CABINET

Medium Term Financial Strategy Review
11 November 2008

Report of the Head of Financial Services

PURPOSE OF REPORT **To provide updated financial projections for future years based on information currently available, in order that Cabinet can review the appropriateness of existing targets for Council Tax increases and make recommendations on to Council as appropriate.**					
Key Decision	X	**Non-Key Decision**		**Referral**	
Date Included in Forward Plan	November 2008				
This report is public.					

RECOMMENDATIONS OF COUNCILLOR MACE TO FOLLOW

The officer options are set out at paragraphs 7 and 8 of the report

1 **Introduction**

1.1 The Council's Medium Term Financial Strategy (MTFS) sets out projections for future years' net revenue spending as compared with the Council's targets for Council Tax. It therefore provides a financial basis on which Members can consider and review what changes need to be made to the level and scope of services provided, if the Council's aims with regard to restricting Council Tax increases in future years are to be met.

1.2 Clearly the financial projections are based on many assumptions and estimates that need to be reviewed and updated regularly; the timetable for this is set out in the Strategy document itself. This report provides information on the first formal review to be undertaken during 2008/09. This is later than originally planned, and initially this was to allow for the latest proposals regarding food waste recycling to be incorporated. Since the last Cabinet meeting other major financial issues have arisen, however, most notably the Icelandic Investments position and Concessionary Travel. Outline updates on these are also provided.

1.3 Cabinet is requested to consider all the information in this report and indicate whether, for the time being:

- target increases for future years' Council Tax should remain at no more than 4% for future years.

1.4 Recommendations would then be referred on to Council and form the initial basis for the budget and planning exercise. **There will still be the opportunity to update the projections and make changes to Council Tax targets later in the exercise, however. This is a key point, as there is much uncertainty regarding the financial outlook at present.**

In considering the report, Cabinet is asked to note that currently the projections cover the period up to 2010/11 but the forthcoming detailed budget preparation will move them forward another year, i.e. covering 2011/12 also.

2 Outcome of Review

2.1 Work has been undertaken to pull together various financial issues that have arisen since the Budget was approved back in February of this year. These may come from many sources, such as:

– Member approvals
– Last year's outturn and this year's financial monitoring
– Economic or other external factors (the 'credit crunch', interest rates, inflation / pay awards etc.)
– Other base budget adjustments (either known or potential, e.g. linked to changes in demand)
– Other issues under consideration (e.g. through Star Chamber)
– Government's Spending Plans and any proposals for changes to the Local Government Finance system.

A schedule of the actual and potential budget changes quantified to date is included at ***Appendix A*** with a summary provided overleaf. Overall there has been a significant deterioration in the position and this is based on some fairly broad assumptions, without any objective assessment or sensitivity analysis of certain key financial risks. It is highlighted, therefore, that the projections have even more risk attached to them than might normally be the case. On balance, it is felt that there is more chance of the position worsening as the detailed budget work progresses.

	2008/09 Budget £000	2009/10 Projection £000	2010/11 Projection £000
Changes approved or considered by Members to date	+212	+72	+327
Other known/ potential budget changes	+362	+814	+979
Changes in contributions to(+) / from (-) balances	-574	+219	-30
Total Increase in Budget Projections	**0**	**+1,105**	**+1,276**
Anticipated Cumulative Reduction in Council Tax Base Forecasts	**--**	**100** Band D properties	**250** Band D properties
Resulting Projected Council Tax Increase (across district)	**n/a**	**27.7%**	**9.9%**
New Net Savings Requirement (assuming a 4% increase in Council Tax for future years)	**n/a**	**1,822**	**2,479**

3 Main Assumptions, Risks and Issues underpinning the Review

3.1 In considering the table and attached details, there are some important points to note:

a) The revised projections take account of the information provided in the Quarter 1 corporate financial monitoring report and where possible this has been updated to include Quarter 2 information. There are still gaps in the analysis, however, and these will be addressed in producing the detailed 2008/09 revised budget.

b) The information also takes account of known, expected changes in future years, arising as a result of either last year's outturn or this year's monitoring. The figures focus on the major expected changes, and again there are gaps to address.

c) It has been assumed that General Fund Balances will be retained at £1M and that surplus balances will continue to be used on the currently approved phased basis, though this is expanded upon later in the report.

3.2 The main financial risks and issues facing the Council at this time are outlined below:

a) From a capital perspective, a number of significant risks exist as listed below and as a result, the Council's exposure is considered much higher than in recent times. These risks may well impact on the MTFS as, if risks materialise and no other sources of funding are found, then the Council would be faced with increasing its borrowing need, the costs of which would be felt on the revenue budget. It is anticipated that progress will be made on most, if not all of these risks as the budget progresses but if this is not the case, then it is advised that the Council would need to curb its plans to avoid taking on further significant financial risk in future, until some issues have been resolved. Again, further advice on this aspect will be provided during the budget process.

– Regarding Luneside, total maximum exposure for outstanding compensation claims, developer contributions, and clawback (net of available funding) remains at over £10M, although negotiations are underway to find a resolution for progressing this development. A report is scheduled for the December Cabinet meeting and this will provide an up to date reassessment of the financial position and remaining risks.

– Further to the capital update provided at the last meeting, Members agreed an increase in unsupported borrowing of £1.4M and this has been referred on to the November Council meeting for approval. The £1.4M is still dependent upon the Council achieving a further £1.2M in asset sales this year. Given the other financial pressures that have arisen since Cabinet considered this matter, it is highlighted that only essential capital works to municipal buildings will be authorised to progress; any other schemes will be incorporated into the usual review underway as part of the budget process. Furthermore it should be noted that the building works are only to improve the condition of the buildings, in line with the Corporate Property Strategy. They are not part of any wider accommodation project under Access to Services. This project is not yet included in the Council's approved spending plans and therefore there is no authority in place to commence such works.

– A report elsewhere on the agenda provides an update on Chatsworth Gardens and this highlights the current £1.2M shortfall on the scheme. The report makes various recommendations to take forward urgent discussions and pursue other options for the scheme; a further update will follow in due course.

– The impact of the Council's investments in Icelandic Institutions may also result in capital pressures (see separate section below).

The above highlights current capital issues only; general capital prospects for future years were covered last month. In particular, Members will recall that the sale of land at south Lancaster is crucial in funding the existing 5 year programme. Whilst there is also the potential for generating an extra £3.4M capital receipts in the medium to longer term, this will be influenced by the economic outlook overall and how soon the current crisis starts to turn round.

As an indication of potential costs for managing the above, the minimum annual cost of borrowing £1M is currently around £85K, allowing for interest at 4.5%. This equates to a little over a 1% increase in Council Tax at Band D. **No additional budget provision has been made at this stage for managing the risks associated with Luneside, Chatsworth Gardens, or any further capital receipts changes.**

b) The position regarding the £6M of investments placed with Icelandic institutions represents another substantial but uncertain risk facing the Council. For information, the latest guidance issued by the Local Government Association is attached at ***Appendix B***. Claims have been registered with the various

Administrators but until some information is known regarding prospects for amounts recoverable and the timescales involved, it is not possible to make any reasonable estimate. The following points can be made, however:

- To the date the banks entered into administration / receivership (i.e. during the week commencing 06 October), the Council was due investment interest of £260K; this too is at risk. A further £135K was due from October to the end of this financial year, with £23K in 2009/10. **These two latter amounts have been excluded from the MTFS projections but this is very much a provisional adjustment and no further losses have been provided for at this stage.** Further guidance is being sought on how any impact will be apportioned between General Fund and the Housing Revenue Account, as this is also very unclear.

- The Government has indicated that it will consider capitalisation applications to allow councils greater flexibility to manage the financial consequences of the Icelandic banking collapse. This means that authorities could:

  - use capital resources such capital receipts etc, to fund any losses, depending on such resources being available; or
  - use borrowing to fund any part of those losses. In effect, this would mean that the Council could finance them over a number of years.

  Whilst it is not known whether the Government will implement a special capitalisation bidding round, the usual annual process has an initial deadline of 15 December. In the unlikely event that no better guidance becomes available before this date, in consultation with her Cabinet Member, the Head of Financial Services will submit an initial application based on best information available at that time. This will in no way commit the Council to a specific course of action; it merely keeps the Council's options open and further updates will be reported during the budget process. Cabinet will also be aware that a special Audit Committee is being held on 17 November.

c) Concessionary travel presents another major financial challenge for the Council. Whilst Lancashire authorities have agreed in principle to enter into pooling arrangements to help spread the costs and risks, the agreement has not yet been finalised. Under the agreement, basically councils would move to being charged their actual share of concessionary travels costs (away from the present estimates) on a phased basis over the next three years. The agreement also provides for the sharing of any scheme surpluses or deficits.

   Very recently information has been released to indicate how the City Council's position stands taking account of 'actuals' data (i.e. from Smartcard readings). This shows that as at the end of July, the extra net costs facing the Council in this are between £129K and £243K. The higher figure takes account of seasonal variations and therefore represents the best estimate; this has been incorporated into the updated budget projections. These figures allow for using £150K set aside in the Concessionary Travel Reserve and assume that the pooling agreement will be implemented, which would benefit the City Council, but it is known that a number of other Councils are now reviewing their positions. The table overleaf shows the potential impact of the proposed agreement for the City Council, taking account of the seasonally adjusted cost projections.

As a final point, Cabinet should note that following last year's budget exercise a review of the community transport element of Concessionary Travel is underway, for consideration by Members.

	2008/09 £'000	2009/10 £'000	2010/11 £'000
Current Concessionary Travel Budget (excluding Community Transport, but including Reserve)	2,207	2,146	2,243
Forecasts – with Seasonal Adjustment:			
City Council Estimated Costs	2,700	2,782	2,863
Less Potential Pooling Arrangement Benefit	(250)	(192)	(91)
Net Cost to Council	2,450	2,590	2,772
Potential Net Increase Required in Budget	**243**	**444**	**529**

d) There are a number of assumptions and risks regarding staffing:

- This year's pay award has not yet been agreed. The budget assumed a pay increase of 2.5% and the latest Employer offer of 2.45% has now gone to arbitration. For every ½% increase on the pay bill, this costs General Fund around £100K. The projections assume that no further offer will be made in this year but future years assume a 3% increase for now. It is hoped that during the period of the MTFS inflationary pressures will reduce from current levels, but on the other hand new pension contribution rates will come in for 2011/12 onwards.

- With regard to Fair Pay, the Council's overall aim is to manage the process within the current ongoing pay bill, with any interim costs to achieve this being met from the Reserve. There are clearly key risks attached to the position but this forms the basis of current budget projections. A report elsewhere on the agenda provides more information but it should be noted that extra turnover savings of £100K per year are assumed, and that these will be used to help fund the overall outcome. Such key financial assumptions will continue to be reviewed and updated as necessary during the project and the budget process.

- For other aspects of turnover, a full analysis of the savings to be incorporated into this year's revised budget will be presented in due course. Coupled with previous years' information, this may highlight any service areas where there could be the potential to convert such turnover savings into permanent reductions for the staffing Establishment. This will also be influenced by the separate report elsewhere on the agenda.

e) With regard to waste management, net savings have been generated on costs associated with recyclables and these have been factored in for future years. The estimated costs associated with the recommended option for food waste recycling (i.e. "Option 3") have been included from 2010/11 onwards.

f) One of the larger variances arising in previous years' outturns has related to the Highways operation. Estimated annual surpluses of around £100K have now been assumed and these will be reviewed and updated as the budget develops.

g) Regarding Civil Parking Enforcement, it is assumed that the City Council's operation will continue to break even in the coming years, under any new arrangements implemented by the County Council.

h) At various times during the year Cabinet has made recommendations regarding the use of Area Based Grant. The updated projections assume that the funding will be used to meet commitments regarding Neighbourhood Management, subject to the budget process, and also to provide some resources for taking forward Equalities in this year. No other specific budgetary provision exists for these items. Cabinet may remember too that any County Council ABG allocations regarding Community Safety are also uncertain for future years.

i) In terms of other various grants, these have been updated to take account of the most recent allocations. Where these have reduced, there may be options to reduce related expenditure accordingly and these will be picked up in future budget reports. No assumptions have been made regarding the new Local Authority Business Growth Incentive (LABGI) scheme, as it will be much smaller and may well last for only 2 years. For other grants, such as Planning Delivery and any others to be fed through the Local Area Agreement (LAA), it is assumed that they will have no impact on the Council's budget overall, but some will be subject to specific consideration by Members in due course as appropriate.

j) There are a number of issues that have been reported to Members and are under further consideration, where it is not yet known what the outcome / financial implications might be. Examples include Access to Services, Williamson Park, Auction Mart Car Park, Lancaster Market, Morecambe Town Council etc etc. Furthermore there are other initiatives being taken forward, such as the Canal Corridor Development, where the Council has options regarding the nature of its future landholdings and these will also impact on the budget. Finally, the impact of the bleak economic outlook and its impact on the demand and cost drivers for council services cannot readily be determined – although some relatively small specific aspects such as Search Fees income have been assessed provisionally. Members are requested to note these uncertainties, in addition to the headline risks reported earlier.

k) Regarding inflation other than pay, factors for next year have not been finalised but for now an adjustment of around £200K has been provided in total, but on the basis that higher inflation is experienced only in 2009/10. The original projections assumed inflation of 2% per year increase, although currently it is running at 5.2% (based on the Consumer Price Index). As a very broad indication, a 1% increase may result in around a £100K net cost to the budget. Once the next Inflation Report has been published, factors for future years will be set and whilst these can be reviewed later during the process, it is expected that inflation forecasts (or alternatively, reduced interest rates) may well give rise to further budgetary pressures.

l) A 1% change in Council Tax amounts to approximately £77K. A 1% change in Government support represents £155K or approximately 2% on Council Tax. The Council Tax Base projections have been reduced provisionally, to take account of the slow down in housing developments. Firm estimates will be produced during December, in setting the Tax Base for 2009/10.

m) The New Net Savings Requirements shown in the table (section 2) do not provide for any other growth; they would need to be increased to provide for any such proposals. A review of progress against this year's savings and growth is also being undertaken, to be fed into the budget.

3.3 Whilst the above points may seem like a long list, inevitably the Council's financial forecasts have many inherent risks attached to them. Clearly demand led activities are subject to market pressures; other areas of spending / income generation will be influenced by internal factors such as competing work pressures and standards of financial management. Also major capital schemes or developments bring with them financial (as well as other) risks that could have revenue implications. The Council's financial monitoring arrangements should help to counter these risks and individual services' performance management should provide additional support. The national economy and Government's other plans can have a marked impact on financial planning, however. Inevitably further changes to the financial projections will arise in producing the detailed budget.

4 Review of Revenue Balances

4.1 As mentioned previously, for now the revised budget projections assume that the current application of surplus balances (in the ratio 3:2:1) would be retained. A supporting statement is attached at ***Appendix C***.

4.2 The main aims of the current phasing are to help smooth out Council Tax increases for the period but also to give more time for identifying savings options, in recognition that some initiatives may take a long time to implement fully. The table below shows the original estimates for Council Tax increases and use of balances, together with the latest projections. This highlights the reliance on their use, especially in the current year:

	2008/09	**2009/10**	**2010/11**
Council Tax Increases:			
MTFS Projection (Feb 2008):	--	13.1%	8.8%
Current Position / Forecast	4.6%	27.7%	9.9%
Use Of Balances:			
MTFS Projection (Feb 2008):	£888K	£432K	£112K
Current Forecast	£1,462K	£213K	£142K

4.3 As at the end of next March balances are currently forecast to reduce to £1.427M and whilst this is still substantially higher than the £1M basic minimum, it is the lowest forecast for some years. It is also highlighted that carrying balances of around £1M can generate around £50K per year in investment interest. Once the funds are spent, the investment interest is lost.

5 Other Issues for Consideration

5.1 Capping Criteria

Members may be aware that in previous years the Government has exercised its capping powers. Effectively this has meant that some councils have been forced to set lower budgets and council tax rates, because they had not met certain Government criteria.

Government did use its powers for 2008/09 Council tax setting. Whilst the average Council Tax increase in England was quoted as 4.0%, not all complied with Government's expectations that council tax rises should be substantially below 5%, hence capping powers were invoked.

A recent Government announcement (made before the current economic crisis) stated "there is no excuse for excessive increases in council tax, and authorities should be in no doubt that the Government will use its full range of capping powers to deal with excessive increases and protect council tax payers in future years".

Cabinet is advised to take this into account in reviewing its MTFS targets for future years.

5.2 Council Priority Setting and Key Partnerships

As mentioned at the start of this report, the MTFS review forms the initial financial basis for progressing the 2009/10 budget and policy framework, and at previous meetings Cabinet has considered the way forward regarding priority setting and the associated consultation exercise. Whilst clearly there is much pressure on authorities generally to save money and restrict Council Tax increases, Members will have aims and aspirations regarding service delivery and potential improvements or reductions etc. It is important that the MTFS is considered in this context; the two processes (i.e. financial planning and priority setting) should inform each other and this is reflected in the timetable approved at the Cabinet meeting back in July.

Cabinet Members may also be aware that another piece of work regarding assessment of the Council's key partnerships is underway, due for completion in March. The outcome of this may also have bearing on the MTFS and associated budget projections for the future.

It is important to note, therefore, that as yet this initial review of the financial projections underpinning the MTFS does not take account of any potential changes in the Council's priorities, and how they fit with other key partnerships. The financial implications and options arising from the outcome of the priority setting exercise will be considered at a later stage during the budget, and fed into the resulting MTFS for consideration at Budget Council.

5.3 Government's Spending Plans and Finance Settlements

Every three years the Government undertakes a strategic Comprehensive Spending Review (CSR) of its spending plans. The last one was completed during 2007 (known as CSR07) and in turn, this informed the first ever three-year settlement for

Councils, which included provisional allocations for 2009/10 and 2010/11 as well as 2008/09.

Latest information is that the 2009/10 and 2010/11 settlement figures will be confirmed in February 2009 and February 2010 respectively. These will each be subject to the usual annual statutory consultation exercise, however, and therefore it is expected that provisional figures will be re-issued in November each year.

For 2011/12, at present it expected that provisional figures will be released only once the next CSR has been completed, i.e. in 2010. The figures would be released as part of the next three-year settlement, i.e. 2011/12 to 2013/14.

In short, there will be no rolling three-year settlement. Each will simply follow on from the next, with no overlap or annual review.

It is also known that Government do not intend to update the provisional allocations for 2009/10 and 2010/11 for any data changes – to give greater certainty to Councils. That said, the Local Government Association and Councils are lobbying the Government to take account of the large increases in costs expected for Concessionary Travel and Energy, as examples, but clearly the Government is facing a very difficult financial outlook at present.

For the MTFS projections, therefore, the existing provisional allocations will be used, and 2011/12 will be addressed later during the budget.

	2008/09 ***Final £'000***	**2009/10** ***Provisional £'000***	**2010/11** ***Provisional £'000***
Total Government Support (known as Formula Grant)	**15,523**	**15,994**	**16,377**
Made up of:			
Redistributed NNDR	13,626	No split available	No split available
Revenue Support Grant (RSG)	1,897		
Year on Year Increase:	**£591K**	**£471K**	**£383K**
	4.0%	**3.0%**	**2.4%**

6 **Details of Consultation**

The consultation on Cabinet's proposed priorities for 2009/10 onwards is currently underway, and this includes future Council Tax targets. The outcome of this will feed into future budget and MTFS considerations.

7 **Options and Options Analysis (including risk assessment)**

Cabinet is asked to consider the financial projections and information included above. Options on the key aspects are set out below.

7.1 **Council Tax Targets:**

(a) Option 1 -retain the existing Council Tax target increases for future years
Current forecasts indicate that this would require net savings of £1,822K and £2,479K to be identified for 2009/10 and 2010/11 respectively.

(b) Recommend an alternative Council Tax target increase for future years.
The level of any net savings requirement (and the associated risks) would depend on the tax level proposed.

The main risks attached to either option follow on from the assumptions and information underlying the revision of the financial projections and the ability of the Council to take decisions on matching service levels with the money available to fund them. In addition, the reputation and public perception of the Council may be affected. The key risks can be summarised as follows:

- Actual savings targets prove to be substantially different from shown above, 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 the increase 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.

The report highlights that there is significant scope for the projections to change, as a result of both internal and external factors. To counter this, there will be further opportunities to review target increases during the forthcoming budget as more definite information becomes available on forecast spending.

With regard to capping, the report provides information on Government's actions this year and its commitment to using its capping powers in future. Should Cabinet wish to support spending levels that result in a Council Tax increase much higher that the current MTFS target, then there are strong indications that the Government is likely to challenge this course of action. This may well result in the Council's budget being capped – in such a situation it would be forced to cut spending / services in an unplanned way and it would incur rebilling costs. Alternatively, if Cabinet wish to support a much lower increase, then future sustainability may become an issue. At present the financial projections for 2009/10 appear much worse than previously reported but they could change significantly, though on balance it is felt they are likely to get worse, rather than better.

In terms of options, the impact on Council Tax payers is key. Members should consider the balance between providing services that the local community needs and wants, against how much it is prepared to pay. There will be reputational, operational and financial risks, opportunities and trade-offs attached to whichever option Cabinet chooses.

8 Officer Preferred Option and Comments

There is no specific officer preferred option with regard to Council Tax levels. That said, the Head of Financial Services would advise against planning for a Council Tax increase of 5% or above at this time as it would in all likelihood be subject to capping, although the Council must also be in a position to set a robust, achievable budget in line with its priorities. Conversely, the Head of Financial Services would advise against aiming for too low a Council Tax level at this time if Members aim to continue to provide a wide range of services to the public and wish to avoid more potential for major service cuts in future years.

Whatever Council Tax targets are in place, Members need to have supporting plans in place to achieve a balanced budget.

9 Conclusion

The Council's financial economic outlook has deteriorated significantly since February, and there is still considerable uncertainty that is likely to result in further pressures. There is now a strong need to respond positively to this challenge, in ensuring greater focus on key service areas and in delivering the necessary savings, including service reductions, to achieve Council Tax targets. This is a scenario facing many councils up and down the country.

RELATIONSHIP TO POLICY FRAMEWORK **The Medium Term Financial Strategy is part of the 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.**	
DEPUTY SECTION 151 OFFICER'S COMMENTS **The s151 officer has produced this report, as part of her responsibilities.**	
LEGAL IMPLICATIONS **Legal Services have been consulted and have no comments to add.** **.**	
MONITORING OFFICER'S COMMENTS **The Monitoring Officer has been consulted and has no further comments.**	
BACKGROUND PAPERS **Medium Term Financial Strategy**	**Contact Officer: Nadine Muschamp** **Telephone:01524 582117** **E-mail:nmuschamp@lancaster.gov.uk**