

# CABINET

## Medium Term Financial Strategy Update 08 November 2011

### Report of the Head of Financial Services

| PURPOSE OF REPORT   |                          |                  |                          |          |                                     |
|---|--------------------------|------------------|--------------------------|----------|-------------------------------------|
| To update Cabinet on the Council's financial prospects for future years, to help inform development of its budget strategy. |                          |                  |                          |          |                                     |
| Key Decision  | <input type="checkbox"/> | Non-Key Decision | <input type="checkbox"/> | Referral | <input checked="" type="checkbox"/> |
| Date Included in Forward Plan   | November 2011            |                  |                          |          |                                     |
| This report is public.  |                          |                  |                          |          |                                     |

#### RECOMMENDATIONS OF COUNCILLOR BRYNING:

1. That Cabinet notes the current position regarding current spending and forecasts for future years, together with associated risks and uncertainties.
2. That in view of the substantial savings needed in future years, Cabinet be requested to identify priority areas in which to develop savings proposals.
3. That Cabinet considers whether it wishes to recommend any changes to Council Tax targets at this stage, or reconsider the matter in December when more comprehensive information should be available.
4. That the key issues arising from this review be reported to Council for information.

#### 1 Background

- 1.1 In planning for the future, the Council needs to be clear about what finances and other resources it will have, to both shape and deliver against its corporate priorities.
- 1.2 To help with such planning, the Council's existing Medium Term Financial Strategy (MTFS) sets out projections for future years' net revenue spending as compared with its targets for council tax. It therefore provides a financial basis on which Members can consider what changes may be needed to the Council's priorities and the associated levels and scope of services provided, and with regard to council tax. This is so that in due course, the Council can set a balanced budget and move towards having a financially sustainable outlook, together with a deliverable Corporate Plan for the medium term.

- 1.3 Each year, Cabinet has responsibility for reviewing the Strategy and recommending any updates to Council. This is normally done twice a year:
- the first review is generally done in the autumn, to see what has changed financially and to assess whether existing council tax targets are still appropriate; and
  - the second update concludes the budget setting exercise, drawing on decisions taken in fixing the budget, to set the financial direction for future years.
- 1.4 Accordingly this first review does not attempt to give an in-depth update on the Council's finances. The aims at this stage are to:
- ensure an appreciation of the financial challenges facing the Council, in order that Members can formulate how best to tackle those challenges;
  - gain initial direction on areas in which Cabinet requires savings proposals to be developed, to help with planning and management;
  - allow initial consideration of whether any changes to future Council Tax targets should be recommended to Council.
- 1.5 During the course of the next year, council housing will also be incorporated into the MTFs. This change has been planned for some time now but there is little point in pursuing it until the implications of the self-financing proposals are known. For now, therefore, this report focuses solely on General Fund services. Future housing rent levels and other associated financial targets will be addressed as part of the budget process; the first full update is scheduled for December Cabinet.

## 2 General Fund Revenue Update: Current Prospects

- 2.1 The starting point for reviewing General Fund financial prospects stems from Budget Council in March 2011. Prospects back then can be summarised as follows:

|   | 2011/12<br>Budget<br>£000 | 2012/13<br>Projection<br>£000 | 2013/14<br>Projection<br>£000 |
|---|---------------------------|-------------------------------|-------------------------------|
| Net Revenue Budget                            | 21,481                    | 21,131                        | 21,726                        |
| Less: Government Support                      | 13,128                    | 11,609                        | 11,377                        |
| <b>Required Council tax funding</b>           | <b>8,353</b>              | <b>9,522</b>                  | <b>10,349</b>                 |
| Tax Base                                      | 43,450                    | 43,500                        | 43,550                        |
| Resulting Band D Council Tax                  | £192.25                   | £218.89                       | £237.64                       |
| <b>Resulting % Increase Year on Year</b>      | <b>0.00%</b>              | <b>13.9%</b>                  | <b>8.6%</b>                   |
| Target Band D Council Tax                     | £192.25                   | £196.10                       | £200.02                       |
| <b>Target % Increase</b>                      | <b>0.00%</b>              | <b>2.0%</b>                   | <b>2.0%</b>                   |
| <b>Budget Savings Required to meet Target</b> | <b>0</b>                  | <b>991</b>                    | <b>1,638</b>                  |

- 2.2 This illustrates the tension between the revenue budget projections, a reducing level of central government support and being able to set council tax at an acceptable level each year.
- 2.3 Inevitably though, circumstances have changed and budget prospects have altered over the last few months. Taking account of information available to date, the changes for current and future years can be summarised as follows:

|  | <b>2011/12<br/>Budget<br/>£000</b> | <b>2012/13<br/>Projection<br/>£000</b> | <b>2013/14<br/>Projection<br/>£000</b> |
|--|------------------------------------|--|--|
| <b>Original MTFS Net Savings Requirement</b>   | <b>n/a</b>                         | <b>991</b>                             | <b>1,638</b>                           |
| Approved or expected Base Budget Savings   | -509                               | -372                                   | -412                                   |
| Approved or expected Budget Increases  | +184                               | +394                                   | +433                                   |
| <b>Total Net Changes (-reduction / + increase)</b>   | <b>-325</b>                        | <b>+22</b>                             | <b>+21</b>                             |
| <b>Updated Net Savings Requirement (based on a 2% council tax increase, but with no growth included)</b> | <b>n/a</b>                         | <b>1,013</b>                           | <b>1,659</b>                           |
| <b>Resulting Projected Council Tax Increase</b>  | <b>n/a</b>                         | <b>14.1%</b>                           | <b>8.5%</b>                            |
| <b>Potential Savings Options identified to date</b>  |                                    | <b>-150</b>                            | <b>-150</b>                            |
| <b>Potential Growth Options identified to date</b>   |                                    | <b>+117</b>                            | <b>+75</b>                             |
| <b>Potential Impact of Council Tax Freeze for 2012/13 (see section 6.2)</b>                              |                                    | <b>-42</b>                             | <b>+171</b>                            |

- 2.4 More details are set out at **Appendix A**. Overall, it can be seen that whilst annually base budget savings of around £400K have been identified, these have been offset by additional cost pressures coming through. This means that the net savings requirements are still around £1M for next year and £1.6M for the year after, and these do not allow any scope for growth. The 2014/15 outlook will be reported later in the budget once the detailed three-year forecasts have been produced, but it is not expected to give a different picture.
- 2.5 In terms of tackling the savings requirements, some outline savings options have been listed but on the other hand, Cabinet has also already identified a number of potential growth areas and where possible, these are also shown. If any growth proposals are to be taken forward by Cabinet, then this will increase the need for savings.
- 2.6 Importantly, the net savings requirements shown are based on existing Council Tax targets; recent developments regarding Council Tax options are covered later in this report.

- 2.7 It should be appreciated that the financial projections shown are only a snapshot and more changes will arise; an in-depth update to current and future years' base budgets is currently underway and this will be reported to Cabinet in due course. Nonetheless, it is considered highly unlikely that this exercise will result in any substantial progress being made to balance the budget.

### 3 Identification of Savings Options

- 3.1 In view of this position, Cabinet is advised to focus its immediate attention on identifying and prioritising areas for saving. Without such an approach, it runs the risk of:

- not being able to formulate a set of balanced budget proposals for consideration by Council in February, or
- resorting to drawing heavily on reserves and balances, and storing up pressures for the following year; and
- not being able to take forward its draft priority list and any associated growth options.

- 3.2 As such, Cabinet may find it useful to recap on the themes for achieving savings, as set out in the MTFs:

#### **Efficiencies**

All Management Team are currently working on identifying and/or progressing options either within their own service areas or more corporately, but Cabinet may have specific ideas or initiatives that they wish Officers to appraise or develop.

#### **Invest to Save Schemes**

Following the last Cabinet meeting a number of energy efficiency schemes are now being progressed and there may be further opportunities but there is nothing to indicate that major revenue savings can be gained over the medium term. Regarding Lancaster Market, a decision is still awaited and some options exist to save over the very long term but at this stage, the short to medium term position is uncertain.

#### **Income Generation**

A corporate update on the Council's charging policies is scheduled for December. This can be used to indicate any areas in which Cabinet may consider increasing fees and charges above the assumptions provided for within the base budget, although difficulties are already being experienced in meeting budgets in some areas.

#### **Service Reductions**

In previous years various exercises have been undertaken to analyse and review statutory and discretionary services, in order to identify where service levels may be reduced, or indeed withdrawn. Cabinet will need to be in position to rank service areas considered most likely for reduction (or put another way, those "least unacceptable") and as such, Members are advised to consider their information needs in order to ensure an informed approach.

- 3.3 It is not expected that the Council will be able to have a sustainable balanced budget without reducing the level or range of services provided.

## 4 Other Key Budget Issues

4.1 To give further context, a number of key issues are also outlined below:

- At the time of writing this report, the Icelandic Supreme Court had not issued its judgment on the local authority test cases, although it is expected that the outcome will be known by the time of the Cabinet meeting. To be clear, the updated revenue budget projections reflect the decision of the District Court, in that they assume a positive outcome will eventually be forthcoming for recovery of the related investments. If that position is maintained, then in the region of £1M reserves would also be freed up. Should the worse case scenario unfold, however, this would add back costs of around £100K per year to the revenue budget.
- The latest projections also allow for the increases in energy costs arising through Quarter 1's monitoring. It is expected that these pressures will increase over the coming years; furthermore they and other inflationary pressures will affect households and in turn that will impact on the demand for various Council services and the ability to generate income. This will need to be reflected in the Council's planning.
- Delays are now expected on completing some land sales, which in turn affects the financing of the capital programme and means that the Council's underlying need to borrow will be around £1M higher than originally projected for the next couple of years at least. This has the effect of increasing financing costs in the revenue budget.
- To allow for revenue and capital growth proposals being considered on an even footing, it has been assumed at this stage that any capital growth options would be financed through prudential borrowing – and in due course its affordability, sustainability and prudence would need to be demonstrated. Members need to be aware that when combined, all the potential pressures on borrowing could make it inadvisable to take forward all proposals at the same time.
- At this stage the budget forecasts assume simply that any welfare reforms (planned for 2013/14 onwards) will be budget neutral, but this is considered a high risk area.
- The levels of provisions, reserves and balances still need to be reassessed, particularly in view of any material changes to the key risks facing the Council. In terms of revenue balances, as a result of last year's outturn and the budget changes identified to date these would be some £984K higher than previously expected; balances as at 31 March 2012 would stand at £2.309M. The use of any such surplus amounts has not been built into the forecasts. Unfortunately though, their application does not generally result in ongoing savings, unless put towards invest to save type schemes or used to help reduce the Council's borrowing requirement / capital financing costs.

## 5 General Fund Capital Investment Update

5.1 In terms of spending the main aspects are as follows :

### - **Municipal Building Works**

The single largest budget is allocated to backlog work on municipal buildings; this year's allocation is £3.2M with a further £2.4M in future years. The

municipal building works programme has made significant progress over the last 12 months. The detailed condition survey on which the original budgets were based is out of date, however, and a new method of developing a rolling plan to tackle the backlog of works needs to be established. In the interim, current budget levels have been maintained for the programme although Officers will work towards re-profiling this where needed. Nonetheless, growth may need to be considered for any specific issues that arise prior to a full rolling programme being established.

- **Luneside East**

The outcome of the lands tribunal is expected around the end of the calendar year and so as yet, it is not known whether there will be any further implications for the Council. The current budget provision is being used to meet legal and other professional fees.

- **Private Sector Housing**

Such schemes have progressed as far as approved funding allows and only the Disabled Facilities Grants scheme continues; all other physical works have stopped. Ring fencing of capital receipts within the programme could help complete some elements of work although this and the financing of various scheme liabilities need to be fully reviewed in the light of the resolutions arising from Cabinet in October.

5.2 In terms of financing the capital programme, there are two main receipts that underpin it, these being the land at South Lancaster and Heysham Mossgate.

- **Land at South Lancaster**

This is still assumed as being receivable in 2011/12. Any further delays in securing this receipt would have implications for the Council; as an indication, from next year financing costs are forecast to reduce by around £400K as a direct result of this land sale.

- **Heysham Mossgate**

This disposal is not now expected to be completed in the current year; there was always this risk given the current housing market. This accounts for the expected increase in capital financing costs outlined at section 4.1.

5.3 In terms of future investment priorities, Cabinet have already identified a number of potential growth proposals that they wish to consider as part of the budget, as referred to earlier. Any further capital investment implications attached to the fourteen draft priority areas will be appraised and reported through in due course. In terms of any reductions to the existing programme, any proposals will be identified to fit with the areas for making budgetary savings, as outlined in section 3 of this report.

5.4 No other changes to the capital financing principles (as set out in the MTFS) are considered appropriate at this stage. As with revenue, the big risk regarding capital investment is affordability. The bulk of the existing capital programme is allocated to essential schemes and unless major revenue savings can be identified, there will be no scope for expanding capital investment – but there is the risk that any non-essential investment will need to be removed.

## **6 Council Tax and Government Support Considerations**

### **6.1 The Localism Bill: Replacing Capping with Local Referendums**

6.1.1 The Localism Bill is still passing through Parliament and therefore it is unclear whether capping powers will be replaced in time for 2012/13 budget setting. Clarification is being sought from Government.

6.1.2 As such, capping powers may still apply for 2012/13. To give context, the basic criterion set by Government for the current year was that a council tax increase would be deemed excessive if it was greater than 3.5%.

### **6.2 Government's Future Targets for Council Tax**

6.2.1 Whilst Government has not announced any formal criteria to fit with future capping or referendum arrangements for 2012/13, in early October it did announce that new support would be available for local authorities to help freeze council tax levels for next year. Any take up of this arrangement would be voluntary. Whilst full details of the scheme have not yet been received, the key considerations are as follows, should the City Council agree to freeze its council tax:

- The Council would receive a grant equivalent to a 2.5% increase; this is estimated at around £210K. As the Council's current forecasts assume a tax increase of 2%, in next year the Council would have a little over £40K additional income to help balance its budget.
- The difficulty is, however, that the compensation grant would be a one-off only. This means that in all subsequent years, when compared with the Council's existing tax plans, it would forgo council tax income of around £170K, unless it considered that it could 'recoup' this income by having higher council tax increases in future years. For example, rather than having a 2% year on year increase in tax, a freeze in 2012/13 and then a 4% increase in the following year would give broadly the same sort of income stream for 2013/14.
- The risk is, however, that a 4% increase would be viewed as unacceptable by Government, which could result in either capping applying or a local referendum being needed, depending on what legislation is in force.
- If the Council determined that it should not (or could not) seek to 'recoup' the income foregone, then there would be the need to generate additional annual savings of around £170K from 2013/14 onwards, adding even more pressure to the budget.
- Based on the City Council's tax rate of £192.25 for a Band D property, a 2% change in tax rate amounts to £3.85 per year or around 7 pence per week.
- The offer of grant support also applies to the County Council, police and fire authorities. For information, the full basic Band D tax for the area is £1,510.47.

6.2.2 It can be seen that the matter is not as straightforward as was a year ago and balancing future years' budgets already represents a huge financial challenge; the task gets even harder if scope is to be created to support any growth.

- 6.2.3 To summarise and drawing on the updated budget projections, the main scenarios for council tax and their implications for savings targets for the next two years are summarised in the table below. These give the following net savings requirements, compared with current MTFS assumptions shown earlier.

| <b>Council Tax Increase Scenarios</b>                   | <b>Indicative Net Savings Requirements</b> |                         |
|---|--|-------------------------|
|   | <b>2012/13<br/>£000</b>                    | <b>2013/14<br/>£000</b> |
| a. 2% both years (existing MTFS targets)                | 1,013                                      | 1,659                   |
| b. 0% then 2%, with 'compensation' in 2012/13           | 972  | 1,830                   |
| c. 0% then 4% - subject to capping or local referendum? | 972  | 1,662                   |

- 6.2.4 In light of the above points, Cabinet is advised to consider carefully whether it wishes to make any recommendations regarding council tax increases at this stage, or whether it would prefer to have more time. When making recommendations on tax levels, ideally it should be confident that it can deliver budget proposals to fit, although there will be opportunities to change the targets again, later in the budget process.

### 6.3 Government Support Prospects

- 6.4 Members will be aware that the Government has recently consulted on proposals for changing how business rates income is distributed across councils from 2013/14 onwards, with the aim of providing incentives to local authorities to promote local business growth. It is too early to predict with any accuracy what that changes could mean for the City Council, but some tools are available to help with modelling and if appropriate, some scenario planning may be factored into future MTFS updates.
- 6.5 At a strategic level, the proposals infer that Government wishes to see local government wholly funded by local taxation in future, ideally with no financial support being provided centrally.
- 6.6 In relation to 2013/14, the Council's budget forecasts assume that Government support (in whatever form) will reduce by 2% when compared with 2012/13. This projection was based on analysis of the 2010 Spending Review and so it is now over 12 months old.
- 6.7 In the more immediate future, confirmation of the 2012/13 provisional Settlement is expected soon. The provisional figures issued almost a year ago allowed for approaching a 12% or £1.5M reduction when compared with the current year's funding levels. There is still some chance that the funding could change further, however, and so the announcement of next year's Settlement represents a key issue for the Council's future planning and budgeting.



## 7 **Details of Consultation**

- 7.1 No specific consultation has been undertaken in connection with this report. Arrangements for community engagement and consultation on the budget have already been approved and feedback will be fed into the budget process as it develops.

## 8 **Options and Options Analysis (including risk assessment)**

- 8.1 This report is primarily for information and for seeking direction from Cabinet and other than for council tax, no specific options are put forward at this time.

- 8.2 The options regarding council tax targets are basically to either:

- retain the existing council tax target of no more than 2% for future years; or
- recommend alternative council tax target increases for future years; or
- delay making recommendations at this stage, until later in the budget process.

The level of any net savings requirement (and the associated risks) would depend on the tax level proposed. Clearly the compensation arrangements in support of a council tax freeze require specific consideration. For information, a 1% change in council tax amounts to about £84K.

- 8.3 The main risks attached to any option follow on from the information in this report and the ability of the Council to take decisions on matching service levels with the money available to fund them. The impact on Council Tax payers is key; the reputation and public perception of the Council may well be affected. The key risks can be summarised as follows:

- Actual savings targets prove to be substantially different from those shown, due to changes in financial projections.
- Required savings targets can't be met, without having an unacceptable impact on service delivery – either from the Council's own viewpoint or from public perception.
- Government / the public perceive council tax levels to be too high, resulting in capping action being taken against the Council and/or a negative impact on public relations and the Council's reputation.
- Council tax targets are too low, resulting in them being unsustainable in the longer term, without having adverse effects on future service delivery and/or the Council's financial standing and reputation.

- 8.4 To counter these risks, there will be further opportunities to review target increases during the forthcoming budget as more definite information becomes available on forecast spending.

## 9 **Conclusion**

- 9.1 Although some progress has been made towards improving the Council's financial outlook, unfortunately additional cost pressures have arisen and therefore, overall, its prospects are broadly the same as they were at the start of the year. It is clear, however, that Cabinet is ambitious and wishes to pursue growth in some service areas but to make this possible, the focus must now be on how and where to make

savings. In terms of council tax, targets for next year are expected to have implications for subsequent years and this needs to be factored into Members' decision-making. It is impossible to get away from the fact that lower government funding and lower council tax increases ultimately mean more savings being needed – with more pressure therefore to reduce service provision.

**RELATIONSHIP TO POLICY FRAMEWORK**

The Medium Term Financial Strategy is the part of the current budget and policy framework.

**CONCLUSION OF IMPACT ASSESSMENT**

**(including Diversity, Human Rights, Community Safety, Sustainability etc)**

There is no direct, quantifiable impact arising at this stage, although the MTFs sets out the level of funding expected for the delivery of council services. As such, it will have a direct bearing on the level and impact of services provided in future.

**FINANCIAL IMPLICATIONS**

As referred to in the report; there are no other quantifiable financial implications at this stage.

**SECTION 151 OFFICER'S COMMENTS**

The s151 officer has produced this report.

**LEGAL IMPLICATIONS**

Legal Services have been consulted and have no observations to raise on this report.

**MONITORING OFFICER'S COMMENTS**

The Monitoring Officer has been consulted and has no comments to add.

**BACKGROUND PAPERS**

None.

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