Committee: **Finance Cabinet Committee** **Date:** **25 September 2006**

Report of: **Joint Chief Executive (Resources)** **Item No:**

Subject: **Budget 2007/08 – Financial Issues Paper**

Recommendations

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

(1) setting 2007/08 budget guidelines for the:

(a) the CSB budget (excluding growth items);
(b) CSB growth items;
(c) DDF items;
(d) the use of surplus General Fund balances;
(e) the District Council tax for a Band 'D' property;

(2) a revised Medium Term Financial Strategy for the period to 2009/10, and

(3) the communication of the revised Medium Term Financial Strategy to staff, partners and other stakeholders.

1 Introduction

1.1 This report provides a framework for the Budget 2007/08 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

- Changes to the waste service and higher recycling targets
- Capitalisation of pension deficit payments
- Customer Services Transformation Programme
- Changes to the statutory concessionary fares scheme
- Future Local Government Finance Settlements
- Restriction on future Council Tax increases
- Ongoing difficulties with recruitment and retention
- Generation of future Capital Receipts

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 2007/08.

2 General Fund Out-turn 2005/06

2.1 Members have already received the outturn figures and the Statutory Statement of Accounts for 2005/06 together with explanations of the variances. In summary the General Fund Revenue outturn for 2005/06 shows that CSB expenditure was £0.994m lower than the original estimate, and £0.639m lower than the revised. The main variance, as in 2004/05, related to staff savings arising from vacancies.

2.2 DDF expenditure was underspent by £0.710m. However £0.575m of this resulted from slippage so both expenditure and financing for this amount has been carried forward to 2006/07. Similarly to 2004/05, the opportunity has been taken to credit the commutation adjustment 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 theis Council no longer makes a minimum revenue provision and so a capitalisation direction has been sought for the commutation adjustment, confirmation of the direction has been received from the DCLG. The Council has discretion over whether capitalisation directions are sought for future years commutation adjustments, and a recommendation is included later in this report. It is appropriate in this instance to treat this £270,000 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 £3m. However, this amount is fully committed to finance the present programme of DDF expenditure.

2.4 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 £0.639m. This translates into an increase in balances of £0.968m compared to the revised estimate of an increase of £0.329m. The original estimate had indicated an increase of £29,000.

2.5 The carry forward of £0.575m plus the net underspend of £0.135m produced an overall variance in the use of the DDF Revenue balances equal to (0.575 + 0.135) £0.710m. When the £55,000 for the transfer from the HRA, following the change in the funding of rent rebates, is added in this translates into an increase in balances of £0.550m compared to the revised estimate of a decrease of £0.215m. The original estimate had indicated a reduction of £0.922m.

2.6 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 2005/06 underspend, analysing information gained from the recent outturn figures and adjusting future years accordingly. Members are requested to note that only items already approved by Council have been included in the forecast. The annex (2b) shows that all other things being equal revenue balances will decrease at the rate of just over £1.1m p.a. rising to just over £1.6m p.a. 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 predicted balance at 1 April 2007 of £5.328m represents just over 32% of the anticipated NBR for next year (£16.52m) and is therefore somewhat higher than the Council's current policy of 25%. However, the additional costs that are now likely to be incurred on the refuse and street cleansing contract mean that by 1 April 2009 the predicted balance will have reduced to £2.65m. This represents only 15% of the net budget requirement for 2009/10 (£17.45m).

3.4 This deterioration in the financial position indicates a need for savings to be identified or the Council Tax to be increased above current target levels during the next four years. For example if Members were prepared to change the level of Council Tax increases from 2.5% p.a. to 4% p.a., appendices 3a & b show that the predicted level of balances at 1 April 2009 becomes £2.99m. This would represent nearly 17% of the new net budget requirement for 2009/10 of £17.79m. The report will return to this issue.

3.5 Estimated DDF expenditure over the period to 2009/10 will consume all remaining balances and transfers from the general fund balance will be necessary to fund DDF items. The four-year forecast approved by Council on 21 February 2006 predicted a DDF balance of £1m at the end of 2009/10. However, DDF supplementary estimates of £995,000 have been approved to date in 2006/07 and the transfer in for the commutation adjustment is no longer being recommended for 2006/07 (£226k) and 2007/08 (£215k). This change is covered in more detail below in the paragraphs on the pension issue.

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

4.1 Annually the Finance and Performance Management Cabinet Committee receive a detailed report on the provisional Local Government Finance Settlement. After three settlements under the previous system a new system was introduced for 2006/07 to produce a two-year settlement, with the intention of providing three-year settlements in the future.

4.2 A “Four Block” system for formula grant has now been adopted which moves away from the notional spending and tax elements that were used in the previous system. This means the Assumed National Council Tax (ANCT) and Formula Spending Shares (FSS), are now redundant phrases.

4.2 The new system of formula grant comprises of four blocks:

- A **relative needs block,** worked out through relative needs formulae (RNF). RNFs are split into blocks covering Children’s Services, Adult Services, Police, Fire and Rescue, Highways, EPCS and Capital Financing. The formula for each service is based on a per client amount with top-ups to reflect local circumstances, including deprivation and area costs.

- A **relative resource amount,** to take account of different capacity to raise income from council tax. This is a negative amount.

- A **central allocation** amount, which is allocated on a per capita basis.

- A **floor damping block,** to ensure that all authorities receive a minimum grant increase.

4.3 The table below shows how these four blocks combine to give formula grant figures both nationally and for Epping Forest District Council.

	National Figures		EFDC Figures	
	2006/07 £m	**2007/08 £m**	**2006/07 £m**	**2007/08 £m**
Relative Needs Amount	14,816.65	15,336.75	5.728	5.742
Relative Resource Amount	-5,129.40	-5,309.46	-4.465	-4.724
Central Allocation	11,172.46	11,564.64	7.854	8.332
Police Grant	3,931.05	4,028.33	0.000	0.000
Floor Damping	0.00	0.00	-0.490	-0.189
Formula Grant	**24,790.76**	**25,620.26**	**8.627**	**9.161**

4.4 Besides the move from formula spending shares to relative needs formulae extensive changes have been made which are reflected in the RNFs. The EPCS block has been updated for the changes to concessionary fares, but this has been done by re-stating the 2005/06 settlement so as not to adversely impact on authorities receiving floor protection in 2005/06. A change that benefited this authority greatly was the discontinuation of the two negative sub-blocks for interest on reserved capital receipts and interest receipts. The exemplifications that accompanied the consultation on the system change showed the Council's FSS could increase by £1.653m due to these changes. Although as FSS no longer exists it is not possible to calculate the exact amount by which our grant has increased as a result of these changes.

4.5 This authority has received floor support for many years and in 2005/06 this was worth some £412,000 to the authority. This is a significant amount of funding and the continuation of floor support has been a major concern. As the authority has benefited from the formula changes it is now in a position of contributing to the floor to support others. The floor increase for shire districts for 2006/07 was set at 3% and 84 districts benefited from floor support. In order to finance the floor, authorities like this one who have had their grant increased by more than 3% are having the amount of grant increase above the floor that they can keep restricted. For 2006/07 we were only able to retain 49.1% of the increase above the floor. This improves in 2007/08 when we are able to retain 60.8% of the increase above the floor, which has been set as 2.7%.

4.6 As the government no longer provides assumed national council tax or formula-spending share figures direct comparisons with previous years are extremely difficult. The position on comparability is made worse by the changes in responsibility and the additional spending due to changes like concessionary fares. The government has attempted to provide an indication of relative changes by re-stating the 2005/06 figures on the new basis, see table below.

	Original 2005/06 £m	Adjusted 2005/06 £m	2006/07 £m	2007/08 £m
Formula Grant	7.299	7.918	8.627	9.161
Increase £	n/a	0.619	0.709	0.534
Increase %	n/a	8.48%	9.0%	6.2%

4.7 Whilst these increases for 2006/07 and 2007/08 were very welcome, a question mark now hangs over the next spending review in 2007. Looking into the future uncertainties arise from the Lyons Review and Council Tax revaluation. The review being conducted by Sir Michael Lyons, was originally due to report before the end of 2005. However, the terms of the review were widened and Sir Michael is still to issue his report. The schemes under consideration include reforming the Council Tax, returning National Non-Domestic Rates to local control and the introduction of a local income tax. A Council Tax revaluation is now less likely, as the plans to have this in place for 2007/08 now appear to have been shelved.

4.8 The outcome of the Lyons Review and the 2007 spending review will be of great significance, as they will form the basis for the three-year settlement from 2008/09. In announcing the current settlement the Government changed its position on the floors and ceilings system. Previously the Government's position had been that floors and ceilings were not sustainable in the long term, this has now changed so that floors and ceilings are seen as an integral part of the allocation system. This does provide a degree of comfort, as even if the next allocation system is not as favourable to the Council we should still receive a floor increase on top of the gains for 2006/07 and 2007/08.

4.9 As outlined above, there are a number of different options to amend or indeed replace the current grant system from 2008/09. The existence of so many options makes it difficult to predict the future level of grant funding. The four-year forecast agreed in February was on the basis that gross government grant would increase by 2% p.a. and that floor limitations would reduce, this produces net grant increases of 3.5% for 2008/09 and 2.5% for 2009/10. Given the comments on floor funding above, the risk of these assumptions is not felt to be excessive but Members should note that a risk exists.

5 CSB

5.1 The CSB saving against revised estimate was £0.639m, compared to £1.029m in 2004/05. The prime cause of this under spend was again salary savings, actual salary spending for the authority in total, including agency costs, was some £18.8m compared against an original estimate of £19.4m. Early indications are that there will again be an underpend on salaries in 2006/07, with spending at the end of June being 5% (£240k) below budget (although it must be remembered that approximately one third of this relates to the HRA).

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 the increase in the retail price index, assumed to be 2.5% 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 2006/07 achieved that objective, with funding from Government grants and local Tax payers exceeding CSB by £540k, the revised estimate for this year now shows the CSB total at £16.78m, which exceeds funding by £0.98m. This revision is primarily based on the increased level of costs for the waste management and street-cleansing contract. These figures show that there is a need for CSB net expenditure to be reduced or tax increases to be raised.

a) Waste Management and Street Sweeping

5.4 After South Herts. Waste Management went into administration supplementary estimates totalling £2.33m have been approved. These additional sums have been necessary to deal with the costs incurred during the administration, the higher level of charges from the interim contractor and enhancements to the service for weekly summertime collections. Members decided at Council on 25 July that any new contract must be tendered on the basis of either weekly collection or at least summertime weekly collection. Therefore, it is clear that when a new contract is let it will be at a far higher price. As part of the tender process a shadow bid will be prepared which will help inform the budgeting process, for the moment the forecast has been revised on the assumption that of the £2.33m additional spend £1.5m represents CSB growth.

5.5 The shadow bid prepared during the previous tender for the cleansing contract provided a good indication of the costs, as of the four bids received two were more expensive and two were cheaper. The SHWM annual figure of £2.78m was £0.25m cheaper than the shadow bid and £0.54m cheaper than the most expensive bid. At this point it is important to point out that these bids were based on a system of alternate weekly collection. To cover the intervening four years inflation needs to be added to these figures and then an additional amount included for at least weekly collection during the summer. Until an updated shadow bid has been obtained £1.5m is a reasonable figure to use for CSB growth, although there is a significant risk that the cost might ultimately prove greater than this.

b) Pension Fund Deficit Contributions and Capitalisation Directions

5.6 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 an application has been submitted for 2006/07, and one will subsequently be made for 2007/08. 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.

5.7 The risk of a direction not being granted has increased significantly following the issue of amended guidance from the Department for Communities and Local Government (DCLG) on 26 June. Concern has been raised by the DCLG that the increasing value of directions issued might threaten the Chancellor's "Golden Rule", as the rule is put under pressure where revenue expenditure is met from any source other than revenue income. This has led to the introduction of a "Two Gate" system, whereby applications must satisfy the previous criteria to clear gate 1 but applications will not pass gate 2 until the national economic impact has been considered in total. Confirmation has been received that the applications to capitalise the additional pension deficit payments for 2006/07 have cleared gate 1. The DCLG will not inform authorities if they have cleared gate 2 for 2006/07 applications until 31 January 2007.

5.8 It is clear that under these new guidelines if the DCLG believes the value of applications is excessive they will limit the directions they issue. For 2004/05 and 2005/06 capitalisation directions have been obtained for the commutation adjustment for £346,000 and £270,000 respectively. These directions have effectively enabled the Council to move these amounts from usable capital receipts into the DDF. Previous forecasts have assumed that this practice would continue and that applications would be sought for 2006/07 (£226k) and 2007/08 (£215k). Given the far greater importance of capitalising the additional pension deficit payments, it is proposed not to seek further directions for the commutation adjustments. The only impact of this is to reduce the funds available to the DDF, as mentioned above, as these funds will now remain in usable capital receipts.

c) Customer Services Transformation Programme

5.9 The revised four year forecast includes all supplementary estimates that have been approved by Council to date. There is one significant project that has been approved by Cabinet but is still to gain Council approval. That project is the Customer Services Transformation Programme (CSTP), which gained in principle support from Cabinet on 10 July. If the supplementary estimates outlined to Cabinet are approved then additional CSB growth of £249k and additional DDF spending of £1.03m will need to be included in the forecast. As the value of DDF projects already approved exceeds the funding available, any further DDF spending will reduce the general fund reserve. In view of the financial position outlined above, and illustrated in the appendices, careful consideration needs to be given to whether the CSTP should proceed at this time.

d) Concessionary Fares

5.10 From 1 April 2006 the statutory requirements for concessionary fares schemes were changed from providing half fare travel within the scheme boundaries to allowing free travel. Additional funding was included in the grant settlement for this change, although as the allocation system itself changed it is not possible to isolate this one factor and say precisely how much additional grant the Council has received to help pay for this change.

5.11 In compiling the estimates for the Essex wide scheme officers are assisted by data supplied by MCL, a specialist consultancy, who help administer the scheme. In formulating the estimates for 2006/07 it was necessary to make assumptions about the amount of increased pass take up and levels of re-imbursement payable to the bus operators. The increase in take up was estimated at 26%, to date growth of nearly 30% has been seen with passes in issue increasing from 6,500 to 8,300. This will have some impact on the cost of the scheme as one of the factors on which re-imbursement to the bus operators is based is the number of passes in issue. The governing principle of the re-imbursement calculation is that the bus operators should be neither better nor worse off for participating, they should only receive an amount equal to the revenue foregone by offering the concession. However, a number of operators are now disputing the basis of these calculations and appealing to the Department for Transport. If these appeals are successful the cost of the scheme may increase significantly. A meeting of authorities participating in the Essex scheme is being held on 13 September and it is hoped that a clearer picture will emerge of any additional costs in either 2006/07 or 2007/08.

5.12 A further complication with concessionary fares is that from 1 April 2008 free travel will be allowed on all local bus services and not just those operating within the scheme boundaries. In theory it will be possible for pass holders to travel free from Epping to Torquay or Newcastle using local bus services. The implications are particularly serious for authorities that are tourist destinations. Currently an Epping resident on holiday in Bournemouth would not be able to use their Essex pass to obtain free bus travel. However, under the scheme from 1 April 2008 a pass holder will be able to use their pass anywhere for local bus services. This means the nature of the passes and the system of re-imbursement will need to change. The passes will require some form of electronic chip that will need to be read by machinery installed on the bus to record the journey and the origin of the pass so that the issuing district can then be recharged. Such a scheme will inevitably be more costly, given the enhanced benefits available, and will also cost more to administer. The Governments proposals on exactly how the scheme will operate and be paid for are eagerly awaited. At the moment the financial forecast does not include any additional costs for either higher charges for the current scheme or the new scheme from 1 April 2008.

5.13 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 £575k represents an increase of nearly £100k on the £479k of slippage for 2004/05. However, Heads of Service are now required to explain slippage and have been warned that repeated slippage could see funding removed from schemes. 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.

6.2 The financial forecast shows that DDF spending will start to be financed from the general fund reserve during 2007/08, with £109k of support being needed. As DDF funds have been exhausted, further requests for DDF expenditure 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 would happen at some time.

6.3 One item that Members need to be made aware of here is the use of DDF to promote economic development within the District. Cabinet took an in principle decision on 19 December 2005 that some of the income from the Local Authority Business Growth Incentive Scheme would be used to promote economic development. However, no schemes have come forward and no amounts have been ring fenced so the forecast assumes this money is available to fund other DDF schemes. If Members wish to allocate a specific amount to economic development this will reduce the funding available for other schemes and mean that even more will have to be transferred from revenue balances to support the DDF.

7. The Capital Programme

Housing Capital Receipts

7.1 The Council suffered a drop in gross receipts to £5.5m in 2004/05 from £11.35m in 2003/04, and so set a prudent estimate for income from right to buy sales in 2005/06. The outturn for 2005/06 showed a higher number of sales than had been anticipated, 40 instead of 30, and higher sales values than expected were also achieved. This meant that £1.57m of transitional relief was available to fund the HRA capital programme, some £0.725m more than estimated.

7.2 In view of the 2005/06 outturn the level and value of sales for subsequent years has been re-assessed. The capital forecast is based on 35 sales in 2006/07, with a reduction to 30 from 2007/08 onwards. Sales for the first third of 2006/07 are in line with expectations with 12 completions, the same number as at this point for 2005/06. The number and value of sales will continue to be closely monitored and future capital programmes will be adjusted for any evident trends.

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%. 2006/07 is the final year of transitional relief and it is estimated that for 2006/07 the Council will be able to retain £722k of receipts that would otherwise have been pooled.

7.4 A revised capital programme and four year forecast was presented to Cabinet on 4 September. The forecast programme includes the adjustments mentioned above for revised levels of receipts from council house sales.

Other Receipts

7.5 Receipts are also generated through the sale of other assets, with the most recent example being the Parade Ground site at North Weald, which was disposed of early in 2006/07. Members will be aware that there are two potential sales at different stages of negotiation that may generate significant receipts in the medium term. The table below lists the anticipated sales and gives an indication of earliest practical completion.

Site	Earliest Completion	Comments
T11 Site Langston Road	During 2007	Currently on a short term let for parking
Langston Road Depot	During 2007	Still in use as a depot, some re-location of services necessary

7.6 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

7.7 The capital outturn report considered by Cabinet on 5 June 2006 pointed out that the underspend of £1.2m was a further improvement on the £1.7m underspend in 2004/05. This underspend was mainly due to slippage but included some genuine savings.

8. The Council Tax

8.1 Band D Council Tax increases were 4% for 2004/05, 3.9% for 2005/06 and 2.5% for 2006/07. Members have indicated that future increases should not exceed the rate of increase in the retail price index. 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.

8.2 The financial position that the Council now finds itself in is significantly different from previous years. Last year it appeared that low levels of increase in the Council Tax were sustainable throughout the four year forecast. However, the collapse of SHWM and new spending pressures in other areas mean that it is now necessary to reconsider the current policy.

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 council tax rises at 4% per annum. By comparing annexes 2 and 3 the increase in income that would arise from 4% increases instead of 2.5% increases can be seen over the next four years. There are other combinations but the ones shown serve merely as examples. It can be seen that the 4% per annum option will leave the authority with £710k more in revenue balances at the end of 2009/10 than the 2.5% option.

9. A revised Medium Term Financial Strategy

9.1 Annexes 3(a/b) show the four-year forecast for the General Fund, based on adjusting the balances for the 2005/06 underspend and known new spending pressures. 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 4% and revenue balances still fall to levels below the current policy. Agreement to this proposal would therefore set CSB expenditure for 2007/08 at £17.55m.

9.2 This proposal sets DDF expenditure at £481k in 2007/08 but this requires funding from the general fund reserve. Any new DDF schemes will require additional funding from the general fund reserve, as DDF funds will all have been consumed by the end of 2007/08.

9.3 No predicted capital receipts are being taken into account at this stage although the actual sale of land in North Weald has been allowed for. If new funding is matched by additional expenditure the effect on the council's financial position is broadly neutral.

9.4 One of the recommendations from the Audit Commission's Use of Resources Audit Score Feedback last year was that the Council should take steps to more pro-actively communicate the Medium term financial strategy with staff, partners and other stakeholders. If Members agree, appropriate steps can be taken to circulate either the full strategy or a summarised version.

10. Conclusion

10.1 The financial position is such that Members must now carefully prioritise the allocation of scarce resources. Any further growth bids will need to be rigorously considered and there is a clear need to reconsider the policy on Council Tax increases and to seek savings. With the general fund revenue balance just short of £6.5m there is no need for short-term panic measures. However, before the end of the current forecast period a thorough review of the entire authority will be needed to ensure that priority services are provided at a sustainable level. If such a review is not conducted and substantial savings are not identified then the authority will be in danger of having spent all of the revenue balances before the end of 2010/11.