HEREFORDSHIRE COUNCIL

DRAFT FINANCIAL STRATEGY 2009-2012

PORTFOLIO RESPONSIBILITY: RESOURCES

CABINET **19 FEBRUARY 2009**

Wards Affected

County-wide.

Purpose

To propose the draft financial strategy for 2009-2012.

Key Decision

This is a Key Decision because it is likely to result in the Council incurring expenditure above agreed budgets for the service or function (shown as a line in the budget book) to which the decision relates but allowing for virements between budget heads and savings within budget heads of up to £500,000 and it is likely to be significant in terms of its effect on communities living or working in Herefordshire in an area comprising one or more wards.

It was included in the Forward Plan.

Financial implications are as outlined the draft Medium Term Financial Management Strategy 2009-2012 appended to this report.

Recommendation(s)

THAT Cabinet recommends to Council the recommendations for updating the current Medium Term Financial Management Strategy and resource model highlighted in the report.

Reasons

2. The current financial strategy set the financial framework for 2008-2011. The strategy now needs to be updated to allow the latest view of financial risks and pressures revealed by the corporate and service planning process.

Considerations

3. Since 2006, the council has operated within the discipline of a Medium-Term Financial Management Strategy (MTFMS). The MTFMS is the framework within which cash resources follow corporate priorities. The MTFMS is attached at Appendix B.

4. The MTFMS also allows longer term financial planning to reflect the various changes that emerge from central government. Local government is an important partner for

central government, as it often uses local government to deliver new services as well as changes to existing services.

5. The overall approach to financial management, especially at a time of financial pressure, must be supported by clarity and transparency around financial policy and resources. The necessary financial discipline includes cash limited budgets, supported by appropriate reserves that need to be managed as part of the overall financial management strategy.

6. The overall level of central government funding for local government has relative stability as a result of Comprehensive Spending Review 2007 (CSR07). The overall increase in Formula Grant for Herefordshire, based on a year-on-year increase, is 4% and this must fund all inflation, service development and increased demand across the council. The efficiency agenda is ongoing, with 3% cashable efficiency savings needed in 2009/10.

7. The latest MTFMS now includes financial year 2011/12. This means that we are already estimating the likely impact of the next Comprehensive Spending Review, due to be announced in 2010. The current economic position is such that the council's new MTFMS assumes nil growth in funding for Herefordshire from 2011.

8. During the Autumn of 2008, the council and PCT jointly commissioned a survey of a representative sample of households across the county to gauge the population's views on the balance we should strike between different priorities and between those and the level of council tax. This was supplemented with workshops for older people in a rural area, disabled people and carers and teenagers. The results for council-led services showed a close correlation between the public's choices and the council's top priorities. The results of the consultation will be considered as part of future planning, along with the findings of the new national Place Survey done in March, 2009.

Economic Downturn

10. The national financial position has changed dramatically since the current MTFMS was agreed by Council on 7 March, 2008. The 'credit crunch' has had a significant impact on the local economy and people of Herefordshire and, as a result, the council's financial planning assumptions have been revisited as the position unfolded.

11. It is clear that assumed levels of income that make a significant contribution to our overall funding will be less in 2009/10. This is based on the evidence already available in this financial year that sees directorate based income falling and investment income declining. It is the job of the MTFMS to bring all these financial elements together to present an overall position.

12. In 2009/10, the loss of income is estimated to be £500k and there is already clear evidence that car parking and planning related income is below anticipated levels built into the revenue budget. As a result, an additional £500k is built into the 2009/10 revenue budget to meet this shortfall.

13. The council produces a Treasury Management Strategy that covers borrowing and investment activities. In 2008, many councils were affected by the banking crisis and lost money invested with Icelandic Banks. Herefordshire Council did not have funds with these banks at the time of their collapse, but it has responded by further tightening investment practices and moving to an even more cautious approach. As a result, we lend balances over a shorter period of time and also find that we have fewer institutions we can deal with, because banks no longer meet our very tight

assessment requirements. This has had a significant impact on this year's investment income and the council's treasury management advisor (Sector) is predicting the bank rate will reduce to 0.5% in 2009/10. The consequent reduction in investment interest rates means that we must plan for £1.5m less income in 2009/10. This is reflected in the MTFMS.

14. The pressures faced by directorates as a result of the downturn are wider than just a loss of income. An increased level of homelessness is already evident and likely to worsen in 2009/10. The Regeneration Directorate see this key pressure as unavoidable and has already taken steps to put the budget on a sustainable footing. Even so, they estimate a £78k requirement for additional services in 2009/10. The same directorate also notes an additional requirement for support to sustain their activity and meet demands, due to the downturn in the economy.

Herefordshire Connects

15. The Herefordshire Connects programme received formal agreement to proceed to its next phase on 31 July 2008. The decision to move to concluding the programme was supported by a review of the financing of the project and this has been built into the MTFMS. The overall approach is to view all corporate efficiency activity as part of the Herefordshire Connects Programme, so that maximum efficiencies are realised. In the 2009/10 budget, the programme is to realise £700k of savings, with an additional £600k in 2010/11 and a further £2m in 20011/12. This indicates the key role the programme will make to the council's overall financial position.

Financial Resource Model 2009/10-2011/12

16. The Financial Resource Model (FRM) is the heart of the MTFMS, as it contains a series of assumptions and assessments that shape the financial plan. These are:

16.1 Future Council Tax Increases: The current MTFMS agreed in March 2008 assumes Council Tax increases of 4.7%. The government has been clear that it expects to see Council Tax increases "substantially" below 5%, but has been unwilling to define what this translates to in terms of level of increase and the situation will need to be carefully monitored.

As a result, it is recommended that a 3.9% council tax increase assumption is now included for the 2009-10 budget and the two remaining years of the MTFMS up to 2011/12.

16.2 Inflation Uplifts: The current FRM includes 2.5% for pay inflation. Clearly, future pay awards can only be estimates but there will be downward pressure on pay settlements. **For 2009/10, the pay increase uplift is therefore 2.0%.**

The current FRM does not include inflationary uplifts on non pay budgets. This does not mean that any external providers cannot expect an inflationary uplift, but it does indicate that the council will continue to use this policy as an efficiency measure, with directorates providing increases from value for money activity. This is a challenging policy, but it does ensure that:

16.2.1 Robust contracts for provision of services are negotiated;

16.2.2 Contracts are performance managed effectively;

16.2.3 Value for money arrangements are more likely to be integrated with

service delivery arrangements.

The policy creates financial pressure on core services, with one such area being the annual increase in elements of the contract with Amey Wye Valley. This will be covered by the service delivery review that will see anticipated cost reduction of £900k in 2009/10.

The current FRM assumes inflation on client and customer receipts budgets of 2.5% unless the fee is dictated by a statutory arrangement. This approach will continue in the draft MTFMS.

16.3 Income Shortfall: The budget includes £500k to offset loss of income resulting from the economic downturn. The proposed allocation is as follows:

16.3.1 Deputy Chief Executive's Directorate: The current target for land charges is likely to suffer a £150k shortfall in 2009/10.

16.3.2 Regeneration Directorate: The recession has impacted upon planning income and the current estimate for 2009/10 is for a shortfall of £175k. However, the Director of Regeneration indicates the directorate could suffer a higher shortfall, depending on the severity of the downturn and the current assessment will be reviewed in 2009/10.

16.3.3 Resources Directorate: A reduction in income for business units is likely and £50k is to be used to support the position.

16.3.4 Environment Directorate: An additional £125k is to be used to support the reduction in car park fee income.

The £500k support will not be permanent and will be reviewed at the next budget cycle and thereafter at each budget setting, until the economic position improves and income budgets can be adjusted to their 2008/09 levels.

16.4 Base Budget Adjustments: As in previous years, the FRM is continually reviewed to refine the budget so that the most up-to-date information is used. It is inevitable that some items will be presented as pressures and require adjustment. The following are the recommended adjustments for 2009/10:

16.4.1 An additional £88k to support Criminal Records Bureau (CRB) checks.

16.4.2 Adding £300k to meet the council's liability for job evaluation costs of staff transferred to external organisations, such as HALO.

16.4.3 Establish a £140k budget for grounds maintenance costs previously met from the general fund reserve.

16.4.4 Build in an extra £275k to meet the commitment given in the 2008/9 budget to provide further funding for Mental Health and Physical Disabilities Services, as a result of the needs analysis work.

16.4.5 Adjust the Local Development Framework funding to a level of £375k in 2009/10.

16.4.6 Remove the assumption that the Customer Service Division would have been self-funded by 2009/10 and replace with a phased target over the remainder of the MTFMS. This measure is temporary and will be reviewed in the forthcoming financial year.

16.4.7 Include the commitment given in 2008/09 to provide £400k to support the ICT Strategy.

16.4.8 Reduce the income from investments to reflect an estimated £1.493m loss of income because of lower interest rates; however, some of this is assessed as recovering by the end of 2011/12.

16.4.9 The FRM includes the updated capital financing costs reflecting slippage and a prudent level of borrowing for new capital investment.

Directorate Position

17. The 2009/10 financial year presents directorates with a series of financial challenges and also a requirement that they support the council's overall budget position to deliver a balanced budget. The process going forward has seen extensive involvement of the Joint Management Team (JMT), commencing with the Performance Improvement Cycle (PIC) in Autumn 2008. The proposals brought forward were subject to a process that saw Directors challenged about spend and saving proposals by the Director of Resources and the Policy and Performance team.

18. A second phase was introduced later, when the scale of the impact of the downturn was evident. This second phase saw Directors work together to further challenge the financial assumptions in directorate proposals and also to bring forward further savings. This was concluded at the end of January 2009 with the outcome reported to the Director of Resources. The detail of expenditure requirements and savings proposals is contained at Appendix A. Overall, the process has made a net contribution to balancing the budget.

Use of Reserves

19. The clear message in this report is that the scale of the economic downturn has affected the council's assumptions about its budget. This change is significant, meaning that the current MTFMS cannot be delivered, given the revised financial position. After adding up all the pressures faced by directorates and loss of investment and other income, a 'gap' of £3m would be evident without remedial action. The economic downturn means the worsened position has arisen quickly and therefore the most appropriate response is to manage the finances in such a way that we continue to deliver essential services and also transformational programmes such as Herefordshire Connects.

20. Delivering a balanced budget in 2009/10 can be achieved by a combination of financial discipline in day-to-day budget management, coupled with appropriate financial planning, including the use of reserves. As a result, In 2009/10, the proposal is to use £1m of general fund reserve to assist meeting pressures. This is a one-off measure and it is essential that it is understood that we cannot use this

source in the longer term. **Therefore, following consultation with the Joint Management Team, the Chief Executive and Director of Resources recommend this capacity is not only "back-filled" in the revenue budget from 2010/11, but that we also top up the general fund reserve by £1m so that it returns to its 2008/09 level. The MTFMS reflects this approach.**

21. The audited accounts for the 2007/08 financial year confirmed an opening general fund revenue balance of £6.728m. This will reduce by £200k reflecting the funding of job evaluation costs in partner organisations. The MTFMS assumes use of £1m in 2009/10 with this being replaced in 2010/11.

    If the overall position is that Directorates achieve a balanced budget in 2008/09, as instructed by the Chief Executive, the likely position will be as follows:

	£m
2009/10 estimated opening balance:	6.728
Use of £1m	-1.000
2009/10 Closing balance	5.728
Add back £1m in 2010/11	1.000
2010/11 balance	6.728

22. At a level of £5.728m in 2009/10, the general reserve is in excess of the council's policy of having a minimum general fund reserve balance of £4.5m to provide adequate cover for demand pressures that are volatile, difficult to predict or unforeseen at the time the budget is set.

23. A further area of proposed support is using an element of the £1.2m local Public Sector Agreement (LPSA) revenue reward grant that relates to areas delivered by the council. **This would give £712k of support and it is proposed that this is used in 2009/10. In 2010/11, its use would be "backfilled".**

Financial Implications

24. If Cabinet agrees the approach contained in this report, the update FRM for 2009-2012 indicates capacity figures as follows:

    a) 2009/10 - No capacity after meeting all the above pressures

    b) 2010/11 - Financial capacity of £766k

    c) 2011/12 - Financial capacity of £4,636k

    The position is therefore one of no additional capacity in 2009/10, a small amount of capacity (£766k) in 2010/11 and then a further £4.64m in 2011/12.

25. This tightening of the financial position for the next two years means there is little cash to allocate to corporate priorities until 2011/12 unless further efficiencies are delivered above and beyond those to be produced by Herefordshire Connects.

Risk Management

26. The report has highlighted that the economic downturn has impacted upon the council's existing MTFMS. The report has indicated how risks such as reduced

income are to be managed.

27. Clearly, there is the potential risk that the economy will be in worse shape than assumed for the purpose of budget setting. The appropriate management would be via cost reduction and a review of levels of general and specific reserves.

28. The additional risk that may occur is if the services currently supported through former specific grants are no longer funded because of a change in priorities. This would need to be managed over time.

Alternative Options

29. Alternative options for balancing the budget were examined that did not use reserves to manage the financial position. These approaches would have led to significant reductions in service.

Consultees

30. Joint Management Team have been consulted on the content of this report.

Appendices

Appendix A: Directorate Expenditure Requirements and Savings Proposals

Appendix B: Medium Term Financial Management Strategy (MTFMS)

Background Papers

- None identified