Committee: **Finance Cabinet Committee** **Date:** **12 September 2005**

Report of: **Joint Chief Executive - Resources** **Item No: 4a**

Subject: **Budget 2006/07 – Financial Issues Paper**

Recommendations

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

(a) setting 2006/07 budget guidelines for the:

(i) the CSB budget (excluding growth items);
(ii) CSB growth items;
(iii) DDF items;
(iv) the use of surplus General Fund balances;
(v) the District Council tax for a Band 'D' property; and

(b) a revised Four year forecast for the period to 2009/10

1 Introduction

1.1 This report provides a framework for the Budget 2006/07 and updates Members on a number of financial issues that will affect this Authority in the short to medium term.

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

- Future Local Government Finance Settlements
- Ongoing difficulties with recruitment and retention
- Changes to the statutory concessionary fares scheme
- Capitalisation of pension deficit payments
- Residual costs following changes in Highways and Leisure
- Generation of future Capital Receipts
- Restriction on future Council Tax increases
- Changes to the waste service and higher recycling targets

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 will be expected to set out, for consultation purposes, the budgetary structure for 2006/07.

2 General Fund Out-turn 2004/05

2.1 Members have already received the outturn figures and the Statutory Statement of Accounts for 2004/05 together with explanations of the variances. In summary the General Fund Revenue Out-turn for 2004/05 shows that CSB expenditure was £1.175m lower than the original estimate, and £0.683 lower than the revised. The main variance related to staff savings arising from vacancies.

2.2 DDF expenditure was underspent by £0.491m. However £0.479m of this resulted from slippage so both expenditure and financing for this amount has been carried forward to 2005/06. Since the Revised Estimate an additional amount has been added to the DDF.

2.3 An authority unable to offset its commutation adjustment against its minimum revenue provision can apply for a capitalisation direction. As a debt free authority we no longer make a minimum revenue provision and so a capitalisation direction has been sought for the whole of the commutation adjustment, confirmation of the direction is still awaited from the ODPM. No decision has been taken on future years commutation adjustments and as the capitalisation direction is still subject to confirmation, it is appropraite to treat this £346,000 as a one off sum and put it into the DDF. The inclusion of the commutation adjustment and the large underspend mean the balance on the DDF has increased to £2.46m. Much of this amount is committed to finance the present programme of DDF expenditure.

2.4 The net underspend of £0.683m on CSB expenditure plus the underspend of £0.491m on DDF was offset by a variance on appropriations of £0.601m to produce an overall variance in the use of the General Fund Revenue balances equal to (0.683 + 0.491 - 0.601) £0.573m. This translates into an increase in balances of £1.026m compared to the revised estimate of an increase of £0.453m. The original estimate had indicated a reduction of £0.099m.

2.5 The difference on appropriations is partly a contra entry in respect of the DDF of £0.491m, with the remaining difference being due to the transfer of £0.110m from the HRA, following the change in funding of rent rebates. These changes combined equal (0.491 + 0.110) the difference on appropriations of £0.601m.

2.6 The carry forward of £0.479m plus the net underspend of £0.012m plus the HRA transfer of £0.110m produced an overall variance in the use of the DDF Revenue balances equal to (0.479+0.012 + 0.110) £0.601m. This translates into an increase in balances of £0.056m compared to the revised estimate of a decrease of £0.891m. The original estimate had indicated a reduction of £0.438m.

2.7 The above figures are shown in tabular form in Annex 1.

3. The Updated Four-Year Financial Forecast

3.1 Annexes 2(a/b) show the latest four-year forecast for the General Fund, which is based on adjusting the balances for the 2004/05 underspend, analysing information gained from the recent outturn figures and adjusting future years accordingly. Members are requested to note that no allowance has been made for net CSB growth/savings beyond 2006/07.The annex (2b) shows that all other things being equal revenue balances will decrease beyond 2006/07at the rate of just under £0.45m p.a. falling to just over £4.7m by 2009/10.

3.2 Members have previously agreed a number of policies to reduce the level of revenue balances in a planned and targeted way. Recently Members have aligned the balances to the Council's 'Net Budget Requirement' (NBR), allowing balances to fall to no lower than 25% of NBR.

3.3 The current balance of £5.488m represents just over 37% of the anticipated NBR for next year (£14.618m) and is therefore somewhat higher than the Council's current policy of 25%. However the out-turn in 2004/05 did benefit significantly from salary savings and additional investment income, which cannot be guaranteed in the future, and avoiding the need to finance a large proportion of DDF expenditure.

3.4 This improved financial position would allow some fine-tuning of the current forecast for the next four years. For example if Members wished to reduce balances to the current target level of £3.75m Council Tax increases of 2.75% p.a. would be permissible rather than the current 4% targeted increases. However this could only be achieved through creating deficit budgets, which would need to be addressed in future years.

3.5 Estimated DDF expenditure over the period to 2009/10 is likely to consume all remaining balances on that account leaving no further funding available beyond 2009/10.

3.6 Capital balances have been updated for recent outturn figures and updated assumptions on capital receipt generation, including the benefits arising from debt free status.

4 The Government Grant Allocation System (FSS)

4.1 It had been hoped that the Government would allow a period of stability in the grant allocation system without further major revisions. Unfortunately this hope has not been realised and a consultation document has been issued, with the consultation period running to 10 October. The document contains 37 questions and 49 options for changes to grant formulae. Not all of these questions and options are relevant to district councils, but there is considerable scope for items that impact on our grant to change.

4.2 One of the major proposals is for a new grant system that moves away from notional measures of spend (Formula Spending Share) and council tax (Assumed National Council Tax). Instead relative differences in needs and resources would be measured through indices. Grant would be split into a needs element, a resources element and a basic amount as well as a damping block. The basic amount would be the same, per head, for all authorities that provide the same services. Opinions expressed on the authorities side at the moment are against this proposal as it is likely to reduce transparency even further.

4.3 The Government has also announced its conclusions on three-year settlements, following an earlier consultation exercise. It is now proposed that the settlement to be announced later this year should cover the two remaining years of Spending Review 2004 (2006/07 and 2007/08). The next spending review will be in 2007, so as to align with the three-year settlement from 2008/09. This should provide greater certainty on funding and assist in providing better forward indications of council tax levels.

4.4 The main funding block for district councils is Environmental, Protective and Cultural Services (EPCS) and a number of changes are proposed to this block. Firstly, the “judgemental weights” are being revisited to reflect the need to spend additional money to be allocated to concessionary fares in order to finance free bus travel for people over 60 and the disabled, as announced in the 2005 budget. It is likely that the weights on density, pensioners on income support and incapacity benefit will be increased. Changes are also proposed to the elements for waste collection and flood defence. Finally in the EPCS block there is a proposal to up rate the fixed cost element from £300,000 to £325,000, in recognition of the cost increases since this element was introduced in 2003/04.

4.5 Other areas likely to change that will affect the amount of grant we receive are capital financing and the area cost adjustment. Formula spending shares include two negative blocks for interest receipts and interest on reserved capital receipts. The government has now recognized that these elements act as a disincentive to holding prudent balances and that the interest on reserved capital receipts element is outdated as it reflects the previous capital regime. The area cost adjustment exists to reflect the higher cost of providing services in some areas, and five options have been presented for amending it.

4.6 An area of particular significance that is commented on every year in this report is floor damping. The value of floor support remains significant at £412,000 for 2005/06, but has reduced from £562,000 in 2004/05. The Government are proposing to remove the adjustment for capital spending, as they believe there is no longer a justification for it. Alternative methods of calculating the minimum increase are outlined, alongside the alternative grant system. It is possible that the system could continue in the same manner, with a minimum increase being applied to the previous years total grant. However, other alternatives include basing the damping on the effect on Band D Council Tax or applying increases to only the basic amount of grant per head. Some comfort can be taken from the fact that there is no proposal to abolish floor support, although the changes outlined above do make it very difficult to predict the level of this support in the future. An added complication here is the additional funding for concessionary fares, mentioned in para 4.4 above. A report was made to Cabinet in April advising Members that unless allowance was made in the grant settlement for the impact of the change in concessionary fares on floor support then the value of the floor could be significantly reduced or even eliminated.

4.7 Looking further into the future additional uncertainties arise from the Lyons Review and Council Tax revaluation. The Government’s Balance of Funding Review produced very little in terms of outcomes. A further review is currently being conducted by Sir Michael Lyons, and a report is due before the end of 2005. The schemes under consideration still include reforming the Council Tax, returning National Non-Domestic Rates to local control and the introduction of a local income tax. The Council Tax revaluation will involve adjusting the council tax bands to reflect general movements in property values. Every home in England will be placed in a new band based on its value in 2005, with revised bills being issued in 2007.

4.8 As outlined above, there a number of different options to amend or indeed replace the current grant system. The existence of so many options makes it particularly difficult this year to predict the future level of grant funding. The four-year forecast agreed in February was based on a continuation of the system but on the basis that total government grant would increase by only 1% p.a. The element of risk associated with this assumption was in part mitigated by the fact that above inflationary increases in FSS would gradually reduce the Council’s reliance on the floor calculation as the figure reduced to zero over time. Unfortunately the prospect of an increase of less than 1% in FSS could increase the amount of RSG that arises from the floor calculation rather than normal entitlement thus increasing the amount of grant that could be at risk if ultimately the mechanism is withdrawn.

4.9 The proposed four year forecast continues to be based on a continuation of the system and on the basis that total government grant would increase by at least 1% p.a. The risk of continuing with this assumption should be noted.

5 CSB

5.1 The £0.683m saving on CSB against revised estimate in 2004/05 was something of a “freak” figure. In recent years the authority has suffered problems with the recruitment and retention of staff but in 2004/05 these problems were particularly severe. Actual salary spending for the authority in total, including agency costs, was some £18.3m compared against an original estimate of £19.4m. If the authority had been operating at full establishment there would have been growth in CSB, and this needs to be borne in mind when considering how the experience from 2004/05 can be built into our forecasts for the future. It is useful to take a longer term view and remember the context of the overall high growth in CSB in recent years:

Year	2000/01 Actual	2001/02 Actual	2002/03 Actual	2003/04 Actual
CSB	£11.947m	£12.575m	£13.258m	£13.692m
% Growth		5.25%	5.43%	3.27%

5.2 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 be at or below 4% for the near future, it is clear that the former will be the determinate. The four-year forecast, agreed in February, includes these assumptions.

5.3 The latest four-year forecast shows that the original budget for 2005/06 achieved that objective, with funding from Government grants and local Tax payers exceeding CSB by £124,000, the revised estimate for this year now shows the CSB total at £13.360m, with funding exceeding this amount by £924,000. This revision is primarily based on information from the recent out-turn figures for 2004/05. These figures allow for the fact that the Council continues to operate at less than full establishment. So whilst the revised estimate suggests that there is some scope for CSB net expenditure to be increased or tax increases to be reduced, care must be taken not to rely on savings that will disappear as the authority moves back towards a full establishment.

5.4 As previously stated the main reason for the recent revenue out-turn figures being lower than anticipated, was due to the high level of vacancies. Significant variances were noted on the out-turn for income shortfalls, £90k for Development Control Fees, £86k for Leisure and £76k for Local Land Charges. These were offset by additional investment income, which was more than £300k higher than the revised estimate. Further analysis needs to be undertaken on these income streams to determine the level of reliance that can be placed on these amounts in the long term. For investment income, this will include the amounts and timescale of capital receipt generation and usage, the split between revenue generating and non-revenue generating capital expenditure and the impact of high capital receipt retention on future government grant assessments.

5.5 Ongoing funding requirements for the pension fund are determined by triennial valuations. The results of the March 2004 triennial valuation require our annual deficit contribution to more than double from £823,000 in 2004/05 to £1,674,659 in 2005/06, with further smaller increases in 2006/07 and 2007/08. In anticipation of this increase £2.5 million was moved to a Pension Deficit Reserve in the Financial Statements for 2003/04. This was done in order to minimise the effect of these additional contributions on the Council Tax. In order to charge the additional contributions to this capital reserve a capitalisation direction was obtained from the Office of the Deputy Prime Minister for 2005/06. Capitalisation directions only last for one year and so it will be necessary to apply again for 2006/07 and 2007/08 and it is possible that a direction may not be obtained for either or both years. If this were the case it may be necessary to seek substantial savings elsewhere or significantly increase the Council Tax.

5.6 The tender process for the alternative management of the Leisure Facilities has now been concluded and it is anticipated that Sports and Leisure Management will be running the Council's sports centres from 1 November. This should reduce the financial uncertainty associated with the provision of a non-statutory service in a competitive market place. However, once the contract has settled down and monitoring arrangements have been put in place a review of costs retained in Leisure Services and support services will need to be undertaken.

5.7 Similarly, following the transfer back to Essex County Council of the highways agency, with effect from 1 April 2005, a review of costs retained in Environmental Services will need to be undertaken. Balancing against these changes are the new activities that government are requiring local authorities to undertake, notably in the areas of licensing, civil contingencies and high hedges. One certainty is that these additional responsibilities will not be adequately reflected in the grant settlement.

5.8 Another significant change to services has come with the introduction of wheelie bins for waste collection. This system will cost more in the short term but by allowing the Council to comply with directives on landfill should avoid penalties being incurred in the future. Although the introduction of the wheeled bin system has been re-affirmed by Members the role out is being done on a staged basis and so the increased costs will impact over more than one financial year. Other changes may also be needed in the future to attain ever more stringent targets for recycling.

5.9 Members are therefore reminded that further net growth in CSB should be restricted and that future growth must be financed from savings, sustainable investment income or carefully selected above-inflation increases in fees and charges. To this end it is important that Members set down early guidelines for CSB expenditure for future years so that the bidding process is a sensible and manageable exercise. The revised four-year plans show indicative figures.

6. DDF

6.1 The carry forward of £479k represents a significant improvement on the £1m of slippage for 2003/04. However, this reduction reflects more the efforts of finance officers to profile expenditure in correct periods than any more prompt implementation of projects. Given the limited funding available from the DDF, only high priority projects should be funded from it. 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. A separate report is being prepared for Members setting out amounts of funding which have been carried forward over several financial years.

6.2 Even though £456k was transferred into the DDF account last year it is expected that funds will be exhausted by the end of 2009/10. Clearly requests for DDF expenditure will continue but these cannot be supported if additional funds are not obtained. Although it is regrettable that these projects must come to an end, Members have always been aware that this must happen.

7. The Capital Programme

Housing Capital Receipts

7.1 The Council has enjoyed a steady stream of capital receipts from council house sales. This has underpinned the Council's significant capital programme over many years. It was inevitable that at some point these receipts would start to decline and capital receipts in 2004/05 were £1.3m lower than estimated. Gross receipts were £5.5m from the sale of 61 properties, compared against £11.35m from 139 sales in 2003/04.

7.2 Clearly as properties tend to become unaffordable the level of sales will reduce even further in future years. The capital forecast is based on 50 sales in 2005/06, with a reduction to 45 from 2007/08 onwards. Sales for the first quarter of 2005/06 are below expectations with only 11 completions. Unless there is a sudden reversal in this trend it will be necessary to make further downward revisions to the estimates for capital receipts in subsequent updates of the capital programme.

7.3 From 1 April 2004, section 11 of the Local Government Act 2003 provided the power for the Secretary of State to require all or part of a housing capital receipt to be pooled. Authorities that were debt free when pooling came into effect are eligible for transitional relief. This allows the retention of 75% of the receipts pooled in the first year, although the funding must be ring fenced for housing and the improvement of other HRA assets. In the second year the proportion falls to 50% and in the third year to 25% with the arrangements ceasing from 2007/08. In 2004/05 transitional relief allowed us to retain nearly £3.2m of receipts that would otherwise have been pooled.

7.4 A revised capital programme and four year forecast was approved by Cabinet on 11 July. The forecast programme included the adjustments mentioned above for reduced levels of receipts from council house sales.

Other Receipts

7.5 Receipts are also generated through the sale of other assets. Members will be aware that there are a number of sales at various stages of negotiation that have the potential to generate significant receipts in the near to medium future. The table below lists the anticipated sales and gives an indication of value and earliest practical completion.

7.6

Site	**Estimated Value**	**Earliest Completion**	**Comments**
Parade Ground Site	£10m	Autumn 2005	Section 106 being negotiated
T11 Site Langston Road		During 2007	
Langston Road Depot		During 2007	

7.7 In line with established policy, neither the capital receipt nor any income that may be generated from it, are included in the estimates prior to completion.

Expenditure

7.8 The capital outturn report considered by Cabinet on 11 July 2005 pointed out that the underspend of £1.7m was a considerable improvement on the £5.7m underspend in 2003/04. This underspend was mainly due to slippage but included some genuine savings. A final settlement for the Loughton Leisure Centre project is still to be agreed, although following mediation it is hoped this will be concluded in the near future.

8. The Council Tax

8.1 Band D Council Tax increases were 14% for 2003/04, 4% for 2004/05 and 3.9% for 2005/06. Members have indicated that further significant increases should be avoided. Indeed the Government has recently used its capping powers on authorities whose rises were unacceptable. Current 4-year forecasts are based on ongoing increases of 4% 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.

8.2 The Leader of Council has indicated that he would like to see a much lower increase in the level of Council Tax rises. The improved financial position of the Council creates the opportunity to do this but it also creates the opportunity to consider different mixes of Council Tax rises with other proposals including net expenditure increases. Clearly these could include increasing expenditure particularly in areas of real concern to the Council such as Recruitment and Retention and flagship services such as Waste Management and Street Cleansing. Increasing expenditure in some areas on full or partial self financing proposals could be considered to compliment a policy of lower council tax increases.

8.3 Members will be able to consider these issues and others in consultation with the overview and scrutiny finance panel over the next few months. However to aid the debate it maybe useful to consider the impact of a council tax rise of 3% per annum. There are other combinations but this is shown to serve merely as an example. It can be seen that the 3% per annum option will cost the authority £0.746m over the next four years. The table clearly demonstrates the accumulative effect small percentage changes can have.

9. A revised Four-Year Financial Forecast

9.1 Annexes 3(a/b) show the four-year forecast for the General Fund, based on adjusting the balances for the 2004/05 underspend. However, although this forecast sets the same targets for CSB expenditure, in contrast to the four-year forecast shown as 2(a/b) council tax increases are set at no more than 3% whilst revenue balances are allowed to fall to levels in accordance with the current policy. Agreement to this proposal would therefore set CSB expenditure for 2006/07 at £14.746m.

9.2 This proposal sets DDF expenditure at £340,000 in 2006/07 but does not allow for DDF expenditure beyond 2009/10. The £340,000 can be adjusted by making opposite increases/decreases with future year forecasts.

9.3 No other major capital receipts are being taken into account at this stage although some are anticipated in the near future from the sale of land in North Weald. If new funding is matched by additional expenditure the effect on the council’s financial position is broadly neutral.

10. Conclusion

10.1 The financial position is never as clear as we would like it to be for setting forward budgets with certainty. As outlined above, there are a number of particular issues at the moment where the outcomes are difficult to predict. The grant settlement will clearly influence our spending plans, but the major overhaul the system is currently undergoing creates uncertainty. The financial picture of the Council’s spending has also been clouded by the large, and ongoing, underspends on salaries. This creates a false picture of resources being available but the resources will disappear as the Council moves back towards a full establishment. So whilst the position remains sound, the temptation to make the most of an apparently improving situation should be resisted and the prudent approach which has served the Council well for many years should be maintained ensuring that whatever financing decisions are made in the future they remain sustainable.