Report to the Finance and Performance Management Cabinet Committee

Epping Forest District Council

Report Reference: FPM-014-2010/11
Date of meeting: 27 September 2010

Portfolio: **Finance and Economic Development.**

Subject: **Financial Issues Paper.**

Responsible Officer: **Bob Palmer (01992 564279).**

Democratic Services: **Gary Woodhall (01992 564470).**

Recommendations/Decisions Required:

(1) To recommend to the Cabinet the establishment of a new budgetary framework;

(2) To recommend to the Cabinet, as part of the new budgetary framework, the setting of following budget guidelines for 2011/12:

(a) The Continuing Services Budget, including growth items;

(b) District Development Fund items;

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

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

(3) To recommend to the Cabinet the agreement of a revised Medium Term Financial Strategy for the period to 2014/15, and the communication of the revised Medium Term Financial Strategy to staff, partners and other stakeholders.

Executive Summary:

This report provides a framework for the Budget 2011/12 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
- Changes in the block grant allocation formulas
- Effects of the "Credit Crunch" and reduced activity in the housing market
- Transfer of commercial property from the Housing Revenue Account to the General Fund
- Using up of capital reserves on non-revenue generating assets
- Next triennial pension valuation
- Capitalisation of pension deficit payments
- Public sector re-organisation/shared services

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 2011/12.

Reasons for Proposed Decisions:

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 2009/10

1. Members have already received the outturn figures and the Statutory Statement of Accounts for 2009/10 together with explanations for the variances. In summary the General Fund Revenue outturn for 2009/10 shows that Continuing Services Budget (CSB) expenditure was £569,000 lower than the original estimate and £702,000 lower than the revised. The main variance, as in 2008/09, related to staff savings arising from vacancies and a lower than anticipated pay award.

2. The revised CSB estimate for 2009/10 increased from £18.015m to £18.148m with the actual being £17.447m. The largest variance on growth and savings items was on waste management where growth of £359,000 had been estimated, but actual growth was only £204,000. A significant variance was also seen on the opening CSB figure, which is consistent with the main variance arising from salary savings.

3. Net District Development Fund (DDF) expenditure was £1.213m lower than the revised estimate. However £523,000 of this resulted from slippage so both expenditure and financing for this amount has been carried forward to 2010/11, giving a net saving of £690,000. Net portfolio DDF spending was £526,000 below the revised estimate, due to under spends of £264,000 in Planning & Economic Development and £164,000 in Corporate Support Services. In addition to this, non-portfolio income items exceeded the revised estimate by £687,000 to give the total DDF saving of £1.213m.

4. The non-portfolio items include the “Fleming Claim” for the repayment of VAT. This had initially been budgeted at £375,000 to match the investment impairment the Council was required to include in the 2010/11 budget. A net refund of £1.158m was achieved, exceeding the estimate by £783,000. The inclusion of the “Fleming Claim” income and the underspend mean the balance on the DDF is higher than previously predicted at £4.041m at 31 March 2010. 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 £569,000, compared to the original estimate. This translates into a reduction in balances of £135,000 compared to the original estimate of £704,000.

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 2009/10 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 £0.632m in 2010/11, £0.408m in 2011/12, £0.456m in 2012/13 and £0.758m in 2013/14 and 0.426m in 2014/15.

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 2011 of £7.668m represents just over 46% of the anticipated NBR for next year (£16.656m) and is therefore somewhat higher than the Council's current policy of 25%. However, predicted changes and trends mean that by 1 April 2015 the revenue balance will have reduced to £5.620m. This still represents nearly 36% of the NBR for 2014/15 (£15.750m).

8. The financial position as at 1 April 2010 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, particularly given indications from the Government that Council Tax should not be increased for the next two years.

9. The target saving for 2011/12 has been set at £500,000; this increases to £900,000 for 2011/12 and then reduces to £500,000 for 2013/14 and £400,000 for 2014/15. 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 £562,000 of DDF funds available at 1 April 2015. The four-year forecast approved by Council on 16 February 2010 predicted a DDF balance of £156,000 at the end of 2013/14 and this has improved slightly.

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 2015 falls to £9.238m. Over this four-year period the capital programme has some £50m 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.

Continuing Services Budget

12. The CSB saving against revised estimate was £0.702m, compared to £0.187m in 2008/09. The prime cause of this under spend was again salary savings, actual salary spending for the authority in total, including agency costs, was some £19.351m compared against an original estimate of £20.082m. There is currently an under spend on the salaries budget in 2010/11, although in part this is due to an anticipated pay award of 1.5% which will not now occur.

13. In addition to the salaries savings, a number of CSB budgets were under spent and these will be closely scrutinised going forward to ensure budgets are more closely aligned with actual spending in prior years.

14. 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 not indicated any desire to contradict Government guidance that council tax increases should be frozen for the next two years, it is clear that the former will be the determinant. The four-year forecast, agreed in February, had included an assumption that

Council Tax would increase annually by 2.5%. Amending the four-year forecast for the revised assumption on Council Tax takes approximately £1m of income out of the forecast for the three years 2011/12 to 2013/14. Clearly if there is to be no increase in Council Tax the link between Council Tax increases and the rate of inflation is no longer relevant. For information, RPI is currently 4.7% and CPI 3.1% and inflation forecasts retain an important role in estimating future costs.

15. The latest four-year forecast (annexes 1a & b) show that the original budget for 2010/11 did not achieve that objective, as funding from Government grants and local Taxpayers fell £0.6m below CSB. The revised estimate for this year shows a small increase in CSB at this time although that is likely to change as we go through the budget process.

The Comprehensive Spending Review

16. When setting the budget in February the Medium Term Financial Strategy (MTFS) assumed a reduction in formula grant of 10% over the life of the next Comprehensive Spending Review (CSR). Whilst it is not yet clear what the exact reduction will be, we can be sure that it will be more than 10%.

17. Rumours of funding cuts of between 25% and 40% have been circulating. Although more recently speculation has focused on cuts in specific grants instead of formula grant. A broad indication will be given on 20 October when some of the headlines from the CSR will be announced. However, specific grant figures for individual authorities will not be provided until late November. During 2010/11 the Council will receive £9.4m of formula grant, an illustration of the effect of different % reductions in grant is shown below:

% Reduction	£ Reduction (M)
20	1.88
30	2.82
40	3.76

18. In terms of specific grants it is worth mentioning the grant received from the Department for Work and Pensions (DWP) to administer the benefit system. Currently the Council receives £0.9m per annum in administration grant. If the DWP has a budget cut imposed by the Treasury of 25% it is likely that will be passed straight on to local authorities. Therefore the MTFS includes an assumption that over the CSR annual administration subsidy will be reduced by some £225,000.

Government Grant Formulae

19. There is a separate report earlier on the agenda setting out the possible changes to the grant formulae and their impact. The key elements worth mentioning again are concessionary travel and the floor mechanism. From 1 April 2011 the responsibility for administering the national concessionary fare scheme moves from district councils to county councils. DCLG have modelled four different scenarios to achieve this transfer. Two of the models leave this authority in a worse position by approximately £100,000 and two in a worse position by approximately £1,000,000.

20. The outcome of the grant formulae calculations has previously been moderated by a system of floors and ceilings that average out the changes so that authorities are prevented from either gaining or losing too much grant. The consultation includes a question about the level at which the floor should be set to allow the outcomes of the formulae to be effective. Given the recent history of poor grant settlements and the impact shown by the exemplifications in the consultation, the proposed response is to seek a high floor averaging out the reductions to give all authorities similar reductions to deal with.

21. The vagaries of the grant system and how this authorities' fortunes have fluctuated since the introduction of the "Four Block" method of allocation are illustrated in the table 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**

22. 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%

23. 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 was not lost, as this provided the base that the floor increase of 1% has been added to.

The "Credit Crunch" and Reduced Housing Market Activity

24. 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. Most recent surveys have shown house prices are falling and new mortgage approvals remain at a very low level. Confidence is fragile and a clear direction is needed from Government on what will replace the regional planning structures and housing targets that have been set aside.

25. The main areas of income related to the housing market are land charges, building control and development control. For 2010/11 land charges income had been estimated at £177,300, consistent with the actual of £183,000 for 2009/10 but less than half the 2006/07 figure of £394,000. At the end of August the cumulative income achieved was less than £1,000 behind the estimate. However, changes to the regulatory regime will result in a reduction in CSB income of at least £25,000 and possibly more once the full changes are confirmed. There is also a possibility of some past fees having to be repaid and this could have a £100,000 impact on the DDF.

26. Building Control fees may fall short of the estimate of £642,000 by as much as £170,000. This is a ring-fenced account and costs within it were successfully managed down last year so that, despite the lower income level, a small surplus was generated. To date Development Control income is doing better, although the outturn here is likely to be closer to £500,000 than the £605,000 originally estimated.

27. 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 £292,000 by £30,000. Total licensing income is also currently slightly ahead of expectations and should exceed the estimate of £256,000.

28. 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.

29. The Council's interest earnings have also been hit by the "Credit Crunch". Earlier in the crisis in 2008/09 as banks struggled for liquidity they were prepared to pay high interest rates to borrow from the Council. This position has now reversed and the base rate has remained at 0.5% for a year and a half with no imminent sign of any upward movement. The original estimates were prepared using the interest rate predictions of the Council's previous treasury management consultants, who had anticipated an increase in interest rates. The outturn is likely to be £342,000 short of the original estimate of £0.897m, 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 new treasury management consultants.

Transfer Of Commercial Property From The Housing Revenue Account To The General Fund

30. The recent consultation on reform of the Housing revenue Account (HRA) highlighted that this account should be a dwelling based landlord account. Since the formation of the Council a substantial number of commercial properties have been accounted for as part of the HRA as they transferred to the authority at the same time as the housing stock. The benefit of this commercial income to the HRA over the last 36 years has meant that it has been possible to achieve the Decent Homes standard whilst still retaining ownership of the housing stock. The HRA is currently on a very sound financial footing with various reserves totalling some £16m.

31. The issues around the transfer were fully set out in a report to Cabinet on 13 September. At that Cabinet meeting, after requests from non-Cabinet Members, it was decided that before any decision is recommended to Council a joint meeting of the Housing and Finance & Performance Management Scrutiny Panels should be held to consider the transfer. This meeting is scheduled to take place on 12 October.

32. The importance of the transfer of these assets is illustrated by the differences in annexes 1 and 2, which show the predicted level of savings needed in the General Fund with and without the income from the commercial properties. For ease of reference this is summarised in the table below.

Financial Year	Savings with transfer £m	Savings without transfer £m
2011/12	0.50	1.00
2012/13	0.90	1.50
2013/14	0.50	0.50
2014/15	0.40	0.40
Total	2.30	3.40

33. It should also be noted that in the model without the transfer of commercial property the balance on the General Fund is £112,000 lower at the end of 2014/15. If Council decides that the commercial properties should be transferred an application will then need to be made to the Secretary of State, although initial indications from the Department of Communities & Local Government (DCLG) are that this should be a straightforward process.

Use Of Capital Resources On Non-Revenue Generating Assets

34. 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 loses out on income and takes on additional costs.

35. This principle has been applied to recent decisions such as procuring equipment for the leisure centres to reduce the CSB payments to SLM and the purchase of the Black Lion car parking area to save on rental costs.

36. The updated Capital Programme will go to Cabinet next month and the figures show spending of £50m over five years. Of this spending, £37m is funded from revenue or grants but the remainder will reduce the balance of capital receipts from £21.1m to £9.2m. 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

37. The MTFS approved in February included assumed annual pay awards of 1.5%. However, the employer's organisation has made it clear that there will be no pay award for 2010/11 and the Government have announced that they expect no pay awards for 2011/12 and 2012/13. The lack of any pay award for three years will produce a considerable saving against the previous MTFS.

38. Having set out the Government's expectations above, a question clearly exists over whether this position is sustainable if RPI remains close to 5%. 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 2010/11 is £20m; therefore for every 1% the pay award increases the Council's pay bill by £200,000. The MTFS has assumed the Government will enforce the extended pay freeze, although if inflation does not reduce significantly this assumption may prove incorrect.

Next Triennial Valuation of the Pension Scheme

39. 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.

40. 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%. The results of the full valuation as at 31 March 2010 are still to be released, but initial indications are that the funding level has dipped back down to a level similar to the 2004 valuation at 71%.

41. The increase in the funding level as at 31 March 2007 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. Whilst full valuation results and an updated Funding Strategy Statement are still awaited, indications from Essex County Council are that ongoing contribution rates are unlikely to change.

42. Recent years have seen a number of changes to the LGPS, with increased contribution rates for employees and a rising of the normal retirement age. Further options for reform are still being examined and it is likely 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 with any certainty.

Capitalisation of Pension Deficit Payments

43. The Council has an established 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.

44. 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 all subsequent years the Government has issued directions for the full amounts applied for.

45. 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. At 31 March 2010 the balance on the Pension Deficit Reserve was £728,000 so a further transfer of £200,000 will be needed to fund the 2010/11 capitalisation.

	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**

Public Sector Re-Organisation/Shared Services

46. Whilst the Government has said it will not legislate to achieve a formal re-organisation of local government it is encouraging a number of shared service initiatives and a major re-structuring of the National Health Service. The possibility of a joint Building Control service was examined with neighbouring authorities. However, it was concluded that this was likely to create a financial burden on this authority and lead to a reduction in the level of service.

47. One successful example of a shared service is within Accountancy, where an insurance claims service is provided for Uttlesford District Council. This has created savings for both authorities and is working well. In evaluating any proposals from any other bodies care needs to be taken to ensure that the legal and financial consequences are fully understood and that arrangements are only entered into where they are genuinely in the best long-term interests of the authority. Entering into any arrangements for short-term expediency is likely to create bigger problems later on.

District Development Fund

48. The carry forward of £523,000 represents an increase of £243,000 on the £280,000 of slippage for 2008/09. This highlights the need for tighter controls on DDF budgets and this issue is covered by an earlier report on this agenda. 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.

49. The financial forecast shows that not all DDF funding is currently allocated to schemes. It is currently anticipated that there will be some £562,000 of DDF available at 1 April 2015.

The Capital Programme

50. The total of 9 Council house sales in 2009/10 was in line with the estimate and was a slight improvement on the all time low figure of 7 in 2008/09. It is not anticipated that sales will return to their previous levels for some time. This is consistent with the two completions so far in the first four months of 2010/11. The Capital Programme has already been adjusted to reflect this anticipated lower level of Council house sales.

51. Significant receipts have previously been generated through the sale of other assets. Land values in some areas are starting to improve again and a number of potential projects are currently being evaluated. As non-housing receipts are not included in the estimates before completion has occurred no allowance has been made in the MTFS.

52. The capital outturn report considered by the Finance and Performance Management Cabinet Committee on 14 June 2010 highlighted that the underspend of £1m was an improvement on the £2.4m under spend in 2008/09. Non-housing expenditure was £0.85m below the estimate at £4.06m, whilst housing expenditure of £9.16m was £0.14m below the estimate of £9.3m. The slippage in the programme will be carried forward to subsequent periods.

The Council Tax

53. Band D Council Tax increased by 1.5% for 2010/11 following increases of 2.5% in the previous two years. The Government has made it clear that it expects authorities to freeze the Council Tax for two years; beyond this it is assumed that future increases will not exceed 2.5%.

A Revised Medium Term Financial Strategy

54. Annex 1(a) & 1(b) shows 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 £500,000 in 2011/12, increasing to £900,000 in 2012/13 before reducing to £500,000 for 2013/14 and £400,000 in 2014/15. These savings would give total CSB figures for 2010/11 revised of £18.160m and 2011/12 of £17.064m.

55. This proposal sets DDF expenditure at £2.389m for the revised 2010/11 and £0.909m for 2011/12, and given the possibility of other costs arising, it is likely that the DDF will be used up in the medium term.

56. No predicted non-housing capital receipts are being taken into account, as any sales are still some way off. Over the period of the MTFS the balance shown at Annex 1 (b) on the Capital Fund reduces significantly from £21.1m at 1 April 2010 to £9.238m at 1 April 2015. 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.

57. Previously the Council has taken steps to communicate the MTFS with staff, partners and other stakeholders. This process is still seen as good practice and a failure to repeat the exercise could harm relationships and obstruct informed debate. If Members agree, appropriate steps can be taken to circulate either the full strategy or a summarised version.

Conclusion

58. The current level of uncertainty on future government grant, the ongoing effects of the "Credit Crunch" and potential changes to the public sector make it difficult to produce robust

financial forecasts. Although the Council is better placed than most to face these challenges, at 1 April 2010 the General Fund balance exceeded £8m, the DDF £4m and capital receipts £21m. 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. The need to seek net savings now far exceeds any possible contribution from “efficiencies” and therefore service reductions are inevitable.

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:

There are 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.