Report to the Finance and Performance Management Cabinet Committee

Epping Forest District Council

Report Reference: FPM-010-2009/10.
Date of meeting: 5 October 2009.

Portfolio: **Finance and Economic Development.**

Subject: **Financial Issues Paper.**

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Recommendations/Decisions Required:

(1) To make recommendations to the Cabinet on establishing a new budgetary framework including:

(a) setting 2009/10 budget guidelines for the:

(i) the Continuing Services Budget (including growth items);

(ii) District Development Fund items;

(iii) the use of surplus General Fund balances; and

(iv) the District Council Tax for a Band 'D' property;

(b) a revised Medium Term Financial Strategy for the period to 2013/14, including the communication of the revised Medium Term Financial Strategy to staff, partners and other stakeholders; and

(c) establishing a joint Member and Officer group to identify areas for review and ensure resources are allocated in line with key Cabinet priorities.

Executive Summary:

This report provides a framework for the Budget 2010/11 and updates Members on a number of financial issues that will affect this Authority in the short to medium term.

In broad terms the following represent the greatest areas of current financial uncertainty and risk to the Authority

- Likely reductions in grant as part of the next Comprehensive Spending Review
- Effects of the "Credit Crunch" and reduced activity in the housing market
- Using up of capital reserves on non-revenue generating assets
- Pay awards
- Next triennial pension valuation
- Capitalisation of pension deficit payments
- Changes to the statutory concessionary fares scheme
- Customer Services Transformation Programme

These issues will be dealt with in the following paragraphs, taking the opportunity to discuss some areas in greater detail following recent developments. Based on the information contained in the report Members are asked to set out, for consultation purposes, the budgetary structure for 2010/11.

Reasons for Proposed Decision:

By setting out clear guidelines at this stage the Committee establishes a framework to work within in developing growth and savings proposals. This should help avoid late changes to the budget and ensure that all changes to services have been carefully considered.

Other Options for Action:

Members could decide to wait until later in the budget cycle to provide guidelines if they felt more information, or a greater degree of certainty, was necessary in relation to a particular risk. However, any delay will reduce the time available to produce strategies that comply with the guidelines.

Report:

General Fund Out-turn 2008/09

1. Members have already received the outturn figures and the Statutory Statement of Accounts for 2008/09 together with explanations for the variances. In summary the General Fund Revenue outturn for 2008/09 shows that CSB expenditure was £509,000 lower than the original estimate and £187,000 lower than the revised. The main variance, as in 2007/08, related to staff savings arising from vacancies.

2. The revised CSB estimate for 2008/09 reduced from £16.828m to £16.506m with the actual being £16.319m. Growth and savings items were largely as estimated with the main fluctuation being on the opening CSB figure, which is consistent with the main variance arising from salary savings.

3. DDF expenditure was underspent by £449,000, compared to the revised estimate. However £280,000 of this resulted from slippage so both expenditure and financing for this amount has been carried forward to 2009/10, giving a net saving of £169,000. Net portfolio DDF spending exceeded the revised estimate by £102,000, due to the surplus balance transferred to the DDF from the Insurance Fund being £117,000 lower than anticipated. However, non-portfolio income items exceeded the revised estimate by £271,000 to give the total DDF saving of £169,000.

4. The non-portfolio items include the Local Authority Business Growth Incentive Scheme (LABGI). Due to the uncertainty over the future of this scheme and legal challenges to the amounts due no income was anticipated but grant of £164,000 was received. In line with the prudent wish to avoid over reliance on investment income to support the CSB, the bulk of the additional investment income earnt in 2008/09 was credited to the DDF. The inclusion of the LABGI income and the underspend mean the balance on the DDF is higher than previously predicted at £3.122m at 31 March 2009. However, the vast majority of this amount is committed to finance the present programme of DDF expenditure, particularly the Local Development Framework.

5. As the underspend on the DDF is matched by the variance on appropriations, the overall variance in the use of the General Fund Revenue balances is equal to the CSB underspend of £509,000, compared to the original estimate. This translates into an increase in balances of £728,000 compared to the revised estimate of an increase of £541,000. The original estimate had indicated an increase of £219,000.

The Updated Medium Term Financial Strategy

6. Annexes 1(a/b) show the latest four-year forecast for the General Fund. This is based on adjusting the balances for the 2008/09 actuals, allowing for items already approved by Council and other significant items covered in the report. The annex (1b) shows that revenue balances will decrease by £0.7m in 2009/10, £0.8m in 2010/11, £0.4m in 2011/12 and £0.1m in 2012/13 before returning to a small surplus in 2013/14.

7. For some time Members have aligned the balances to the Council's 'Net Budget Requirement' (NBR), allowing balances to fall to no lower than 25% of NBR. The predicted balance at 1 April 2010 of £7.485m represents just over 43% of the anticipated NBR for next year (£17.558m) and is therefore somewhat higher than the Council's current policy of 25%. However, predicted changes and trends mean that by 1 April 2014 the revenue balance will have reduced to £6.216m. This still represents nearly 36% of the NBR for 2013/14 (£17.274m).

8. The financial position as at 1 April 2009 was better than had been anticipated, however the change in the key assumption about future grant funding has increased the level of savings that need to be identified. This may prove difficult to achieve without the Council Tax needing to be increased above current target levels during the next four years.

9. The target saving for 2010/11 has been left at the original level of £300,000; this increases to £600,000 for 2011/12 and then reduces to £400,000 and £200,000 for the subsequent years. These net savings could arise either from reductions in expenditure or increases in income. What is clear is that given the levels of savings now required, it is no longer sufficient to talk in terms of "efficiencies". Members will have to make difficult decisions about reducing or stopping some non-priority services. If Members feel that the levels of net savings being targeted are appropriate, it is proposed to communicate this strategy to staff and stakeholders.

10. Estimated DDF expenditure has been amended for carry forwards, supplementary estimates and income shortfalls and it is anticipated that there will be £492,000 of DDF funds available at 1 April 2014. The four-year forecast approved by Council on 17 February 2009 predicted a DDF balance of £488,000 at the end of 2012/13 and this has not changed significantly.

11. Capital balances have been updated for recent outturn figures and updated assumptions on capital receipt generation. The reduction in estimated capital receipts means that the predicted balance at 1 April 2014 falls to £10.930m. Over this four-year period the capital programme has some £49m of spending. As capital balances are used up the revenue benefit from interest earnings is reduced and so care needs to be exercised in expanding the capital programme any further, particularly on non-revenue generating assets.

Government Grant Allocation

12. There is nothing new to report on the current Comprehensive Spending Review (CSR) as the Department for Communities and Local Government (DCLG) has indicated that the settlement already notified for 2010/11 will be honoured. Members will already be aware from previous papers that our initial pleasure at the outcome of the "Four Block" method of allocation was turned to dismay when the model was subject to an "update and fine tune" for the current CSR. For ease of reference the table showing the outcomes of the model over its five year life is given below.

	2006/07 £m	2007/08 £m	2008/09 £m	2009/10 £m	2010/11 £m
Relative Needs Amount	5.728	5.742	5.455	5.457	5.464
Relative Resource Amount	-4.465	-4.724	-5.228	-5.096	-4.956
Central Allocation	7.854	8.332	8.793	8.834	8.871
Floor Damping	-0.490	-0.189	0.302	0.173	0.036
Formula Grant	**8.627**	**9.161**	**9.322**	**9.368**	**9.415**

13. The figures shown above represent a poor settlement for the Council and give grant increases of only 1% (against the adjusted 07/08 figure) for 2008/09 and only 0.5% for 2009/10 and 2010/11. This seems odd given the sizeable grant increase seen under this system for 2006/07 and 2007/08.

	2006/07 £m	2007/08 £m	2008/09 £m	2009/10 £m	2010/11 £m
Formula Grant (adjusted)	8.627	9.161 (9.229)	9.322	9.368	9.415
Increase £	0.711	0.534	0.093	0.046	0.047
Increase %	9.0%	6.2%	1.0%	0.5%	0.5%

14. The introduction of the four block system saw the Council change from receiving floor support of £412,000 to losing £490,000 to support the floor for others. It had been hoped that the move away from the floor would last longer than two years. However, the benefit of the previous large increase has not been lost, as this has provided the base that the floor increase of 1% has been added to.

Continuing Services Budget

15. The CSB saving against revised estimate was £0.187m, compared to £0.585m in 2007/08. The prime cause of this under spend was again salary savings, actual salary spending for the authority in total, including agency costs, was some £19.1m compared against an original estimate of £19.4m. Current indications are that the underspend on salaries in 2009/10 will reduce as some of the posts that have been difficult to recruit to, such as the Assistant Director vacancies in Planning, have now been filled.

16. Previously it has been agreed that CSB expenditure should not rely on the use of balances to provide support but should be financed only from Government grant (RSG + Distributable NDR) and council tax income. This means that effectively the level of council tax will dictate the net expenditure on CSB or the CSB will dictate the level of council tax. As Members have previously indicated that future council tax increases should not exceed 2.5% for the near future, it is clear that the former will be the determinant. The four-year forecast, agreed in February, includes these assumptions. The link between council tax increases and the rate of inflation was replaced with the 2.5% guideline last year. For information, RPI is currently -1.4% and CPI 1.8% and inflation forecasts retain an important role in estimating future costs.

17. The latest four-year forecast (annexes 1a & b) show that the original budget for 2009/10 did not achieve that objective, as funding from Government grants and local Taxpayers fell £0.7m below CSB. The revised estimate for this year shows no change in CSB at this time although that is likely to change as we go through the budget process.

The Next Comprehensive Spending Review

18. It was noted above that the Government have said the grant settlement for 2010/11 will be honoured. The very big question is how the winners of next year's general election will go about achieving the necessary improvements in the state of the overall public finances. It has been well documented that the bail out of the financial sector and effective nationalising

of some of the countries largest banks has put an unprecedented strain on the public finances. Every month as the Government borrowing figures are announced they establish new records and it is clear that the current position is not sustainable.

19. Whilst the banking sector has now stabilised it is likely to still be several years before a full return to private ownership is possible. This means solutions must be found in other areas and there are already suggestions that an incoming Government will need to cut big programmes such as identity cards and the replacement of Trident. However, the size of the problem makes it inevitable that local government will have to share some of the pain. Best estimates are that grant will fall 10% over the next CSR with the reduction in the first year likely to be 5%. This means in 2011/12 grant is likely to reduce by £471,000 and over the three year CSR grant support could fall by £1m. These are estimates based on the public pronouncements of the parties to date and the ultimate reductions may of course be very different.

<u>The “Credit Crunch” and Reduced Housing Market Activity</u>

20. The Council’s CSB contains a number of income streams that have been adversely affected, to varying degrees, by the current state of the housing market. Recent surveys have been inconclusive, although some indicate house prices are starting to rise and new mortgage approvals are increasing from a very low base. The Government have provided kick start funding to a number of housing projects, including the Parade Ground development at North Weald. Although while banks remain cautious with mortgage funding and developers wait for better rates of return any recovery in the housing market is likely to remain fragile.

21. The main areas of income related to the housing market are land charges, building control and development control. For 2009/10 land charges income had been estimated at £150,000, consistent with the actual of £146,000 for 2008/09 but a long way from the 2006/07 figure of £394,000. At the end of August the income achieved was slightly ahead of the estimate, with the last three months showing an improvement after a slow start in April and May. Building Control fees may fall short of the estimate of £642,000 by as much as £150,000. This is despite changes to the fee structure and further steps will be necessary to address the state of the Building Control ring-fenced account. To date Development Control income is doing marginally better, mostly due to the fee for the St Johns School development, although the outturn here is likely to be closer to £500,000 than the £605,000 originally estimated.

22. Moving briefly off of housing market related income it is worth noting that some of the Council’s other income streams are doing well. The MOT income from Fleet Operations may exceed the estimate of £225,000 by £80,000. Total licensing income is also currently slightly ahead of expectations and should exceed the estimate of £252,000.

23. All of the above income streams will continue to be monitored on a monthly basis. Adjustments have previously been made to CSB income levels and no further reductions are planned at this time, although some extra allowance may be needed in the DDF.

24. One beneficial effect of the “Credit Crunch” had been the higher interest rates in 2008/09 that banks have been prepared to pay to borrow from the Council. It was evident that this would not continue for long and so £334,000 of investment income was credited to the DDF in 2008/09 instead of the CSB. Investment income this year is behind the estimate as interest rates have fallen lower than anticipated and seem set to remain at 0.5% for months to come. The outturn is likely to be £400,000 short of the original estimate of £2.1m, although a large portion of this is credited to the HRA. The Medium Term Financial Strategy (MTFS) has taken a prudent view on future interest rate movements, based on advice from the Council’s treasury management consultants.

Use of capital resources on non-revenue generating assets

25. In recent years the Capital Strategy has stressed the need for capital projects to be used to improve the Council's revenue position, either by saving costs or increasing revenues. This issue has also been recognised on the Council's Corporate Risk Register. Capital receipts generate investment income and so if they are used up on non-revenue generating assets there is a "double whammy" whereby the Council looses out on income and takes on additional costs.

26. The updated Capital Programme will go to Cabinet this month and the figures show spending of £48.5m over five years. Of this spending, £35m is funded from revenue or grants but the remainder will reduce the balance of capital receipts from £24.3m to £10.9m. In view of this Members should carefully consider whether existing schemes are essential and any additional schemes should only be approved where there is a positive revenue contribution, after allowing for any loss of investment income.

Pay Awards for 2009/10 and Subsequent Years

27. In previous years the pay award has been used as a generic term taken to cover all staff. There are actually a number of separate negotiating bodies, although they do usually reach similar agreements. Negotiations have again been protracted and have resulted in a settlement of 1.25% for the lowest paid staff (scale points 4 to 10) and 1% for most other staff (scale point 11 up to and including Assistant Directors). A settlement is still to be agreed by the bodies representing Directors and Chief Executives, following a 0% offer from the employer's body.

28. Against the backdrop of the negotiations it is worth considering this Council's pay bill and the effect that different levels of pay awards might have. The total salary estimate for 2009/10 is £20m; therefore for every 1% the pay award increases the Council's pay bill by £200,000. The annual pay bill is one of the key parts of the Council's overall estimates and so the assumptions made about pay awards are particularly significant. In the current economic climate with the overall public finances in a poor state it is difficult to envisage pay awards exceeding 1.5% for the foreseeable future, although if inflation starts to increase this assumption may not prove correct.

Next Triennial Valuation of the Pension Scheme

29. The Local Government Pension Scheme (LGPS) is an umbrella term for a number of schemes across the country, most commonly administered at a county level. Most local government bodies in Essex pay contributions into the fund administered by Essex County Council. The level of contributions is based on an actuarial evaluation of the fund's assets and liabilities at a given date. These valuations are conducted on a triennial basis, with annual interim valuations being used only to update the annual accounts.

30. The last triennial valuation was undertaken as at 31 March 2007 and showed a significant improvement on the 2004 valuation. As at 31 March 2004 the scheme was only 71% funded (the value of the scheme's assets only covered 71.4% of the liabilities), by 2007 the funding level had improved to 81.2%. This meant that it was possible to reduce the amount of the deficit contributions but due to other factors, such as increasing life expectancy, it was necessary to increase the ongoing contribution rate from 10.1% for 2007/08 to 13.1% for 2010/11.

31. Recently share prices have rallied and the FT100 share index has gone back above the 5,000 level. This is encouraging but is still 18% below where the index was at the last scheme valuation date. As approximately 70% of the schemes assets are invested in shares, unless there is a further substantial increase in the index before 31 March 2010 it is likely that the valuation will show an increase in the overall deficit.

32. A number of changes have been made to the LGPS, with increased contribution rates for employees and a rising of the normal retirement age. Further options for reform are currently being examined and it is possible that in the long term the defined benefit scheme could be closed to new entrants or pensions could be based on average earnings instead of final salary. There is a general acceptance that the scheme in its current form is not sustainable, although at this time it is not possible to predict the outcome of these discussions or the triennial valuation with any certainty.

Capitalisation of Pension Deficit Payments

33. As part of the budget setting process for 2009/10 Members decided to continue with the policy of seeking annual capitalisation directions for pension deficit payments. There are strict financial criteria laid down by the Government that you must satisfy to be eligible for a capitalisation direction. If you satisfy the criteria you get a Gate 1 approval but it is only after the Government has considered all Gate 1 approvals in aggregate that it decides the amount of Gate 2 or final approvals.

34. Since the capitalisation policy was put in place the Council has generally been successful in obtaining directions. A direction was first applied for in 2005/06 and one was obtained for the full amount requested. It was in 2006/07 that the Two Gate System was introduced and that year saw all applicants receive directions for only 57% of the amounts applied for. In both 2007/08 and 2008/09 the Government has issued directions for the full amounts applied for.

35. The amounts that will be applied for are set out in the table below and given recent history it has been assumed that full directions will be obtained. To fund the capitalisations £2.5m was moved to the Pension Deficit Reserve in 2007/08. If this assumption proves incorrect any amounts that cannot be capitalised will have to be charged to revenue.

	2008/09	**2009/10**	**2010/11**	**Total**
	£'000	**£'000**	**£'000**	**£'000**
General Fund	**662**	**644**	**626**	**1,932**
HRA	**311**	**302**	**294**	**907**
	973	**946**	**920**	**2,839**

National Concessionary Fares Scheme

36. With effect from 1 April 2008 the countywide concessionary fare scheme ended and a new national scheme began. The national scheme allows pass holders to travel free on local bus services anywhere in England. District Councils payments for the previous schemes were largely determined by the number of passes issued to the residents of their district. Under the national scheme districts are required to pay for all journeys by pass holders in their district regardless of where the pass was issued. The Government has acknowledged that the national scheme will be more expensive and has provided specific grants to support these costs. The Local Government Association has argued that these grants are inadequate, particularly for districts that attract high numbers of visitors for purposes such as tourism or shopping.

37. In Essex, the Districts and the County Council have worked together to achieve a transfer of the duties and risks associated with being travel concession authorities. A Participation Agreement was approved by Cabinet on 9 March 2009, under which Essex County Council took over the administration of the scheme from the districts. The serious potential impact of the national scheme has been highlighted previously in budget reports. As the scheme is demand led there was concern that districts were receiving limited funding from the Government but were being required to provide a blank cheque for the bus operators.

38. Concerns were also expressed by the bus operators that districts would try to impose unreasonable reimbursement schemes that would fail to comply with the requirement to ensure that the bus operators were no worse off for participating in the scheme. The concerns of the operators led many of them to register appeals against the reimbursement scheme that was originally proposed within Essex.

39. The transfer removed a substantial financial risk from this authority and places it with Essex County Council for 2009/10 and 2010/11. Beyond 2010/11 there is a risk that the general removal of this function from districts and the associated re-working of the grant formula could adversely impact on the Council's overall financial position. It is also worth reminding Members that not all of the appeals raised by the bus operators have been settled and further costs may still arise from these.

Customer Services Transformation Programme

40. A task and finish panel was established to consider how best to take forward the Customer Services Transformation Programme (CSTP). The findings of the panel were endorsed by the Overview and Scrutiny Committee on 11 December 2008 and a total of nine recommendations were put to Cabinet on 6 February 2009. At that time Cabinet were concerned that the full implementation of the recommendations would have increased budgetary requirements at a time when a clear need for savings had been identified. Consequently the matter was referred back to the task and finish panel with a request that they prioritise their recommendations.

41. No CSB or DDF amounts have been programmed for this initiative but some £2.1m of expenditure is still included in the capital programme. It may be necessary to re-schedule the capital expenditure as £0.5m is in the programme for 2009/10. It is unlikely that the Council will have received the Panel's amended recommendations and determined the way forward in sufficient time for the project to commence before the end of the current financial year.

District Development Fund

42. The carry forward of £280,000 represents a reduction of nearly £200,000 on the £469,000 of slippage for 2007/08. This is a further improvement on the reduction seen last year and illustrates how the requirement to explain slippage has helped improve forecasting. Given that DDF funding is limited, it should only be used to support high priority projects. If a project takes several years to be implemented questions may arise over whether it was really a priority and if that money could have been used for a more urgent purpose.

43. The financial forecast shows that not all DDF funding is currently allocated to schemes. It is currently anticipated that there will be some £492,000 of DDF available at 1 April 2014.

The Capital Programme

44. The total of 7 Council house sales in 2008/09 was in line with the estimate and it is not anticipated that sales will return to their previous levels for some time. This is consistent with the four completions so far in the first five months of 2009/10. The Capital Programme has already been adjusted to reflect this anticipated lower level of Council house sales.

45. Significant receipts have previously been generated through the sale of other assets. Land values have fallen substantially from their peak and Cabinet has generally decided against marketing further surplus land until market conditions have improved. As non-housing receipts are not included in the estimates before completion has occurred no adjustment to the MTFS is necessary.

46. The capital outturn report considered by the Finance and Performance Management Cabinet Committee on 15 June 2009 highlighted that the underspend of £2.4m was similar to

the £1.7m under spend in 2007/08. Non-housing expenditure was £0.95m below the estimate at £2.02m, whilst housing expenditure of £8.45m was £1.47m below the estimate of £9.93m. The slippage in the programme will be carried forward to subsequent periods.

The Council Tax

47. Band D Council Tax increases were 3.5% for 2007/08, 2.5% for 2008/09 and 2.5% for 2009/10. Members have indicated that future increases should not exceed 2.5%. Current 4-year forecasts are based on ongoing increases of 2.5% p.a., which should not fall foul of the capping criteria. However, Members will need to indicate whether they are in agreement with this assumption as it is a fundamental component to setting the budgetary framework for the Authority.

48. The financial position that the Council now finds itself in is more challenging than last year. A prudent view was taken on the CSB reductions in significant income streams and adequate allowance was made for the enhancements to the waste management service. However, the degree of uncertainty about the future health of the economy in general and the public finances in particular provide a difficult environment for financial forecasting.

49. Given the desire of Members to remain a low tax authority and not increase the burden on tax payers in the recession, it has been assumed that the target for Council Tax increases will remain 2.5%. Therefore no alternative forecast has been prepared, although if Members wish to see one a model could be produced with Council Tax increases set at 4% or 5%. Members will be able to consider these issues and others in consultation with the Finance and Performance Management Scrutiny Panel over the next few months.

A Revised Medium Term Financial Strategy

50. Annexes 1(a&b) show a four-year forecast with target levels of savings to bring the projections closer to the policy of keeping reserves above 25% of the NBR. The net savings included are £300,000 in 2010/11, increasing to £600,000 in 2011/12 before reducing to £400,000 for 2012/13 and £200,000 for 2013/14. These savings would give total CSB figures for 2009/10 revised of £18.015m and 2010/11 of £18.319m.

51. This proposal sets DDF expenditure at £1.54m for the revised 2009/10 and £0.82m for 2010/11, and given the possibility of other costs arising, it is likely that the DDF will be used up in the medium term.

52. No predicted non-housing capital receipts are being taken into account, as no sales are likely to progress in the current economic climate. Over the period of the MTFS the balance shown at Annex 1 (b) on the Capital Fund reduces significantly from £24.3m at 1 April 2009 to £10.9m at 1 April 2014. This has impacted on interest earnings within the forecast and it is important that any new capital schemes either save revenue costs or generate income.

53. The Key Lines of Enquiry used as part of the Audit Commission's Use of Resources assessment have been updated. Previously the Council was required to take steps to communicate the Medium Term Financial Strategy with staff, partners and other stakeholders. This process is still seen as good practice under the revised assessment criteria and a failure to repeat the exercise could harm subsequent scores. If Members agree, appropriate steps can be taken to circulate either the full strategy or a summarised version.

Conclusion

54. The current level of uncertainty on future government grant, the ongoing effects of the "Credit Crunch" and the next valuation of the pension scheme makes it difficult to produce robust financial forecasts. Although the Council is better placed than most to face these challenges, at 1 April 2009 the General Fund balance exceeded £8m, the DDF £3m and

capital receipts £24m. These balances can be used over the medium term to support a structured reduction in net expenditure and it is clear that Members will need to make tough decisions in prioritising the allocation of resources. Any further growth bids will need to be rigorously considered and the need to seek net savings now far exceeds any possible contribution from “efficiencies”.

Resource Implications:

The report covers resource implications over a four-year period and provides an updated Medium Term Financial Strategy.

Legal and Governance Implications:

None.

Safer, Cleaner, Greener Implications:

The Safer, Cleaner, Greener initiative is considered in the report.

Consultation Undertaken:

None.

Background Papers:

None.

Impact Assessments:

No equalities impacts.

The report sets out some of the key areas of financial risk to the authority. At this time the Council is well placed to meet such challenges, although particular care needs to be exercised in taking on any additional capital projects.