Herefordshire Council

MEETING:	OVERVIEW AND SCRUTINY COMMITTEE
DATE:	18 JANUARY 2010
TITLE OF REPORT:	MEDIUM TERM FINANCIAL STRATEGY 2010-13
PORTFOLIO AREA:	RESOURCES

CLASSIFICATION: Open

Wards Affected

County-wide.

Purpose

To seek the Committee's views on the draft Medium Term Financial Strategy (MTFS) 2010/13.

The Committee's views will be considered by Cabinet on 21 January, when they will make recommendations to Council on 5 February about the budget, including the level of council tax for 2010/11 and the financial strategy for 2010/11 to 2012/13.

Recommendation(s)

That Overview and Scrutiny Committee comments on the contents of the Medium Term Financial Strategy so that Cabinet is informed of its views.

Alternative Options

1 Joint Management Team (JMT) have approved a balanced budget for 2010/11 and this is summarised in the Financial Resource Model (FRM) in the attached MTFS. It incorporates inflation, service pressures and other spending requirements, the financing of which has been identified from within the Formula Grant, service efficiencies and council tax.

2 No other alternative has been provided.

Reasons for Recommendations

3 The proposed MTFS, shown in Appendix A provides a financial planning framework for the next three years.

4 A proposed council tax increase of 2.9% facilitates budget setting for 2010/11.

Introduction and Background

5 Cabinet will consider the budget proposals set out in the MTFS, in order to make a recommendation to Council for setting the 2010/11 revenue budget and set a level of council tax increase.

Further information on the subject of this report is available from
Anne Phillips, Head of Financial Services on 01432 383173

6 The provisional local government settlement was announced on 26th November 2009. It confirmed the final year of the three-year Comprehensive Spending Review 2007 (CSR07), the key components were:

- The Formula Grant, which includes Revenue Support Grant and Redistributed Business Rates, is set at £57.584m, an increase of 4%, equating to £2.232m. It is unlikely there will be changes to this figure when the final settlement is published in late January 2010.

- Area Based Grant is set at £10.128m. This now includes the Supporting People Grant and from October 2010 will have additional funding to mitigate the income loss from the implementation of the proposals in the Personal Care at Home bill.

- The baseline budget has not been adjusted for Adult Learning Disability budgets that have been transferred from health to social care; the Primary Care Trust will continue to receive the funding in 2010/11 and transfer it through to the council.

- Indicative figures have not been provided on government department spending limits after 2010/11. At the same time it was announced front-line schools, hospitals and policing would receive real-terms increases, whilst overall public spending growth would shrink to 0.8% by 2013/14. This suggests a much tighter financial picture for local government. Headline changes that will affect future budgets include:

    - Public sector pay settlement increases will be capped at 1% from 2011.

    - 5% increase in National Insurance contributions for employers from April 2011

    - Free school meal provision will be extended to 500,000 school children not previously eligible

7 Dedicated Schools Grant (DSG) is estimated (as at 21st December) at £88.237m, based on pupil numbers of 22,703. This figure will be revised for the January pupil census, although the outcome will not be published until June 2010. Schools are currently budget planning using September 2009 pupil numbers of 22,517.

Key Considerations

8 The Council operates within the discipline of a MTFS. It is the framework within which cash resources follow corporate priorities, supporting the achievement of the council's overall objectives and delivery of services.

9 The financial model (FRM) at the heart of the MTFS has been updated and includes the following:

a. Directorate pressures;

b. Directorate savings;

c. A change management reserve of £915k;

d. A spend to save contingency of £150k;

e. A revenue contingency of £300k;

f. Updated capital financing costs;

g. Shared services savings of £1m in 2010/11 rising to £4.8m by 2012/13.

9 The MTFS facilitates longer term financial planning to reflect the changes that emerge from central government as well as changing local priorities and emerging service pressures. The changing nature of central government's priorities needs to be incorporated as local government is an important partner for central government, and is often used to deliver new services as well as delivering changes to existing services.

10 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 directorate budgets, supported by appropriate reserves that need to be managed as part of the overall financial management strategy.

11 Over the last three years the level of local government funding provided by central government has remained stable as a result of CSR07. The overall increase in 2010/11 Formula Grant for Herefordshire, based on a year-on-year increase, has been 4%, however this must fund inflation, service development, and increased demand for services across the council. There is also a requirement to deliver ongoing efficiency targets, with 4% cashable efficiency savings needed in 2010/11. This equates to £6.7m.

12 JMT also confirmed that in recommending the MTFS to cabinet it will enable the delivery of the targets and key projects that JMT members have proposed for the joint corporate plan 2010/13.

13 The proposed MTFS builds on last year's significant review of the strategy's content by putting in place an approach to support the move towards a joint financial strategy with NHS Herefordshire. The joint MTFS will be the key financial document for both organisations and the relevant council elements will be clearly identifiable to support council tax setting. The move to a joint approach is timely given the deepening partnership between both organisations; the Total Place agenda; the drive to deliver greater efficiencies across the public sector and the impact of World Class Commissioning on the integrated commissioning of services.

14 The government has signalled a significant reduction in capital expenditure because of the tightening of public expenditure over forthcoming years. This is likely to see reduced capital grants for major projects and other capital funding support. This means it is appropriate to carry out a fundamental review of the existing capital programme to provide assurance that the existing programme supports future priorities and models of service delivery. Therefore indicative funding for the capital programme is included but decision making on expenditure will follow the review that will assess whether our existing programme is suitable for the new joint corporate plan and also whether previous decisions meet new service delivery models.

Economic Downturn

15 Since the last MTFS there has been the continuation of the downturn in the economy and clarity about how the "credit crunch", has impacted across the world. In order to mitigate the effects of the downturn the UK Monetary Policy Committee has been injecting money into the UK economy since March 2009. This policy, known as "quantitative easing", has seen £200 billion injected from purchasing gilts and other assets, but the Bank of England has now signalled this will end.

16 To reduce the UK's deficit the Treasury is proposing cuts to public sector spending over the

coming years. Public spending may need to reduce by up to 15% and tax rises are also possible. The outcome of the 2010 General Election may see this position change further.

17 The economic downturn has affected the assumptions in the Treasury Management Strategy that covers borrowing and investment activities. Since the collapse of the Icelandic Banks we have implemented a more risk averse strategy resulting in tightening investment practices and only lending balances (over a shorter period of time) to highly credit rated establishments. This has had a significant impact on investment income and is not set to improve until 2011/12, when interest rates are predicted to rise.

Shared Services / Herefordshire Connects

18 The Shared Services initiative has subsumed the Connects project into the wider Transformation Project. The overall approach is to view all corporate efficiency activity as part of the programme, so that maximum efficiencies are realised. In the 2010/11 budget the programme is to realise £1m of savings, with an additional £1.6m in 2011/12. This confirms the key role the programme will make to the council's overall financial position at a time when central government funding is likely to reduce.

19 As was explained in the Cabinet report on 18th December, further financial savings are likely to be delivered from Shared Services and improved procurement processes, but additional costs may also be incurred. A further report providing greater detail will be presented in March 2010.

Financial Resource Model 2010/13

19 The FRM is central to the MTFS, as it contains a series of assumptions and assessments that shape the financial plan. These are:

a) Future Council Tax Increases: The government has been clear that it expects to see Council Tax increases "substantially" below 3%, but as in previous years has been unwilling to define a precise figure below which councils will not face capping.

As a result, it is recommended that a 2.9% council tax increase assumption is now included for the 2010/11 budget and the two remaining years of the MTFS up to 2012/13.

b) Inflation Uplifts: The Government's Pre Budget report on the 9th December specified all public sector pay settlement increases will be capped at 1% (except for members of the armed forces) from 2011. As a result the council has now moved to a general approach to inflation to allow greater flexibility and therefore an overall cash limited sum covering all inflation is now included.

20 It is proposed that a number of services receive funding for inflation pressures, resulting from either contracts or market pressures:

- Children and Young Peoples Directorate £60k
- Integrated Commissioning £714k
- Environment and Regeneration £170k

21 The current FRM assumes inflation on client and customer receipts budgets of 2.0%. A review of the policy for income is underway, identifying where more appropriate charges for services

can be considered ensuring, where possible, tariffs are set at levels that fully recover costs so that subsidies for service provision do not occur. A policy will be presented to Cabinet in Spring 2010.

a. Base Budget Adjustments: As in previous years, the FRM is continually reviewed to refine the budget using up-to-date information. The approach taken this year is to allow directorates to present pressures that require adjustment. The following are the recommended adjustments for 2010/11:

	£'000
Legislative changes	807
Inflation uplifts to key contracts	1,024
Economic downturn – impact on impact	180
Demographic changes	591
Frontline service pressures	1,572
Service modernisation pump priming	566
Other service changes	489
	5,249

b. To help balance the budget the following efficiencies have been identified:

	£'000
Vacancy Management	762
Impact of full cost recovery for charging	225
Rationalisation of Property Services	180
Business process improvements	227
Implementation of new commissioning plan	450
Implementation of care brokerage	84
Reduction in unit costs for in-house services	159
Directorate reductions	2,528
	4,615

Use of Reserves

22 For the 2009/10 budget the council temporarily used general fund balances to ease financial pressure over more than one year. This helped demonstrate the value of financial planning over more than one year. In line with the decision taken for the 2009/10 budget the FRM reimburses reserves used to set the previous year's budget:

- £1m was used to fund service pressures, which is now backfilled and an additional £1m is used to top up the reserve to its 2008/09 level

- LPSA reward grant support of £712k is back filled and covers its use in 2009/10

23 At a forecast level of £5.9m as at 31st March 2010, the general reserve is in excess of the council's policy of having a minimum general fund reserve balance of £4.5m (3.5% of net revenue budget) to provide adequate cover for demand pressures that are volatile, difficult to predict or unforeseen at the time the budget is set. Given the likely pressures from 2011/12 when central government funding will reduce it is appropriate to hold a higher level of balances.

24 There are expected to be specific reserves of £15.3m, a significant proportion belong to schools and cannot be used to pay for non-schools services.

Community Impact

25 The budget proposals continue to support front line service delivery, partnership working and sustaining economic growth.

Financial Implications

26 If Cabinet agrees the approach contained in this report, the updated FRM for 2010/13 indicates capacity figures as follows;-

a) 2010/11 - Balanced position

b) 2011/12 - £13k deficit

c) 2012/13 - Financial capacity of £1.485m

These figures assume a 5% reduction in central government Formula Grant from 2011/12.

Legal Implications

27 Local authorities must decide every year how much they are going to raise from council tax. They base their decision on a budget that sets out estimates of what they plan to spend on services. Because they decide on the council tax before the year begins and can't increase it during the year, they have to consider risks and uncertainties that might force them to spend more on their services than they planned. Allowance is made for these risks by:

- making prudent allowance in the estimates for services; and
- ensuring that there are adequate reserves to draw on if the service estimates turn out to be insufficient.

28 Local government legislation requires an authority's chief finance officer to make a report to the authority when it is considering its budget and council tax. The report must deal with the robustness of the estimates and the adequacy of the reserves allowed for in the budget proposals, so members will have authoritative advice available to them when they make their decisions.

Risk Management

29 The report has highlighted that the economic downturn has impacted upon the council's existing MTFS. The report has indicated how risks such as reduced income are to be managed.

30 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.

31 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.

32 It is appropriate to indicate that this year's general election may impact on the assumptions

made in the MTFS. As the MTFS is under regular review to allow for emerging pressures and legislative changes any consequences of a change in central government policy will be modelled and reported to cabinet along with advice on whether any remedial action is required.

Consultees

33 The Joint Management Team have approved this report and attachments on 5th January 2010.

34 The Overveiw and Scrutiny Committee will be consulted on 18th January 2010; a verbal update will be given.

35 An update from the consultation with Business Rate Payers will be provided.

Appendices

36 Appendix A – Medium Term Financial Strategy

Background Papers

- Provisional Local Government Financial Settlement 2010/11
- Treasury Management Strategy 2009/10