272,955
31-Mar-15	£2,899,030	£4,304,009	£1,038,079	£1,344,215	£4,243,245	-£60,764	£50,370	£1,459,125	£306,136
31-Mar-16	£2,783,069	£4,271,399	£1,064,031	£1,405,377	£4,188,446	-£82,953	£49,618	£1,425,790	£341,346
31-Mar-17	£2,671,746	£4,243,582	£1,090,632	£1,469,322	£4,141,067	-£102,515	£48,109	£1,371,383	£378,689
31-Mar-18	£2,564,876	£4,220,454	£1,117,898	£1,536,176	£4,101,052	-£119,403	£45,909	£1,297,890	£418,278
31-Mar-19	£2,462,281	£4,201,917	£1,145,845	£1,606,072	£4,068,353	-£133,564	£43,089	£1,207,415	£460,226
31-Mar-20	£2,363,790	£4,187,878	£1,174,491	£1,679,148	£4,042,938	-£144,940	£39,723	£1,102,198	£504,656
31-Mar-21	£2,269,238	£4,178,251	£1,203,854	£1,755,549	£4,024,787	-£153,464	£35,891	£984,625	£551,695
31-Mar-22	£2,178,469	£4,172,957	£1,233,950	£1,835,427	£4,013,895	-£159,062	£31,678	£857,242	£601,477
31-Mar-23	£2,091,330	£4,171,920	£1,264,799	£1,918,939	£4,010,268	-£161,652	£27,175	£722,764	£654,140
31-Mar-24	£2,007,677	£4,175,072	£1,296,419	£2,006,250	£4,013,927	-£161,145	£22,477	£584,096	£709,831
31-Mar-25	£1,927,370	£4,182,349	£1,328,829	£2,097,535	£4,024,904	-£157,445	£17,688	£444,339	£768,705
31-Mar-26	£1,850,275	£4,193,691	£1,362,050	£2,192,972	£4,043,247	-£150,444	£12,919	£306,814	£830,922
31-Mar-27	£1,776,264	£4,209,046	£1,396,101	£2,292,753	£4,069,017	-£140,030	£8,288	£175,073	£896,651
31-Mar-28	£1,705,213	£4,228,364	£1,431,004	£2,397,073	£4,102,286	-£126,078	£3,921	£52,916	£966,069
31-Mar-29	£1,637,005	£4,251,601	£1,466,779	£2,506,140	£4,143,145	-£108,457	-£46	-£55,587	£1,039,361
31-Mar-30	£1,571,525	£4,278,719	£1,503,448	£2,620,169	£4,191,694	-£87,025	-£3,468	-£146,080	£1,116,721
31-Mar-31	£1,508,664	£2,502,395	£642,611	£1,142,324	£2,650,988	£148,593	-£2,512	£0	£499,713
Totals	66,506,658	108,346,563	28,589,783	41,080,017	107,586,675	-759,888	759,888		12,490,234

ANNUNITY METHOD

APPENDIX B

Financial Year Ending	Government Grant - Annuity	Payment to Contractor	Original DBC Resources	DBC Resources + MTFP Plan for Affordability Gap	DBC Required Contribution	Total Resources	+/- to Fund	Interest	Government Grant Fund	Annuity Affordability Gap
	a	b	c	c (1)	d	e	f	g	h	i
31-Mar-06	£1,997,694	£2,151,852	£385,791	£426,372	£426,372	£2,424,067	£272,215	£4,764	£276,979	£40,581
31-Mar-07	£3,196,311	£4,752,257	£852,000	£941,622	£941,622	£4,137,933	-£614,324	-£1,509	-£338,855	£89,622
31-Mar-08	£3,196,311	£4,676,702	£873,300	£984,466	£984,466	£4,180,776	-£495,926	-£29,341	-£864,121	£111,166
31-Mar-09	£3,196,311	£4,607,033	£895,133	£1,029,259	£1,029,259	£4,225,570	-£381,463	-£52,743	-£1,298,327	£134,126
31-Mar-10	£3,196,311	£4,543,086	£917,511	£1,076,090	£1,076,090	£4,272,401	-£270,685	-£71,683	-£1,640,695	£158,579
31-Mar-11	£3,196,311	£4,484,705	£940,449	£1,125,052	£1,125,052	£4,321,363	-£163,342	-£86,118	-£1,890,155	£184,603
31-Mar-12	£3,196,311	£4,431,742	£963,960	£1,176,242	£1,176,242	£4,372,553	-£59,189	-£95,987	-£2,045,332	£212,282
31-Mar-13	£3,196,311	£4,384,059	£988,059	£1,229,761	£1,229,761	£4,426,072	£42,013	-£101,216	-£2,104,535	£241,702
31-Mar-14	£3,196,311	£4,341,523	£1,012,760	£1,285,715	£1,285,715	£4,482,026	£140,503	-£101,714	-£2,065,747	£272,955
31-Mar-15	£3,196,311	£4,304,009	£1,038,079	£1,344,215	£1,344,215	£4,540,526	£236,517	-£97,374	-£1,926,604	£306,136
31-Mar-16	£3,196,311	£4,271,399	£1,064,031	£1,405,377	£1,405,377	£4,601,688	£330,289	-£88,073	-£1,684,388	£341,346
31-Mar-17	£3,196,311	£4,243,582	£1,090,632	£1,469,322	£1,469,322	£4,665,632	£422,050	-£73,668	-£1,336,006	£378,689
31-Mar-18	£3,196,311	£4,220,454	£1,117,898	£1,536,176	£1,536,176	£4,732,487	£512,032	-£53,999	-£877,973	£418,278
31-Mar-19	£3,196,311	£4,201,917	£1,145,845	£1,606,072	£1,606,072	£4,802,383	£600,466	-£28,887	-£306,394	£460,226
31-Mar-20	£3,196,311	£4,187,878	£1,174,491	£1,679,148	£1,303,231	£4,875,459	£311,664	-£5,270	£0	£128,739
31-Mar-21	£3,196,311	£4,178,251	£1,203,854	£1,755,549	£981,940	£4,951,860				-£221,913
31-Mar-22	£3,196,311	£4,172,957	£1,233,950	£1,835,427	£976,646	£5,031,738				-£257,304
31-Mar-23	£3,196,311	£4,171,920	£1,264,799	£1,918,939	£975,609	£5,115,249				-£289,189
31-Mar-24	£3,196,311	£4,175,072	£1,296,419	£2,006,250	£978,761	£5,202,561				-£317,657
31-Mar-25	£3,196,311	£4,182,349	£1,328,829	£2,097,535	£986,038	£5,293,846				-£342,791
31-Mar-26	£3,196,311	£4,193,691	£1,362,050	£2,192,972	£997,380	£5,389,283				-£364,670
31-Mar-27	£3,196,311	£4,209,046	£1,396,101	£2,292,753	£1,012,735	£5,489,064				-£383,366
31-Mar-28	£3,196,311	£4,228,364	£1,431,004	£2,397,073	£1,032,053	£5,593,384				-£398,951
31-Mar-29	£3,196,311	£4,251,601	£1,466,779	£2,506,140	£1,055,291	£5,702,451				-£411,488
31-Mar-30	£3,196,311	£4,278,719	£1,503,448	£2,620,169	£1,082,408	£5,816,480				-£421,041
31-Mar-31	£1,732,401	£2,502,395	£642,611	£1,142,324	£769,995	£2,874,725				£127,383
Totals	£80,441,557	£108,346,563	£28,589,783	£41,080,017	£28,787,826	£121,521,574	£882,821	-£882,820		£198,044