

Committee: Finance & Administration

Date: 12 October 2009

Title: Medium Term Financial Strategy Review

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Agenda Item

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Item for
decision

Summary

- 1 The Council approved the present Medium Term Financial Strategy (MTFS) "Sustain and Build" in February. The MTFS forecasted a progressively worsening in-year budget deficit culminating in an savings target of £1.3m in the year 2013/14.
- 2 The assumptions underpinning the MTFS have been reviewed to take account of changing circumstances. The net effect of the review is that the forecasted budget requirement has reduced, however, expected cuts in government funding, on which there is material uncertainty, mean that the big picture is largely unchanged.
- 3 Assuming a 10% cut in government funding, which is felt to be the most likely scenario, the savings target in 2013/14 is now assessed to be £1.25m.
- 4 The savings target could vary between £0.9m and £1.9m depending on the different scenarios regarding government funding. Clarity on this point is not expected until after the General Election, and probably not until late 2010.
- 5 The Strategic Management Board has identified a range of possible strategic solutions, grouped within five workstreams, to meet the savings targets. These suggestions shall form part of the reports going to Full Council on 20 October.

Recommendations

- 6 The Committee is recommended to note and approve the revised financial forecasts as set out in this report.

Background Papers

[Sustain and Build](#) – Medium Term Financial Strategy approved February 2009

Impact

Communication/Consultation	None
Community Safety	None
Equalities	None
Finance	Detailed in the report.
Human Rights	None
Legal implications	None
Sustainability	The Medium Term Financial Strategy is designed to ensure stability and sustainability of the Council and its budget decisions.
Ward-specific impacts	None
Workforce/Workplace	None

Review of Assumptions

- 7 The key assumptions underpinning the 5 year forecast in the MTFS have been reviewed. The key changes are set out below.

Changes that improve the forecasted budget requirement

- 8 **Staff pay award.** The previous MTFS assumed an annual staff pay award of 2.5%. The 2009/10 award has been settled at 1% and there is every indication that public sector pay restraint will continue for the foreseeable future. The revised MTFS model assumes an annual pay award of 1%.
- 9 **Pension Fund Deficit Contribution.** In December 2008, Essex Pension Fund was indicating that increases in pension fund deficit contributions equivalent to 7% of salary would be required from 2011/12. In August, this indication was revised to 1.3% of salary in 2011/12, 2.6% in 2012/13 and 3.9% in 2013/14. This reflects an improved outlook with regard to investment values and the likelihood of the actuary determining a longer deficit recovery period, in order to keep deficit contributions more affordable by employers.

- 10 **Investment Income.** The previous MTFS assumed that investment income would remain at 2009/10 estimated levels during the period of the forecast. Recent estimates by the Council's independent treasury management advisers, Arlingclose, suggest that the Base Rate will begin to increase in late 2010/early 2011 and continue to increase steadily. The revised MTFS therefore includes increases in investment income commensurate with the predicted interest rate rises.
- 11 **Borrowing Costs.** The Dunmow offices sale has boosted the level of capital receipts available to fund capital expenditure and as a result the amount of borrowing forecasted to be necessary has reduced.

Changes that worsen the forecasted budget requirement

- 12 **Benefits.** A reassessment of benefits expenditure and government subsidy has been carried out in the wake of increased caseload. It has been identified that previous estimates about government subsidy were optimistic and in some cases greater than the level of forecasted expenditure. The revised MTFS assumes that 99% of benefits expenditure will be funded by subsidy, which is achievable if the service performs well, improves accuracy and minimises error.
- 13 **Fees & charges income.** The previous MTFS assumed an average inflationary increase of 2% for most sources of fees & charges income. There is now evidence of pressure on some sources of income suggesting that to assume an average increase is no longer appropriate. The revised model assumes an average increase of 0%. This does not mean that fees & charges will not be increased: it assumes that such increases are likely to be offset by a reduction in activity or demand and/or an increase in bad debts. Fees & charges will be subject to review and adjustment in the normal way.
- 14 There is a specific risk to land charges income due to recent Information Commission Office's guidance that councils should treat property search data as environmental information and allow property search companies to inspect it free of charge. The LGA's guidance is that the ICO guidance is non-statutory and that the existing legislative framework is unchanged. Counsel opinion is being sort and legal challenges are likely. Meanwhile, the revised MTFS has made no adjustment to take account of this risk, although has assumed reductions in land charges income to reflect recessionary pressures generally. The forecast level of income in 2009/10 is £160,000, reducing to £100,000 by 2013/14.

Revised Forecast Budget

- 15 The following table shows the revised forecast budget which takes into account the adjustments referred to above.

£m	2010/11	2011/12	2012/13	2013/14
Service expenditure	33.495	35.217	37.104	39.177
Service income	-23.515	-24.958	-26.575	-28.397
Net service expenditure	9.981	10.259	10.529	10.780
Capital financing costs	0.329	0.341	0.360	0.357
Investment income	-0.080	-0.204	-0.356	-0.408
Transfer to HRA	-1.137	-1.137	-1.137	-1.137
Pension Fund Deficit Contribution	0.370	0.463	0.558	0.654
Pension Fund Added Years Contribution	0.095	0.095	0.095	0.095
Working Balance Top Up	0.073	0.068	0.075	0.081
Forecast budget	9.631	9.886	10.124	10.423
Previous MTFS	9.492	10.468	10.911	11.391
Worsening / improvement (-)	0.139	-0.582	-0.787	-0.968
<u>Reasons for change:</u>				
Reduction in pension deficit assumption	-0.050	-0.483	-0.407	-0.330
Revised investment income forecast	0.026	-0.099	-0.251	-0.302
Reduction in borrowing costs assumption	-0.103	-0.100	-0.076	-0.074
Reduction in pay award assumption	-0.215	-0.442	-0.686	-0.947
Reduction in Working Balance Top Up	-0.018	-0.060	-0.058	-0.071
Modified assumptions regarding benefits	0.461	0.518	0.584	0.658
Modified inflation assumptions	0.039	0.084	0.107	0.097
Total revisions	0.139	-0.582	-0.787	-0.968

Funding Available

- 16 It is now necessary to review assumptions about funding available to support the forecast budget, in the form of Council Tax and central government funding via the Local Government Finance Settlement.
- 17 As will be seen, reductions in funding are expected which puts additional pressure on the financial model and effectively negates the improved forecasts detailed above.

Council Tax

- 18 The previous MTFS assumed an annual increase of 4.9%. Based on informal discussions with the Administration, the assumed increase has been revised to 3.9% for 2010/11 and 2.5% per year thereafter.
- 19 A taxbase increase of 0.5% per year has been assumed in the revised MTFS, compared with 1% in the previous version.

Local Government Finance Settlement

- 20 There is widespread consensus that cuts in public sector expenditure are likely in the next Comprehensive Spending Review, which will cover the period 2011/12 to 2013/14. Local government is expected to suffer a reduction in government funding.
- 21 It is not possible accurately estimate what level of funding will be made available. Depending on which public services are considered to be highest priority by the Government, different types of Council may experience different levels of reduction.
- 22 Informal feedback from other local authorities suggests that anything from a freeze on government funding up to a 30% cut is being assumed. The Institute of Fiscal Studies has reported that leaked Treasury Papers imply that the average reduction in public sector expenditure will be 8.6% over 3 years.
- 23 Until better information becomes available, the revised MTFS will make a planning assumption that the Local Government Financial Settlement for this Council will be reduced by 10% during 2011/12 to 2013/14.

Budget Equalization Reserve

- 24 As a result of the one-off VAT refund in 2009/10, which the Finance & Administration Committee decided to allocate to the Budget Equalization Reserve, the balance available to support the Council's financial stability is greater than assumed in the previous MTFS.
- 25 The total Budget Equalization Reserve available during 2010/11 to 2013/14 is £1.423m. Use of this can be phased in many different ways. A phasing has been chosen which allows a stepped progress towards the 2013/14 savings target to be made that is manageable.
- 26 The Council currently has £993,000 allocated to the Landsbanki Contingency Fund. If the settlement is favourable, some of this money could be reallocated to the Budget Equalization Reserve, allowing some pressure to be taken off the model in the short to medium term.
- 27 Notwithstanding the above, use of reserves to balance the budget is not sustainable in the longer term and the Council must take steps to bring its annual costs in line with the in-year funding available.

Summary model

28 Below is a summary table that pulls together the revised forecast budget model and assumptions about funding available. It shows that the big picture has slightly eased but substantially unchanged in that significant reductions in the Council's annual running costs are needed. The annual savings target progressively increases to a figure of £1.25m in 2013/14.

£m	2010/11	2011/12	2012/13	2013/14
Forecast budget	9.631	9.886	10.124	10.423
Use of Budget Equalization Reserve	-0.403	-0.488	-0.352	-0.179
Net Budget Requirement	9.228	9.398	9.772	10.244
<u>Funding available</u>				
Local Government Finance Settlement	4.106	3.969	3.832	3.696
Council Tax	4.843	4.989	5.139	5.294
Collection Fund Balance	0.078	0.039	0.000	0.000
Total Funding available	9.028	8.998	8.972	8.990
Savings Target	0.200	0.400	0.800	1.254
Savings Target in previous MTFS	0.250	0.500	1.000	1.307

29 The table shows that the structural deficit going into 2014/15, equivalent to the sum of the 2013/14 savings target and the 2013/14 use of the Budget Equalization Reserve, is approx £1.4m.

30 Appendix A is an illustration of different scenarios relating to the Local Government Finance Settlement. Four scenarios have been modelled based upon a freeze, and reductions of 10%, 20%, 30%. The four scenarios give a 2013/14 savings target that ranges from £0.9m to £1.9m with a structural deficit going into 2014/15 ranging from £1m to £2.2m.

31 Savings targets at the higher end of that range would in all probability be virtually impossible to achieve without disabling the Council. The Government would realise this and that is why a reduction in the region of 10% is felt to be the most likely scenario.

32 Full Council on 20 October will receive suggestions from the Strategic Management Board on possible Strategic Solutions and areas to examine to meet the forecasted savings target requirement.

Risk Analysis

Risk	Likelihood	Impact	Mitigating actions
Changes in circumstances and/or new information becomes available that affects the assumptions in the MTFS	3 (inherent risk of variability in any budget model which increases the further into the future that forecasts relate to)	3 (sums involved are potentially significant)	<p>Keep MTFS under constant review within minimum twice yearly formal update</p> <p>Keep abreast of developments in local government finance</p> <p>Implement Strategic Solutions savings programme</p>
The Landsbanki settlement may require a reallocation of reserves and adjustment to forecasts	4 (near certain that the Landsbanki settlement will require a level of adjustment different to that provided for)	3 (sums involved a potentially significant but the Landsbanki Contingency Fund is currently equivalent to 42% of the sum at risk, which ought to be sufficient)	<p>Keep Landsbanki situation under review</p> <p>Lobby for central government funding and/or capitalisation support</p>

1 = Little or no risk or impact

2 = Some risk or impact – action may be necessary.

3 = Significant risk or impact – action required

4 = Near certainty of risk occurring, catastrophic effect or failure of project.

ALTERNATIVE SCENARIOS – LOCAL GOVERNMENT FINANCE SETTLEMENT

SCENARIO A: FREEZE IN LOCAL GOVERNMENT FINANCE SETTLEMENT				
£m	2010/11	2011/12	2012/13	2013/14
Forecast budget	9.631	9.886	10.124	10.423
<u>Resources available</u>				
Local Government Finance Settlement	4.106	4.106	4.106	4.106
Council Tax	4.843	4.989	5.139	5.294
Collection Fund Balance	0.078	0.039	0	0
Total resources available	<u>9.028</u>	<u>9.135</u>	<u>9.246</u>	<u>9.400</u>
Budget deficit	0.603	0.751	0.879	1.023
Withdrawal from Budget Equalization Reserve	-0.503	-0.451	-0.379	-0.090
Savings Target	0.100	0.300	0.500	0.933
SCENARIO B: 10% CUT IN LOCAL GOVERNMENT FINANCE SETTLEMENT OVER 3 YEARS				
£m	2010/11	2011/12	2012/13	2013/14
Forecast budget	9.631	9.886	10.124	10.423
<u>Resources available</u>				
Local Government Finance Settlement	4.106	3.969	3.832	3.696
Council Tax	4.843	4.989	5.139	5.294
Collection Fund Balance	0.078	0.039	0	0
Total resources available	<u>9.028</u>	<u>8.998</u>	<u>8.972</u>	<u>8.990</u>
Budget deficit	0.603	0.888	1.152	1.433
Withdrawal from Budget Equalization Reserve	-0.403	-0.488	-0.352	-0.179
Savings Target	0.200	0.400	0.800	1.254

Continues....

APPENDIX A (continued)

ALTERNATIVE SCENARIOS – LOCAL GOVERNMENT FINANCE SETTLEMENT

SCENARIO C: 20% CUT IN LOCAL GOVERNMENT FINANCE SETTLEMENT OVER 3 YEARS				
£m	2010/11	2011/12	2012/13	2013/14
Forecast budget	9.631	9.886	10.124	10.423
<u>Resources available</u>				
Local Government Finance Settlement	4.106	3.832	3.559	3.285
Council Tax	4.843	4.989	5.139	5.294
Collection Fund Balance	0.078	0.039	0	0
Total resources available	9.028	8.861	8.698	8.579
Budget deficit	0.603	1.025	1.426	1.844
Withdrawal from Budget Equalization Reserve	-0.353	-0.425	-0.326	-0.318
Savings Target	0.250	0.600	1.100	1.526
SCENARIO D: 30% CUT IN LOCAL GOVERNMENT FINANCE SETTLEMENT OVER 3 YEARS				
£m	2010/11	2011/12	2012/13	2013/14
Forecast budget	9.631	9.886	10.124	10.423
<u>Resources available</u>				
Local Government Finance Settlement	4.106	3.696	3.285	2.874
Council Tax	4.843	4.989	5.139	5.294
Collection Fund Balance	0.078	0.039	0	0
Total resources available	9.028	8.724	8.424	8.169
Budget deficit	0.603	1.162	1.700	2.254
Withdrawal from Budget Equalization Reserve	-0.303	-0.362	-0.400	-0.358
Savings Target	0.300	0.800	1.300	1.897