Report to the Finance and Performance Management Cabinet Committee

Date of meeting: 24 September 2007.

Epping Forest District Council

Portfolio: **Finance, Performance Management and Corporate Support Services.**

Subject: **Budget 2008-09 – Financial Issues Paper.**

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Recommendations/Decisions Required:

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

(a) Setting 2008/09 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; and

(v) The District Council Tax for a Band 'D' property;

(b) A revised Medium Term Financial Strategy for the period to 2010/11, including the communication of the revised Medium Term Financial Strategy to staff, partners and other stakeholders; and

(c) The capitalising of additional pension fund deficit payments for the period 2009/10 to 2011/12.

Introduction:

1. This report provides a framework for the Budget 2008/09 and updates Members on a number of financial issues that will affect this Authority in the short to medium term.

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

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

3. 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 2008/09.

General Fund Out-turn 2006/07:

4. Members have already received the outturn figures and the Statutory Statement of Accounts for 2006/07 together with explanations of the variances. In summary the General Fund Revenue outturn for 2006/07 shows that CSB expenditure was £84,000 higher than the original estimate, and £807,000 lower than the revised. The main variance, as in 2005/06, related to staff savings arising from vacancies.

5. The revised CSB estimate for 2006/07 had increased from £15.253m to £16.144m, largely as a result of the former waste management contractor being placed in administration. However, close management of the interim contractor and the decision to purchase the refuse fleet meant that revenue costs were contained and a saving of nearly £200,000 achieved against the revised estimate.

6. DDF expenditure was underspent by £1.17m, compared to the original estimate. However £0.868m of this resulted from slippage so both expenditure and financing for this amount has been carried forward to 2007/08. Given the rationing by the Department for Communities and Local Government (DCLG) of capitalisation directions, it was decided not to seek a direction for the commutation adjustment in 2006/07 and consequently no credit to the DDF arose. In 2005/06 a credit to the DDF of £270,000 was achieved by capitalising the commutation adjustment.

7. The authority has benefitted substantially from the Local Authority Business Growth Incentives Scheme (LABGI), with grant of £0.803m exceeding the revised estimate by £0.303m. Following the settlement of a legal challenge by two other authorities notification has recently been received of an additional £41,000 of grant for 2006/07. The inclusion of the LABGI income and the large underspend mean the balance on the DDF has increased to £3.181m at 31 March 2007. However, more than half of this amount is committed to finance the present programme of DDF expenditure.

8. 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 overspend of £84,000, compared to the original estimate. This translates into an increase in balances of £0.305m compared to the revised estimate of a reduction of £0.502m. The original estimate had indicated an increase of £0.389m.

The Updated Four-Year Financial Forecast:

9. Appendices 1(a/b) show the latest four-year forecast for the General Fund. This is based on adjusting the balances for the 2006/07 underspends, the costs of the newly let waste management contract and adjusting future years accordingly. Members are requested to note that only items already approved by Council have been included in the forecast. The Appendix 1(b) shows that all other things being equal revenue balances will decrease at the rate of £0.718m p.a. rising to just under £1.2m p.a. by 2010/11.

10. 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 2008 of £6.408m represents just over 37% of the anticipated NBR for next year (£17.17m) and is therefore somewhat higher than the Council's current policy of 25%. However, the additional costs (compared to those of the previous contractor) that will be incurred on the refuse and street cleansing contract mean that by 1 April 2011 the predicted balance will have reduced to £3.891m. This represents less than 22% of the NBR for 2010/11 (£18m).

11. This financial position is better than had been anticipated at this time last year but still indicates a need for savings to be identified or the Council Tax to be increased above current

target levels during the next four years. If it is assumed that Members will want to adhere to the policy of not increasing Council Tax by more than the rate of increase in the Retail Prices Index then savings must be made in net expenditure.

12. Appendices 2(a/b) show a possible financial strategy with target levels of saving to be achieved over the four-year period. The target net savings proposed are £100k in 2007/08 followed by £200k in each of the following three years. These net savings could arise either from reductions in expenditure or increases in income.

13. The level of revenue balances at 1 April 2011 is predicted to be some £1.7m higher than shown in the first model at £5.609m. As this level of balances represents just over 31% of the NBR for 2010/11 (£18m) it can be seen that the savings realign the four-year forecast with the requirement that revenue balances should not fall below 25% of NBR. If Members feel that the levels of net savings being targeted are appropriate, it is proposed to communicate this strategy to staff and stakeholders.

14. Estimated DDF expenditure is the same in both models and it is anticipated that there will still be £1.3m of DDF funds available at 1 April 2011. The four-year forecast approved by Council on 20 February 2007 predicted a DDF balance of £0.81m at the end of 2010/11. However, additional LABGI income of £0.3m and DDF savings in 2006/07 of £0.4m have substantially increased that figure.

15. Capital balances have been updated for recent outturn figures and updated assumptions on capital receipt generation, including the recent sale of the T11 site. Similarly to the DDF, both models use the same assumptions for capital and predict a balance of £18.128m at 1 April 2011. Over this four-year period the capital programme has some £45.1m 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.

The Government Grant Allocation System :

16. The DCLG is currently conducting a consultation, which closes on 10 October, on possible changes to the grant allocation system from 1 April 2008. In the supporting papers for the consultation the DCLG have stated that they regard this as a fine tuning exercise and that wholesale changes to the system are unlikely. Given the closing date of the consultation and the time then needed to evaluate responses and make any adjustments it is unlikely that any figures will be received from the DCLG until December. When the figures are released it is hoped that they will cover a three-year period. The DCLG has previously stated their intention to move to three-year settlements to assist medium term forecasting. However, the last settlement was only for two years so as to align the next settlement with the Comprehensive Spending Review (CSR) period.

17. The two-year settlement mentioned above introduced a “Four Block” system for formula grant that moved away from the notional spending and tax elements that were used in the previous system. As it appears this system is to be retained the previous explanation of it is repeated below for ease of reference.

18. The system of formula grant currently 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.

19. As figures are not yet available for 2009/10 it has not been possible to update the table below showing how these four blocks combine to give formula grant figures both nationally and for Epping Forest District Council. Under the four-block model this authority changed from receiving floor support of £412,000 in 2005/06 to loosing £490,000 and £189,000 to support others in 2006/07 and 2007/08 respectively. 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% have had 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 improved in 2007/08 when we are able to retain 60.8% of the increase above the floor, which was set as 2.7%.

	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**

20. The DCLG consultation has 29 questions covering specific changes, although the document also invites respondents to propose new options. Some of the areas will not impact directly on the Council, for example social services, police and fire and rescue, but many will, for example capital finance, area cost adjustments and the tapering down of floor grants. The EPCS block will also be updated for the changes to concessionary fares. This change is described in detail later, but it is also necessary to consider the possible impact on the Council’s grant funding. Additional money is being put into the Revenue Support Grant system to pay for the enhanced travel scheme but the Government is still to decide on how this, and possibly existing funding, will be allocated. Some authorities have argued that the funding that was put into the system to pay for the change from a half fare scheme to a fare paid scheme was not distributed fairly and that the authorities that benefited most from the additional funding were not necessarily the authorities that experienced the greatest increase in concessionary fare costs.

21. To address the concerns about fairness the Government is considering ways to get a greater share of the funding to those authorities suffering the greatest increases in costs. This might involve some form of specific grant rather than distributing through the four-block mechanism, although this method has a number of other problems associated with it. In trying to construct a specific grant formula there is no guarantee that in the first year the allocation will be any fairer as it will be necessary to create a new model to predict where the greatest burdens of the new scheme will fall. If money already in the system is withdrawn and also allocated by specific grant some authorities could experience large swings in their grant allocations. As an authority that has done relatively well under the current system, we would be likely to suffer from a specific grant system, particularly if funding already in the system is to be re-allocated by such a mechanism.

22. There is also concern about the effect that the CSR and the next stage of the efficiency agenda will have on the levels of grant. The Government has already made it clear that it is trying to restrict growth in public spending and so the settlement for district councils from this CSR is unlikely to be generous. Grant may also be reduced as part of the efficiency agenda. So far authorities have been able to keep any efficiencies they achieve for re-investing in priority services and have been able to claim both cashable and non-cashable

efficiencies. The Government appears intent on sharing the benefit of efficiencies generated by increasing the target level from 2.5% of annual expenditure to 3%, making this amount fully cashable and reducing grant by this amount. The Local Government Association has lobbied against this but the effectiveness of their campaign will only be clear when the grant settlement is announced.

23. As outlined above, there are a number of different options to amend the current grant system from 2008/09. The existence of these 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.

CSB:

24. The CSB saving against revised estimate was £0.807m, compared to £0.639m in 2005/06. The prime cause of this under spend was again salary savings, actual salary spending for the authority in total, including agency costs, was some £17.9m compared against an original estimate of £18.7m. Early indications are that the underspend on salaries in 2007/08 is reducing, with spending at the end of July being 2.3% (£145K) below an adjusted estimate (although it must be remembered that approximately one third of this relates to the HRA). However, an additional complicating factor this year is that the pay award is still not agreed. The original estimates were calculated allowing for an increase of 2.65%, which is below the employers current offer of 2.5%.

25. 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.

26. The latest four-year forecast (Appendices 1(a/b)) show that the original budget for 2007/08 failed to achieve that objective, with funding from Government grants and local Tax payers falling short of CSB by £0.321m. The revised estimate for this year now shows the CSB total at £17.012m, which exceeds funding by £0.353m. This revision includes the CSB growth already approved for the parking contract and assumes that the CSB reduction from the new waste management and street-cleansing contract will benefit the authority in 2008/09. These figures show that there is a need for CSB net expenditure to be reduced or tax increases to be raised, as discussed in paragraph (11) above.

Internal and External Restructuring:

27. The Council is still undergoing a major internal restructuring. At the top of the organisation a single Chief Executive and his deputy are now in post and proposals are being consulted on to assimilate some Heads of Service to new Service Director posts. This new structure reduces the top management from twelve (two joint chief executives and ten heads of service) to eight (chief executive, deputy, assistant and five service directors). It will take some time for the Service Directors to establish any additional costs that may be necessary to ensure adequate organisational capacity and any savings that may arise through the merging of sections/functions now duplicated in the new structure. Some DDF expenditure may also be necessary on accommodation and equipment to make sure that each business unit is appropriately located and resourced. Given this level of complexity and uncertainty the financial forecasts currently assume that once the internal restructuring has been completed it will be cost neutral.

28. External restructuring is used here to cover the possibilities of services either being out sourced or provided jointly with another local authority. The Government has placed much emphasis on "Shared Services" as a way of generating efficiencies and there already appear to be a number of different models of closer working emerging across the county. Private sector partners already provide the Council's waste, parking and leisure management services. Once the internal restructuring has settled down the Council will have to give serious consideration to its future direction and the nature of service provision that is to be pursued. No assumptions have been built into the four-year forecast for changes to service provision and any associated higher or lower costs.

Concessionary Fares:

29. 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 mentioned above some authorities have disputed the fairness of the allocation. The bus operators have also been unhappy with their payments under the new system. 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 disputing the basis of these calculations and appealing to the Department for Transport. Several of these appeals have been successful for 2006/07 and are now continuing in 2007/08 and may increase the costs to local authorities significantly.

30. 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. 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. It has now become clear that the district in which the journey commences will be charged, rather than the district that issued the pass. The implications are particularly serious for authorities that are tourist destinations. Such a scheme will inevitably be more costly, given the enhanced benefits available, and will also cost more to administer. The Government's 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.

Pension Fund Deficit Contributions and Capitalisation Directions:

31. Ongoing funding requirements for the pension fund are determined by triennial valuations. The results of the March 2004 triennial valuation required 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 a fresh application was submitted for 2006/07. However for 2006/07 DCLG introduced a two gate system for rationing capital directions, and although gate one clearance was achieved for the whole amount only 57% ultimately received gate two approval. The DCLG have advised that they have seen a reduction in the overall level of applications for 2007/08 and so the forecast assumes that a direction will again be obtained for the full amount. It is possible that a direction may not be obtained or like 2006/07 may only cover part of the amount requested. If this were the case it may be necessary to seek substantial savings elsewhere or significantly increase the Council Tax.

32. The outcome of the latest triennial valuation, as at 31 March 2007, is still awaited. Some preliminary information has been released by Essex County Council which shows that the percentage of the schemes liabilities covered by its assets has increased from 71% at the 31 March 2004 valuation to 85% at the current valuation date. Although this will not necessarily lead to a reduction in deficit payments as these are based on actuarial assumptions of future trends as well as the funds current position. A key factor here is longevity and the assumptions used in 2004 underestimated average future life expectancy by four years. There have also been a number of changes to the Local Government Pension Scheme, including changes to ill health retirement terms and the introduction of variable contribution rates which the actuary will have to evaluate before concluding on the deficit payments required.

33. The original decision to capitalise pension deficit payments was based on a desire to keep Council Tax as low as possible and help safeguard revenue reserves through the use of capital. Even though the exact amount of these payments is still to be determined it is proposed that the policy of capitalisation is continued and that in order to facilitate this £2.5m of usable capital receipts are moved to the Pension Deficit Reserve.

Customer Services Transformation Programme:

34. On 9 October 2006 Cabinet decided to defer the Customer Services Transformation Programme (CSTP). No CSB or DDF amounts have been programmed for this initiative but some £2.2m of expenditure is still included in the capital programme. Given the uncertainty over the timing and nature of any CSTP £0.5m has been left in the programme for 2008/09 with the balance of £1.7m being shown in 2009/10. It may only be when a clear picture emerges of the final outcomes from the internal and external restructurings mentioned above that it will be possible to set out an updated vision for a CSTP.

35. 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, firstly without net savings and then with suggested levels of target savings.

DDF:

36. The carry forward of £868k represents an increase of over £100k on the £575k of slippage for 2005/06. However, Heads of Service are now required to explain slippage and have been warned that repeated slippage could see funding removed from schemes. 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.

37. The financial forecast shows that not all DDF funding is currently allocated to schemes. It is currently anticipated that there will be some £1.3m of DDF available at 1 April 2011. Although it is likely that the costs of the restructurings mentioned above will have an impact on this figure.

38. An item that Members need to be reminded 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, the only scheme to have come forward is a relatively small one in Waltham Abbey and no other 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.

The Capital Programme:

Housing Capital Receipts:

39. Following a series of reductions in the level of Council house sales from 139 in 2003/04 to 61 in 2004/05 and 40 in 2005/06 the forecast for 2006/07 was set at 35. However, the recent trend of falling sales was reversed with a total of 46 sales completed in the year. This meant that £0.987m of transitional relief was available to fund the HRA capital programme, some £0.265m more than estimated.

40. In view of the 2006/07 outturn the level and value of sales for subsequent years has been re-assessed. The capital forecast was based on 30 sales in 2007/08, but that has now been increased to 32 with a reduction to 30 from 2008/09 onwards. Sales for the first third of 2007/08 are in line with expectations with 9 completions, three less than at this point for 2006/07. The number and value of sales will continue to be closely monitored and future capital programmes will be adjusted for any evident trends.

41. A revised capital programme and four year forecast are being presented to Cabinet on 8 October. The forecast programme includes the adjustments mentioned above for revised levels of receipts from council house sales.

Other Receipts:

42. Receipts are also generated through the sale of other assets, with the most recent example being the T11 site at Langston Road, which was disposed of early in 2007/08. Members will be aware that there are other sites under consideration for disposal and that they may generate significant receipts in the medium term. In line with established policy, neither the capital receipts nor any income that may be generated from them, are included in the estimates prior to completion.

Expenditure:

43. The capital outturn report considered by the Finance and Performance Management Cabinet Committee on 18 June 2007 highlighted that the underspend of £5.1m was significantly higher than the £1.2m underspend in 2005/06. This underspend arose from slippage in both non-housing and housing programmes. The non-housing programme was underspent by £1.1m, with the largest items being £271K on parking and traffic schemes and £186K on town centre enhancements. The general fund housing programme was underspent by £1.9m, with the largest items being £1m on affordable housing and £378K on a compulsory purchase order. The HRA programme was £2.2m underspent, with the largest items being planned maintenance at £833K and structural schemes at £505K.

The Council Tax:

44. Band D Council Tax increases were 3.9% for 2005/06, 2.5% for 2006/07 and 3.5% for 2007/08. 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.

45. The financial position that the Council now finds itself in is significantly different from last year. A prudent view was taken on the additional costs following the collapse of SHWM and new spending pressures in other areas. These factors combined meant that the medium term forecast presented in the previous financial issues paper showed revenue reserves falling to little more than £1m by 1 April 2010. With the better than anticipated outturn for 2006/07 and the success of the tendering exercise for the waste management contract these concerns have been partially allayed. Even the four-year forecast at Appendices 1(a/b) that does not include target savings has revenue reserves of nearly £3.9m at 1 April 2011.

46. Given the improved financial position it was felt that Members would be keen to keep the target for Council Tax increases in line with increases in the Retail Prices Index. 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 overview and scrutiny finance panel over the next few months. Accelerating the increases in Council Tax is an alternative that can be kept under consideration if the target savings suggested prove difficult to find.

A revised Medium Term Financial Strategy:

47. Appendices 2(a/b) show a four-year forecast with target levels of savings to bring the projections back in line with the policy of keeping reserves above 25% of the NBR. The net savings included are £100k in the revised 2007/08 figures and then £200k in the three subsequent years. These savings would give total CSB figures for 2007/08 revised of £16.912m and 2008/09 of £17.314m.

48. This proposal sets DDF expenditure at £2m for the revised 2007/08 and £186k for 2008/09, and although the possibility of other costs arising has been touched on above, it is unlikely that the DDF will be used up in the medium term.

49. No predicted capital receipts are being taken into account at this stage although the actual sale of land at T11 has been allowed for. If new funding is matched by additional expenditure the effect on the council's financial position is broadly neutral.

50. The Council has previously scored a 3 for Financial Management as part of the Audit Commission's Use of Resources assessment. To maintain that score the Council must take steps to more pro-actively communicate the Medium Term Financial Strategy with staff, partners and other stakeholders. This Key Line of Enquiry has become mandatory to achieve a 3 in the current assessment. If Members agree, appropriate steps can be taken to circulate either the full strategy or a summarised version.

Conclusion:

51. 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 seek savings. With the general fund revenue balance just short of £6.8m there is no need for short-term panic measures. However, before the end of the current forecast period the restructuring of the authority must be completed to ensure that priority services are provided at a sustainable level. If such a review is not conducted and the target savings are not identified then the authority will breach its target for reserves and be in the dangerous position of having increasing deficit budgets.