

CABINET

Medium Term Financial Strategy Update 31 August 2010

Report of the Head of Financial Services

PURPOSE OF REPORT			
To update Members on the Council's financial prospects for future years, taking account of last year's outturn, current year's monitoring and known or expected changes being introduced by Government.			
Key Decision	<input type="checkbox"/>	Non-Key Decision	<input checked="" type="checkbox"/>
Date Included in Forward Plan	November 2009		
This report is public.			

OFFICER RECOMMENDATIONS:

1. That Cabinet notes:

- the current position regarding current spending and forecasts for future years, together with the associated risks and uncertainties;
- the expectation that the Council's current council tax targets of no more than 3.75% will need to be significantly less in future, in light of section 4 of the report;
- in responding to any further specific funding reductions, Service Heads will ensure that appropriate remedial action is taken as soon as possible and in accordance with any delegations, to avoid any situations arising that are contrary to budget, as outlined in section 3.7 of the report;
- the key issues arising from this review will be reported to Council for information; but that
- a further update is scheduled to be reported to Cabinet in November, at which time it is hoped that sufficient information will be available for Cabinet to make recommendations to Council regarding new council tax targets, in light of Government's spending review and any changes to existing capping arrangements.

1 Background

- 1.1 The Council's existing 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 may be needed to the Council's priorities, either in terms of the level and scope of services provided, or with regard to council tax increases. This is in order to achieve a balanced and financially sustainable budget, together with a deliverable Corporate Plan.
- 1.2 Generally, a mid-year update on the budget and forecasts underpinning the MTFS is presented to Cabinet in autumn time and from there, Cabinet makes its initial recommendations on to Council. Given the number of funding and other changes being implemented or under review by Government, however, this interim update has been produced for information only. It helps to set the scene for other current developments in the budget and planning cycle such as consultation, which is covered in a separate report elsewhere on the agenda.
- 1.3 It is useful to highlight at this point that the Council's spending plans will be affected both directly and indirectly by Government changes, through involvement with various partners. Many agencies, such as the North West Development Agency (NWDA) and Arts Council, have been (and will be) affected by reductions in public expenditure and in turn, these impact on the Council's ability to take forward or contribute financially to various initiatives. Other organisations that the Council currently helps grant fund are facing reductions from other partners, which in turn is likely to increase pressure on the Council to at least maintain its contributions. This is particularly so for various arts organisations and the voluntary sector.
- 1.4 A further financial update will be produced after the Government has completed its Comprehensive Spending Review (CSR) although the Council may still not, by that time, have a clear picture of how its core funding will change in future years. This is because the provisional Local Government Finance Settlement is not expected until late November and information on some key specific changes at authority level may not be available until then. This is covered in more detail in section 5 of this report.
- 1.5 This report also outlines the key financial issues facing the Housing Revenue Account (HRA) at this time. At some stage over the next year or so, housing finance matters will be incorporated into the MTFS more formally and so it is important that this area is not overlooked.

2 Council Housing (Housing Revenue Account) Update

- 2.1 The Corporate Financial Monitoring to June 2010, as reported elsewhere on the agenda, outlines the latest forecasts for the HRA. When projected forward, this would give the following variances for future years:

	2010/11	2011/12	2012/13
	£000	£000	£000
Housing Revenue Account (HRA) Deficit	+373	+564	+564

2.2 Clearly this position is not sustainable; current policy is to maintain HRA Balances at only £350K and this would not cover the above deficits. Actions are underway to address this position and these too are set out in Quarter 1 monitoring, but in essence savings need to be made to give financial sustainability. The main issues that may impact on Council Housing's financial position over the coming years are summarised as follows:

- Whilst the Government consultation exercise into the withdrawal of the current subsidy system has been completed, it is not yet known what the outcome will be or whether Government will consider any alternative financing proposals, or indeed take a different strategic direction for remaining local authority housing provision.
- Government is also considering other service related ideas (such as tenancy changes) and these too could have financial implications for the future.
- Recent senior management changes present a good opportunity to assess opportunities for further efficiencies and other savings options for the service.
- There is still the pressing need to tackle the overspendings on responsive repairs, to prevent this being a recurring event in current and future years. This is due to be considered by Budget and Performance Panel.
- Targets for future years' increases in average housing rents were retained at 5% year on year, pending the outcome of the housing finance review, although this year's increase was much lower at 2.75%. In the past, at times there has been inconsistency between social housing rent convergence policies, inflation provisions within the subsidy system and various caps and limits schemes. Even if the Government does not abolish the current system, there will still need to be some tidying up of the current framework.

2.3 In summary, whilst council housing has fared comparatively well budget-wise in recent times, the Council now needs to respond positively to the financial pressures and opportunities arising from a variety of sources.

3 **General Fund Revenue Update**

3.1 Similarly for General Fund, based on the monitoring report elsewhere on the agenda and other information as set out at **Appendices A and B**, the budget prospects for future years can be summarised as follows:

	2010/11 Budget £000	2011/12 Projection £000	2012/13 Projection £000
Net Savings approved by Members to date	-47	-244	-246
Other known/ potential budget savings and reductions	-222	-2,554	-2,654
Additional Contribution to balances (i.e. transfer of surplus)	+269	-	-
Reductions in projected Government Support	-	+2,500	+2,500
Total Net Saving	-	-298	-400
Resulting Projected Council Tax Increase	n/a	9.4%	7.9%
Original MTFs Net Savings Requirement	n/a	771	1,267
Remaining Net Savings Requirement (but still allowing for a 3.75% council tax increase at this stage)	n/a	473	867

3.2 In essence, whilst prospects have improved by between £300-400K each year, the remaining savings targets are still based on the Council increasing council tax by 3.75%. In view of Government's position, it is expected that the Council will have to reduce its tax assumptions significantly and this is considered in more detail in section 4 below.

3.3 In terms of net spending, the position is influenced by many key risks and assumptions. Some of these have been broadly quantified and factored into the updated projections, but there are many for which it has not yet been possible to quantify their likely implications. By far the biggest element of the Council's budget is spent on staffing and therefore a number of points are highlighted as follows:

- All savings from approved restructuring to date are included.
- Savings from other interim measures and proposals currently being developed are included to a degree. Other known plans are not provided for, however, these include final completion of the senior management review. In addition, further work is now underway on the second pay and grading review under Fairpay as well as a review for craftworkers, who were not party to the original agreement.
- With regard to turnover, whilst this year's latest forecast is included, no further assumptions have been built into future years. It is expected that the work ongoing to reflect previous years' outturn performance and also further restructuring will be consolidated to improve future years' budget setting for staffing costs, and then any further turnover will be considered separately.
- It is assumed that there will be no pay award in this year, in line with the Employers' current position nationally and this affects future years' base forecasts too. At present though, there is no formal stance regarding any pay awards in future years as Employers are awaiting the CSR to inform their views on what may be affordable. Given this, existing pay award assumptions for

2011/12 onwards have been retained for the time being, in the absence of any better information. The 1% per year increase provided for amounts to around £200K in 2011/12 and £400K in 2012/13.

- Similarly, existing assumptions on employer superannuation contribution rate increases have also been retained. The 2% estimated increase from 2011/12 onwards (which would take contribution rates up to 21.1%) amounts to around £400K each year. The triennial actuarial review is underway for the Lancashire Pension Fund and the outcome of this will determine employer contribution rates for the next three years. Pension costs and liabilities are still a concern nationally though and for the medium term further proposals are expected at some stage, which could well have implications for employers as well as staff.
- 3.4 The above points give an indication of budget sensitivity to staffing factors both within and outside of the Council's control. It should be appreciated too that any major shifts in the Council's establishment, through general efficiencies, reductions or shared service arrangements, may alter these sensitivities.
- 3.5 As well as staffing matters, there are a number of other issues that have influenced the Council's latest financial prospects:
- Not surprisingly, concessionary travel still features. Although there are claims outstanding with bus operators, latest monitoring now indicates an underspending of around £160K this year. For future years, it is clear that responsibility for concessionary travel will transfer from districts to county councils. The biggest implication for the Council is how this transfer will be reflected in the Settlement and this is outlined in section 5 below. Although the position is far from clear, at this stage it has been assumed that the Council will be around £200K better off from 2011/12 onwards.
 - Interest on Icelandic investments needs to be brought into the budgets, now that full cover has been provided for potential losses. As an indication only, £50K is now allowed for in 2011/12 and 2012/13.
 - Government grant reductions have only had a relatively minor impact on the Council's budget with a loss of £2.7K in respect of the Area Based Grant for Cohesion. In addition, the second year grant for free swimming for over 60's has also been withdrawn, which has meant reducing the expenditure budgets back to the level they were at prior to the original funding being given. Finally, the second instalment of the Performance Reward Grant has been cut, which has reduced the amount to be allocated by £478K (half revenue, half capital).
- 3.6 In terms of revenue balances, as a result of the 2009/10 outturn and the budget changes identified to date, these would be some £513K higher than previously expected; balances as at 31 March 2011 would stand at £1.583M. The use of any surplus amounts has not been built into the forecasts, nor has there been any review of other earmarked reserves. This is useful to know, as any surpluses could be used to help ease the Council's financial position, albeit as a one-off.
- 3.7 It cannot be stressed enough however that the above information represents only a snapshot of financial pressures. Many further changes are expected, as the Government continues with its review of public spending and funding streams. Officers are working on the basis that where an initiative (such as free swimming) was introduced on the back of external funding, then should such funding be

withdrawn, appropriate remedial action will be taken as soon as possible and in accordance with any delegations, to avoid or minimise any budgetary implications. Portfolio holders and other stakeholders would be advised accordingly. Cabinet is requested to note this position.

4 Council Tax Considerations

4.1 Consultation on Replacing Capping with Local Referendums on Council Tax

4.1.1 The Government recently issued a consultation document on proposals to replace current council tax capping arrangements, with measures that would require an authority to undertake a local referendum if it wished to pursue a council tax increase above certain 'principles' set out by Government.

4.1.2 The Council's proposed response will be considered by Council Business Committee on 02 September and Members are requested to refer to that agenda for full details. In summary though, the proposals would involve:

- Government announcing around November/December time, at the same time as the Settlement, what its 'principles' are, i.e. what would be acceptable in terms of council tax increases;
- any authority planning a higher increase would be required to produce a 'shadow' budget to fit within Government's principles (as well producing budget proposals to fit with its higher spending proposals);
- if the higher proposals are approved, then a local referendum would be undertaken no later than the first Thursday in May;
- if there is a 'no' vote, then the shadow budget must be adopted with subsequent re-billing and associated administration.

4.2 Government's Future Targets for Council Tax

4.2.1 Notwithstanding the above consultation, Government has made it very clear that "it will work in partnership with local authorities to implement a freeze in council tax in England in 2011/12. The Government will clarify in due course the terms under which local authorities that commit to freeze or reduce their council tax will be compensated." (*Source: Budget 2010*).

4.2.2 No further details are known as yet, but one way or another it is clear that the Council will need to consider budget proposals that fit with a tax increase lower than the 3.75% on which current projections are based.

4.2.3 To help with this, in addition to the existing MTFs core projections, two alternative scenarios have been modelled:

- b. Based on a 0% increase in 2011/12 but with one off funding 'compensation' equivalent to a 2.5% increase in Council Tax in that year, then a 2.5% increase in Tax for 2012/12. This has been chosen in view of the earlier Conservative Party pledge.

- c. Based on a 0% Council tax increase year on year, but with no compensating additional funding from Government;

4.2.4 These give the following net savings requirements, compared with current MTFS assumptions shown earlier. These are also shown in **Appendix B**.

Council Tax Increase Assumptions	Net Savings Requirements	
	2011/12 £000	2012/13 £000
a. 3.75% both years (existing MTFS targets)	473	867
b. 0% then 2.5%, with one-off 'compensation' in 2011/12	577	1,297
c. 0% both years	786	1,506

4.2.5 Obviously lower council tax increases would add further pressure on the Council's budget, meaning more savings would need to be identified.

5 Formula Grant (i.e. Finance Settlement) Considerations

5.1 Consultation on Formula Grant Distribution Changes

5.1.1 Unfortunately there are further complexities to add. As mentioned earlier, Government is currently consulting on changes to the distribution of formula grant between local authorities. The main change is in relation to concessionary travel and the key issues arising on this particular change are outlined below.

- i. Although the consultation stresses that the figures are for exemplification only, as a starting point the calculations assume that the Council's existing level of formula grant would be reduced by the net cost of concessionary travel in 2008/09. Unfortunately costs were at their peak in that year.
- ii. At present there are 24 possible outcomes to consider; half have been exemplified by the Government and they all give the same result. The indicative reduction in the Council's formula grant amounts to £2.5M.
- iii. This results in the somewhat bizarre scenario that the Council could stand to lose substantially more in formula grant than its current net spending on concessionary travel. Net costs in this year are currently estimated at around £1.7M.
- iv. Nonetheless, this possibility was recognised a year ago and therefore the budgetary forecasts for concessionary travel were kept relatively pessimistic. As a result, if the exemplifications prove right the Council would, in budget terms, have a £200K net saving arising from the transfer.
- v. This saving assumes for now that the Council would continue with discretionary elements of the scheme, but future responsibilities and powers remain unclear.

5.1.2 Other changes put forward in the consultation relate to flood defence and visitor nights and whilst in some ways they are of less significance, on balance there is

more risk that the Council would be adversely affected by them, possibly by around £300K net. Officers are consulting with other local authorities and forums, including the Local Government Association (LGA). There is some uncertainty surrounding some of the base data but overall, these changes simply add to the already significant funding reductions potentially facing the Council.

- 5.1.3 The closing date for responding to the consultation is 06 October, but further supporting data may still be published before then. Given this and the nature of the consultation, it is intended that an Officer response will be submitted in due course.

5.2 General Prospects for Formula Grant Reductions

- 5.2.1 There continues to be many announcements and much speculation surrounding reductions in public spending generally, but firm prospects for all the various Government departments will not be known until the outcome Comprehensive Spending Review, due on 20 October.

- 5.2.2 To give some idea of the sensitivity of the Council's financial planning to formula grant changes, **Appendix C** sets out various scenarios:

- a. a freeze in grant levels (though this is not considered likely);
- b. the existing core MFTS assumption of a 3% year on year cut;
- c. a 6.25% year on year cut, which represents broadly a 25% cut over four years, referred to as a possibility in the Chancellor's Emergency Budget;
- d. a 10% year on year cut, being the worst case scenario previously modelled and referred to in some Treasury documents.

- 5.2.3 The Appendix combines the above scenarios with various options for council tax, and gives indications of what further net savings would be needed to balance the budget. As examples:

- At worst for next year, further savings of £1.752M would be needed if there was no increase in council tax, no 'compensation' from Government, and a 10% reduction in formula grant.
- At best for next year, further savings of only £59K would be needed, if council tax rose by 3.75% and formula grant was frozen.

- 5.2.4 The most likely scenario is felt to be somewhere in between, but that will depend on decisions to be taken by Members, as well as by Government. Beyond next year, as the modelling simply assumes the same grant reductions year on year, savings requirements progressively increase.

- 5.2.5 Overall it is clear that the Council has financial challenges ahead – but the scale of those challenges is far from certain. Whilst this position is difficult, the Council does have other work underway to identify more savings options, as well as having reserves available to help manage the position. The reductions in public spending may be viewed as an opportunity to re-focus on exactly what the Council's key priorities are, and as a driver to ensure that appropriate changes are delivered.

6 Capital Investment Update

6.1 The information below provides an update on some of the key aspects of the Council's capital investment plans; for now it focuses very much on General Fund.

6.2 In terms of spending the position is as follows :

- **Municipal Building Works**

The single largest net budget is allocated to backlog work on municipal buildings. This year's budget is £2.143M covering re-roofing, emergency electrical works, emergency backlog works and other minor schemes. Actual costs are subject to tender values and also further options appraisal, as there are non emergency works that could sensibly be done at the same time as emergency works (e.g. reviewing solar panel provision on the town hall roofs, or making accommodation changes in line with recent restructuring and the earlier Access to Services objectives). At present it is likely that there will be slippage of at least £1M into 2011/12, although over the 5 year programme there is real risk that the total budget is insufficient for the actual value of works required, mainly as the original condition survey is likely to be out of date, but also because of other elements identified above.

- **Lancaster Science Park**

Members will be aware that North West Development Agency (NWDA) funding is not now expected for progressing this project any further. In due course Members will be asked to reflect this formally within the Capital Programme, together with any other relevant developments for the scheme, including any alternative funding opportunities. As it stands, the Council will simply hold the site until any alternative plans are approved by Members.

- **Luneside East**

The legal case is still ongoing and there is still no actual valuation for settlement, or judgement on the ultimate allocation of legal costs. Clearly, this uncertainty poses a material risk to the Council, however this is judged to be a substantially lesser risk than a year ago.

- **Icelandic Impairment**

Should a favourable outcome on creditor status be forthcoming, most or all of the £2.1M capitalisation could be reversed in future years. However, there is little chance of a decision on this by the Icelandic courts before the end of the current financial year.

- **IT Capital**

The 2010/11 budget for IT capital covers a number of schemes, one of which, the leisure system estimated at £106K, has been put on hold and this may well result in a saving in due course. All other schemes are either currently being implemented or worked up by officers.

- **Other Schemes**

All other schemes are either committed or pending further officer appraisal prior to progressing further.

6.3 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. Secretary of State approval has been obtained for the disposal and the Town Green application has been turned down. There is still, however, the planning application to be determined.

- **Heysham Mossgate**

The disposal is also still assumed as income in 2011/12. Property Services are currently working with Regeneration and Policy Officers to ensure the best approach regarding exposure to the market. Until this has been done, sale proceeds remain subject to change.

6.4 No specific proposals are put forward at this stage, but as for revenue planning, a key task over the coming months will be to update the Council's capital investment plans to reflect available funding levels. This will also have bearing on various services' workloads and associated revenue budgets. Investment priorities will be considered in the November update, when funding prospects should be a little clearer.

7 **Details of Consultation**

Proposals regarding community engagement and consultation on the budget are included elsewhere on the agenda. The Council's financial prospects need to inform the context and content of that consultation as it develops, to help manage expectations regarding the range and level of services that the Council will be able to afford in future.

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

This report is primarily for information and therefore no specific options are put forward at this time. There are many issues covered, however, and it may be the case that Cabinet would wish separate reports back on specific key issues. With regard to future council tax targets, for the reasons identified Cabinet is not requested to make formal recommendations at this time, but it may identify any preferred option or options on which to focus future modelling and scenario planning, if it is felt that this would help in future.

9 **Officer Preferred Option and Comments**

Officer recommendations are as set out in the report.

10 **Conclusion**

At present there is no clarity on the Council's financial prospects, other than reductions in funding are expected and the Council should plan for much lower target increases in council tax than those currently approved. The Council does have various options and work underway to help manage the position, but over the coming months it will need to reappraise its strategic direction for the future, informed by (and to inform) its financial planning.

RELATIONSHIP TO POLICY FRAMEWORK

The Medium Term Financial Strategy is part of the current 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 should set 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 and various reports are scheduled, to tackle specific issues.

DEPUTY 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 further comments.

BACKGROUND PAPERS

Medium Term Financial Strategy

Contact Officer: Nadine Muschamp

Telephone: 01524 582117

E-mail: nmuschamp@lancaster.gov.uk