

REPORT TO COUNCIL

REPORT OF: Director of Finance and Strategic Resources

REPORT NO: FIN239 as amended

DATE: 8 September 2005

TITLE:	Medium Term Financial Strategy And Budget Preparation 2006/07
FORWARD PLAN ITEM:	Yes
DATE WHEN FIRST APPEARED IN FORWARD PLAN:	16 June 2005
KEY DECISION OR POLICY FRAMEWORK PROPOSAL:	Future Policy Framework Proposal
COUNCIL AIMS/PORTFOLIO HOLDER NAME AND DESIGNATION:	Finance Portfolio Corporate Governance
CRIME AND DISORDER IMPLICATIONS:	N/A
FREEDOM OF INFORMATION ACT IMPLICATIONS:	N/A
BACKGROUND PAPERS:	Report FIN241 to Cabinet 25th July 2005

Recommendations

1. To recommend the adaptation of the financial strategy as outlined in the report.
2. To prepare a response to the ODPM consultation document on Formula Grant Distribution for 2006/2007.
3. To adopt the approach to budget development for 2006/2007 and value for money framework outlined in the report.
4. To implement an effective budget consultation strategy for 2006/2007.
5. To review the purpose and amounts of reserves held.
6. To develop detailed options appraisal analysis of the impact of stock transfer on the General Fund.
7. To develop options for Council Tax setting for future years.

Introduction

1. The purpose of this report is to consider the updated Medium Term Financial Strategy (MTFS) for the period 2006/07 to 2010/11 and to examine the main influences on the budget preparation for 2006/07 and consider any changes necessary during 2005/06.
2. It reviews
 - (i) the issues raised in the MTFS presented in October 2004 and their subsequent impact on the 2005/06 budget.
 - (ii) the position on reserves and balances.
 - (iii) the financial strategies and their appropriateness.
 - (iv) the main budgetary issues for 2005/06 and 2006/07.

Background

3. In preparing the existing MTFS the following were the main issues facing the Council.
 - (a) constrained financial settlement from the government, with limited ability to increase Council Tax.
 - (b) impact of job evaluation.
 - (c) protecting against the impact of significant rises in employers' pension contributions.
 - (d) the bringing in-house of waste management.
 - (e) analysis of areas of cost rising at faster rates than general inflation - pay award and insurance premiums.
 - (f) acceptance of limited capital programme.
 - (g) the resourcing of priorities, finding savings and delivering efficiencies.
4. Over the past year the Council has made progress in all the above areas. In particular the financial management of job evaluation, forward financing of the likely impact of expected rises in employers' pension contributions, tight cost control of the waste management function, development of sophisticated risk management strategy to help reduce insurance premiums, and the development of the capital programme to reflect Council priorities. The above was all achieved within a 4.95% rise in Council Tax and did not attract capping from the government.

Financial Strategies

5. In developing the likely expenditure/income profile it is important to have regard to the current financial strategies as approved by the Council.
- 5.1 **Strategy No. 1 - That the Council must be prudent in making estimates of external funding from the Government.**
- 5.2 In 2003/04 the methodology changes to the formula for grant distribution benefited the Council. In 2004/05 further changes to the grant system caused further difficulties in assessing the grant settlement, in particular the switch in funding source for housing benefit administrative grant from the Office of the Deputy Prime Minister (ODPM) to the Department of Work and Pensions (DWP). On a like for like basis the general level of grant received was a 2.3% increase this being below the rate of general inflation. For 2005/06 the formula was more consistent than the previous 2 years, although the capping criteria was harsher.

5.3 Assessment of future levels of government grant is always difficult. The main indicator comes from the Spending Review 2004, where the Treasury publishes its spending plans for the period 2004/05 to 2007/08. The Treasury expects to see the Environmental Protection and Cultural Services (EPCS) block increase by 8% over that period. The table below puts that in perspective. The APSS block is the lowest increase for planned expenditure other than highway maintenance. This gives a clear message about the importance (or otherwise) of the services District Councils provide. Given the complexities of the grant distribution system and relative impact of headline census data I believe an annual figure of a 1% increase on a like for like basis is a prudent basis for financial planning.

	2004-5	2005-06	2006-07	2007-08	Change 2007-08 2004/05 %
	£m	£m	£m	£m	
FSS:					
Education	26402	27963	29863	31663	19.9%
Children's Social Services	3737	4016	4316	4516	20.8%
Adults Social Services	8690	9553	9933	10373	19.4%
Police	4355	4553	4768	4993	14.6%
Fire	1848	1898	1961	2035	10.1%
Highways Maintenance	2004	2054	2054	2054	2.5%
EPCS	11152	11217	11606	12040	8.0%
Capital Financial Costs	2802	3269	3599	3924	40.0%
Total	60990	64522	68099	71597	17.4%

5.4 In report FIN241 presented to Cabinet on 25th July, I reported on the key elements of the Missing Millions Campaign, Formula Grant Distribution and Business Rate Incentive Scheme. Since the Treasury has postponed the spending review by one year, it is likely the quantum of grant money will be largely unaffected from 2006/06 and the levels of general grant restricted. This ultimately means the interest receipts in the General Fund will be required to underpin the base level of revenue expenditure.

5.5 In terms of the impact the government has on the level of Council Tax and increase thereof, is dealt with under Strategy No. 8.

5.6 **Strategy No. 2 - The Council should continue to review all of its services in relation to its corporate objectives.**

5.7 The work carried out over the past year has been of vital importance in ensuring resources will follow priorities. This is a key issue identified by the CPA assessment and forms a key component of the Change Management Plan. The issue for medium term financial planning is to be able to release resources that have been secured from elsewhere.

5.8 Strategy No. 3 - Ensure that following approval of the budget, those officers responsible for delivering the associated work programmes deliver the outputs within the approved allocation.

5.9 This is achieved through comprehensive budget monitoring and adherence to the Council's approved financial regulations. Historically the strong control of corporate budgets has allowed the Council to be flexible in its approach to budget monitoring and delivery of new services. To further strengthen the current process, the service planning process will be aligned more closely to the budget process, with increased information being available to service managers regarding their service costs.

The early part of 2005/06 has been characterised by requests for additional funding, either by supplementary estimate or by virement. This is a departure from previous years and means action for 2006/07 and beyond must resolve this issue. In preparing for 2006/07, the budget process has begun at an earlier date. Proformas have been sent to Service Managers to link in with the Medium Term Financial Strategy development. The value for money assessment to be conducted under the 'Use of Resources' Judgement requires Services to be benchmarked against other Authorities' relevant service performance. It is therefore important that Service Managers take a medium term view of their service, bid for the appropriate realistic level of funding and operate within an approved allocation.

5.10 A briefing has been given to the Cabinet and Resources DSP on the value for money approach outlined in the Audit Commission's 'Use of Resources' documentation. The Council has always striven to deliver value for money services and must show evidence of the achievement. This will be done through the self-assessment process. Value for money needs to be embodied into the Service Plan development and owned corporately by staff and members.

5.11 Strategy No. 4 - The Council must continue to find new sources of funding for its activity.

5.12 Government funding continues to be 'top-sliced' for specific projects. If the specific schemes link with the Council's priorities then bids should be submitted. The secured use of S106 agreements help to develop community assets with less reliance upon the Council's own resources. The recent bid for recycling from DEFRA is a good example of additional external funding for an identified Council priority.

Further examples include the receipt of Planning Delivery grant, useful for funding one-off initiatives and the Public Service Agreement (PSA) (Round 2) bid with the County Council where the District Council may receive performance reward grant if it can demonstrate achieving 'stretch' targets in line with the PSA. It is hoped that Service Managers will have built the achievement of these targets into their service plans. The medium term financial issues arising from additional funding streams are

- (a) if commitments are made that extend past the period or amount of grant funding what is the exit strategy for the service?
- (b) or Service Manager need to integrate various funding streams into their programme delivery and (i) be clear about the use and timespan of that funding, and (ii) be clear about the outputs required as a result of receiving that funding.

5.13 Strategy No. 5 - Optimising the financial return on the Council's assets and ensuring capital receipts are at required levels.

It is important that the Council commits to reviewing its asset base and the returns upon them.

The Council's Asset Management Plan (AMP) should be the core document identifying those assets either not being fully utilised or those that are surplus to requirements. The Property Performance Management Group has operational responsibilities for evaluating any issues arising from the AMP and feeding them back to the Corporate Management Team and the Cabinet.

5.14 Strategy No. 6 - To improve Treasury Management performance.

The addition of the prudential code on borrowing has given the Council more freedom in managing its debt in relation to the capital programme. The current flexible approach to debt redemption and borrowing should be maintained. In terms of investment performance regular reports will be presented to the Constitutional and Accounts Committee.

This will be an important element within the value for money assessment. The Council has been repaying debts for a number of years and is left with a low level of debt but at 'relatively' high interest rates. If this is repaid early the Council will pay a premium for doing so, hence the current policy of repaying on maturity.

Given a requirement to have an enhanced capital programme the Prudential Code will be used to ensure the decisions made with regard to borrowing reflect affordability, sustainability and value for money. This will involve consideration of the following issues

- (a) Balancing investment income against new borrowing, ie may be cheaper to bring back investments to fund new capital expenditures
- (b) Leasing versus Buying Outright
- (c) Ensuring that the balance of investment between General Fund and Housing Revenue Account is well defined taking into account the impact of changes to debt and investment structure on both funds. This is particularly relevant to the proposals on stock option appraisal.

5.15 Strategy No. 7 - To annually review the scale of charges for Council services.

New levels of charge often result from normal inflationary increases, statutory review of charges, best value service reviews or from new services being delivered. During budget development, the balance between who pays for local services, the user or taxpayer, needs to be reviewed.

5.16 Strategy No. 8 - The policy on Council Tax increases is that any increase should aim to be equal to the change in the retail price index. Any increase above this should include any identification of particular service objectives that the additional tax revenue would be used to finance.

5.17 This is an important area to be considered. During the budget preparation for 2004/05 the wide public consultation on priorities was coupled with discussion on future years' Council Tax increases. Feedback indicated that reasonable increases in Council Tax are acceptable providing service improvements are visible. The 2005/06 budget consultation gave a similar conclusion. Value for money was a key issue for consultees.

5.18 It is proposed to carry out budget consultation for 2006/07 through (a) joint public meeting with Police and County Council, (b) LAA, (c) through a budget survey with options being given. The latter item can target upon the spend, save and efficiency agenda items previously discussed.

5.19 Strategy No. 9 - All potential capital schemes are appraised and fed into the capital strategy.

The Council approved the appraisal process in 2003/04 and a revised programme in 2004/05. This has been and will continue to be incorporated into the medium term strategy and an updated programme for 2005/06, and beyond. The process must be flexible to deal with emerging or urgent schemes.

5.20 Strategy No. 10 - To maximise the financial viability of the Housing Revenue Account (HRA) within government guidelines.

The production of the 30 year business plan for the Housing Revenue Account as part of the stock option appraisal process has enabled full financial assessment of the HRA.

The only consideration in this report is the impact on the General Fund of a successful/unsuccessful ballot.

Estimated Budget Requirements - 2005/06 to 2009/2010

6. Given the national position on Revenue Support Grant and likely allowable Council Tax increases the following table presents the likely budget requirement for SKDC over the next 6 years. It includes Special Expense Area expenditure, since this forms part of the Council's expenditure.

Profile of External Financing 2004/05 to 2009/10

	2004/05 £000	2005/06 £000	2006/07 £000	2007/08 £000	2008/09 £000	2009/10 £000	2010/11 £000
Government Grant	7965	8368	8451	8535	8620	8706	8793
Council Tax - General Income	4115	4374	4592	4821	5062	5315	5580
Council Tax Income - SEA - collection fund	471	550	550	550	550	550	550
SKDC Budget Requirement	12551	13292	13593	13906	14232	14572	14923
Allowable Growth in Net Spend	-	-	301	313	326	339	351
Increase %			2.3	2.3	2.3	2.4	2.4

Assumptions

- (i) Government Grant increase - 1% per year
- (ii) Tax Base inc - 1% increase p.a. - no assessment of the impact of Council Tax Valuation.
- (iii) Council Tax - 4% increase p.a.

Impact on Financing of Services on Budget Requirement

7. Starting Position - 2004/05 Outturn

The final position for 2004/05 is now available. This shows:

- (a) an underspend at panel level of £573,000 against the revised position. This needs to be analysed to establish whether (i) commitments have been made but not spent, (ii) additional income received, (iii) poor budget management.
- (b) Interest receipts are over £1m for 2004/05. This is a direct result of limited capital programme, general underspending and a rise in interest rates over the year.
- (c) The General Fund Reserve has been increased to £3.3m, with a £1m specific reserve set up to cover the one-off costs of the Stock Option ballot.

The approval of service plans and budget development for 2006/07 need to ensure that the base budget approved for 2005/06 is being utilized properly and spending should be close to that budgeted. Otherwise there is a danger that increases in budget in priority areas will not take place because of 'hidden' budget capacity elsewhere.

It is proposed to review all of the specific reserves held and their appropriate levels as part of budget setting for 2006/07. I recommend a planned approach to their use, linking the fall in interest receipts likely to occur, with the revenue efficiency agenda. In particular, the use of the Minimum Revenue Provision (MRP) reserve, Building Control Reserve and Insurance Reserve need to be reviewed for appropriateness.

7.1 What does this mean for Revenue costs

7.2 These estimated budget requirements will need to deliver the resources for stepped improvements in the priority areas. The table at Appendix I provides an initial assessment of the impact of growth areas, efficiency savings and known liabilities, at this early part of the year 2005/06. The figures within the table are broad estimates that need to be worked into detailed estimates, when service plans have been received from Service Managers. An update on this table will be given at the meeting. This is very much work in progress identifying the likely spending scenarios over the coming years. A commentary on the key issues follows below.

7.3 The model assumes that the identification of costs associated with the non-priority services will be realised. If the savings are not realised the budget requirements will remain higher than desired. Current analysis indicates that the savings identified for 2005/06 have been delivered and therefore reflected in the budget requirement. The targets for 2006/07 will be much harder to achieve, and the commitment to achieving them needs reviewing. The position of Pest Control full cost recovery for 2005/06 will be difficult to achieve.

7.4 Gershon Efficiency Savings - the model only focuses upon the cashable savings – i.e. those that impact upon service delivery and real costs. I have assumed that the Authority will re-invest cashable efficiency savings when they have proved they have been achieved. Thus the model shows efficiency savings accruing in one year and re-invested in the next financial year.

7.5 The proposed re-organisation costs were £300,000 per annum. These would accrue from 1 April 2006. Nothing has been assumed for additional support for the three Strategic Directors.

7.6 It would be sensible to allow an increase in budget to deal with the Capacity issues facing the Council if it is not to slide back relative to other Councils. This is necessary if the requirement of the Use of Resource Statement and CPA - The Harder Test are to be achieved.

7.7 The impact of stock transfer is crucial to the Medium Term Financial Strategy. If transfer went ahead in 2007/08, the projected capital receipt is £32m. Interest receipts of £1m per annum may accrue on the retained portion. The Council would need to watch the markets carefully because any downward movement in interest rates would have a big impact on the bottom line. It would be a good exercise to analyse the purposes to which the receipt could be put, whilst retaining a minimum proportion to support the revenue account.

If stock transfer does not go ahead:

- (a) the cost of preparation for ballot etc would be a charge on the General Fund. Estimate £1,000,000 (one-off cost)

(b) the separate identity/location of Housing Services means costs currently allocated from the Corporate Centre in terms of management and accommodation would fall back upon the General Fund. Estimate £250,000 ongoing.

7.8 I have assumed that a Leisure Trust will be set up and save the Council £150,000 per annum from 2007/08. Further analysis is required for this to be assessed.

7.9 The base-budget for 2005/06 included £500,000 for the new priorities. I have included the £250,000 per annum to reflect the re-cycling costs of green waste. One-off income of £150,000 falls out, and the delivery of 11,000 more bins will increase the revenue costs of the service. It is proposed the budget for 2006/07 should reflect the level of service being provided.

7.10 It is likely that some services will require additional funding to fulfil new statutory requirements, eg Travel Concessions. I have allowed a provisional sum of £100,000 per annum.

7.11 Supplementary estimates approved in 2005/06 funded from reserves, increase the budget requirement.

7.12 The Grounds Maintenance Contract is due for renewal in 2006/07. It is thought that the base-costs will rise by £400,000 under the new contract. Work is underway to ensure the increase is kept below this level by careful structuring of the contract.

7.13 Scale of Charges - some charges will need to be inflated above RPI in order to close the deficit between spend and tax income. This will be calculated when service plans are known.

7.14 The capital programme is now in place, decisions made will impact on the General Fund in two ways

(a) Reduction in Capital Reserves - therefore less interest accruing in the General Fund

(b) If borrowing is required interest payments will fall to the General Fund.

7.15 The model assumes that the identification of costs associated with the non-prioritisation of services will be realised. If the savings are not realised the budget requirement will remain higher than desired.

What does it tell us?

7.16 At the current time, there is a need to consider, either the use of reserves or to find further savings. The following will be worked upon.

(a) The starting budget requirement has consistently been greater than the actual expenditure incurred. This implies that an element of growth can be constrained within existing parameters.

(b) The use of reserves will be expected for future years. They have been set aside for specific purposes and should be released in a planned way to help fund stepped changes in service improvement.

- (c) The funding gap could be closed by further increases in Council tax;
 - (i) by assuming full cost recovery in Special Expense areas
 - (ii) by a general rise greater than 3%. I would urge caution on simply financing expenditure by this method alone. Capping is a realistic government option and must be carefully considered by the Council.
- (d) Timing the investment in new areas with the release of cash savings.
- (e) Reviewing the impact of Stock Transfer on the General Fund.

Conclusion

8. At this stage in the development of the budget for 2006/07 and future years, I recommend a starting budget requirement of £13,593,000. If this cannot be achieved, or other factors become relevant, it will be reviewed and the impact on Council Tax assessed.

John Blair
Corporate Director of Finance and Strategic Resources
01476 406202
j.blair@southkesteven.gov.uk

POTENTIAL INFLUENCES ON DRAFT BASE BUDGET

	2005/2006 £000	2006/07 £000	2007/08 £000	2008/09 £000	2009/10 £000	2010/11 £000
Business Rate Incentive Scheme	(300)	(600)	(900)			
(Economies) Re-distribution of Savings - Target		200	200	200	200	200
Efficiencies Gershon Efficiency Savings Cashable	Included in Budget Requirement 2005/06	(252)	(252)	(300)	(300)	(300)
Cashable Efficiencies		252	252	252	300	300
Re-organisation costs		300	300	300	300	300
Impact of Stock Transfer - A			(1,000)	(1,000)	(1,000)	(1,000)
Impact of No Stock Transfer - B			1,250	250	250	250
Impact of Leisure Trust				(150)	(150)	(150)
Priorities Additional Spend - recycling		250	250	150	250	250
Statutory Growth		100	100	100	100	100
Supplementary Estimate Approved	100					
Grounds Mtce base + Contract Increase		400	400	400	400	400
Scale of Charges inc above inflation		N/A	N/A	N/A	N/A	N/A
Revenue impact on Capital Programme		300	300	300	300	300

N/A = Needs Assessing