OVERVIEW & SCRUTINY	**9 SEPTEMBER 2010**
CABINET	**16 SEPTEMBER 2010**
COUNCIL	**29 SEPTEMBER 2010**

FINANCIAL FORECAST
(Report by the Director of Commerce & Technology)

1 PURPOSE

1.1 This report aims to stimulate discussion of financial options prior to this year's budget/MTP process. It provides Members with an update of the financial position in the light of the likely deficit for the year, falling revenue reserves, the emerging prospects for lower government funding and government plans to replace Council Tax capping from 2012/13.

2 BACKGROUND

2.1 For a number of years financial forecasts have highlighted the need to substantially reduce expenditure and/or increase income. The Council is in the process of consulting with the public on their preferences regarding cuts in services and increases in Council Tax. The results of these consultations will not be known until the end of September.

2.2 The approved Budget and Medium Term Financial Plan (MTP) provided for expenditure of £25m in 2010/11 funded £13m by government, £7m by Council Tax and £5m from reserves. Revenue reserves were, and still are, planned to fall to £12m by March 2011. The financial plan for subsequent years required substantial savings to remove the revenue deficit by 2014/5 when revenue reserves would have fallen to a minimum level.

3 SUMMARY

Cuts are expected in the level of government funding. These are likely to amount to over £3m p.a. within 5 years.

The total budget shortfall rises to over £8m p.a. in 4 years time.

Expenditure reductions of £8m p.a. will require Members to approve substantial changes to the scope and nature of services provided by the Council and how they are provided. This could fundamentally change the role of the Council.

Reserves are sufficient to allow changes to be introduced at the rate of £2m in each of the next 4 years. However further delay is not prudent.

The scale of savings, and complexity of the consequences, requires decisions on how the first £5m of savings are to be made during this year's budget/MTP process.

If no action is taken reserves will run out in March 2013.

The budget consultation will indicate the public's relative appetite for council tax rise and service cuts. It will also identify which services have a lower priority.

The Government is consulting on a proposal that Council Tax rises above a predetermined limit would be subject to achieving a majority in a public consultation and wishes to avoid centrally imposed capping. Although the April 2011 Council Tax increase will not be subject to a formal referendum future rises may be subject to such a referendum. .

Conclusion
In advance of the budget process all Members are urged to give consideration to:

1. **The nature of services which the Council should continue to provide.**
2. **Whether the Council's low tax level should be maintained in preference to the provision of services or vice versa.**
3. **The extent to which services should be managed by the District Council or devolved to Towns, Parishes or localities.**
4. **The results of the budget consultation when they become available.**

4 2009/10 OUTTURN

The Council has benefited from some one-off windfalls which have allowed a Special Reserve of £1.9M to be set up to fund the up-front costs of achieving savings.

4.1 In 2009/10 the Council managed to keep its spending £1.9M below budget, predominantly due to a high Housing and Planning Delivery grant settlement (£0.6M extra) and a one-off VAT refund (£0.7M). This saving was placed in a Special Reserve to meet the up-front costs of making savings, including the costs of redundancy in line with the updated policy and schemes on which the Employment Panel is consulting the staff side. £3.7M was taken from general reserves to fund spending last year. At 1st April 2010 Revenue Reserves stood at £15.9M.

4.2 Capital expenditure was £6.2M lower than budgeted due to savings of £0.8M and timing changes of £5.4M. Most of this was anticipated in the MTP leaving an extra £2M to be deferred to the current year. This results in some interest and MRP (provision for repaying debt) savings for 2010/11.

5 CHANGES TO FUTURE NET SPENDING

The impact of changes from the approved forecasts due to inflation, interest rates etc. is modest.

5.1 At this initial stage of the MTP process the changes to net spending are limited in number. They include:

- revisions to interest rates and the amounts that interest is earned on due to last year's outturn and this year's forecast. Further refinements to the forecasting model have been made to improve accuracy in this area.

- inflation adjustments. It has been assumed that changes will be made to the Local Government Pension Scheme such that no further increases in employer's contributions are required after 2014/15. Further changes will be necessary once we get the actuary's revaluation of the scheme towards the end of this calendar year. The previous government proposed a NI increase from April 2011 but the new government is proposing to introduce some changes to the thresholds to reduce the impact. Until the thresholds have emerged it is impossible to forecast the reduction in impact as it will vary with the profile of salary levels within any organisation.

- some deferment of capital expenditure.

- removal of concessionary fares from April 2011 which is offset by reduced Government Grant (see para. 6 below).

- removal of assumption that an extra £250k of specific grants will be received each year due to the cut back in government grants that has already taken place.

- introduction of a much more detailed calculation of the Minimum Revenue Provision (MRP) (statutory provision for repaying debt). This has resulted in some increases but because of the basis chosen this is significantly off-set by reduced interest costs. Guidance requires formal approval of this basis every year and Annex C provides the explanation of the basis agreed and used last year. This approach is still in the Council's best interests and is recommended for endorsement.

5.2 The following table shows the variations due to these items:

VARIATIONS	2011/12 £000	2012/13 £000	2013/14 £000	2014/15 £000	2015/16 £000	2016/17 £000	2017/18 £000	2018/19 £000
Interest and Loan repayments	-371	-200	-140	-53	184	387	532	673
Inflation	83	162	258	347	-25	-159	-272	-270
Concessionary Fares	-740	-740	-740	-740	-740	-740	-740	-740
Provision for extra grants removed	250	250	250	250	250	250	250	250
Other Adjustments	407	15	15	15	15	0	0	0
	-370	**-513**	**-357**	**-182**	**-316**	**-262**	**-230**	**-87**

Based on the 'Government Preference' Council Tax option described in para. 9.4 below. The interest figure and inflation figures will vary for other options due to variations in the speed with which reserves are used and savings requirements due to conversion to current prices.

6 GOVERNMENT GRANT

Government General Grant will reduce in cash terms for the next few years and the forecast has been based on a 25% cut spread over 5 years. This and some losses from formula changes would result in a loss of £3.3M per year by 2014/15.

6.1 In December 2007 the Government introduced three year grant settlements to give greater planning certainty for local authorities. They kept to this commitment despite the economy being in a difficult position by last autumn when the 3rd year's allocation was confirmed with no changes. There are rumours that this year's announcement may only be for two years.

6.2 It is also now clear that the Government intends to reduce public spending and figures of 25%, or even 40%, in cash terms are being suggested. This contrasts with last year's assumption in the MTP that there would be a real terms cut because but no actual cash reduction over the next three years.

6.3 It is also expected that District Councils may lose out in the distribution mechanism of this reduced total because of the perceived priorities of Education and Social Services. However, in order to not be too pessimistic at this stage, it has been assumed that grant will fall at 5% per year in cash terms for 5 years.

6.4 There are also likely to be changes to the allocation formula and the Department for Communities & Local Government (DCLG) have distributed a range of exemplifications indicating possible impacts. The most significant change is the transfer of concessionary fares to County Councils in April but it appears that the exemplifications on this may have an error. For the purpose of this forecast it has therefore been assumed that the concessionary fares impact will be neutral i.e. the loss of grant will equal the saving in expenditure. This may prove to be optimistic.

6.5 There may well still be some form of maximum loss of grant to protect the most significantly affected authorities and, because this will have to be funded by the other authorities, the forecast is based on us still not receiving all of the withheld grant that the Council was entitled to in 2010/11.

6.6 The Government are consulting on a new grant to reward Councils that support housing development. It would be based on awarding a grant equivalent to the Council Tax on the new houses for 6 years. It is expected that it will not be new money but top-sliced off of general grant. If 550 extra homes were achieved every year, the grant could grow to about £360k per year after 6 years, assuming it is just the District element of the tax, but it would need to be offset by a share of the reduction in general grant. Whilst we would expect to gain it is premature to model the likely impact until there is more clarity about whether it relates to just the District element of the Council Tax, the expected national scale to judge the offsetting RSG loss and the date it will be introduced. It will be built into the MTP as soon as clarification emerges. Its exclusion at this stage also mitigates the potential downside from a loss relating to the concessionary fares transfer and the possibility of reductions in excess of 25%.

6.7 The following table compares this forecast's assumptions with those in the approved MTP:

GRANT* FUNDING	Budget	MTP				FORECAST			
	10/11 £M	11/12 £M	12/13 £M	13/14 £M	14/15 £M	15/16 £M	16/17 £M	17/18 £M	18/19 £M
Current Approved MTP									
2010/11 True Grant	**13.4**	13.4							
Less Concessionary Fares ##	0.0	-0.7							
Net	13.4	12.6							
Forecast change %		**0.0%**	**0.0%**	**0.0%**	**2.5%**	**2.5%**	**2.5%**	**2.5%**	**2.5%**
Forecast True Grant		12.6	12.6	12.6	12.9	13.3	13.6	13.9	14.3
Withheld	-0.4	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grant Receivable	**12.9**	**12.4**	**12.6**	**12.6**	**12.9**	**13.3**	**13.6**	**13.9**	**14.3**
This Forecast									
2010/11 True Grant	**13.4**	13.4							
Less Concessionary Fares ##	0.0	-0.7							
Less Formula Changes		-0.1							
Net	13.4	12.5							
Forecast change %		**-5.00%**	**-5.00%**	**-5.00%**	**-5.00%**	**-5.00%**	**2.50%**	**2.50%**	**2.50%**
Forecast True Grant		11.9	11.3	10.7	10.2	9.7	9.9	10.2	10.4
Withheld	-0.4	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grant Receivable	**12.9**	**11.7**	**11.0**	**10.3**	**9.7**	**9.9**	**10.1**	**10.4**	**10.7**
Reduction this time	**0.0**	**-0.7**	**-1.3**	**-1.9**	**-2.8**	**-3.6**	**-3.7**	**-3.8**	**-3.9**

*Grant includes Revenue Support Grant and NNDR which are in aggregate distributed in line with the grant formula.

Loss of RSG assumed to equal reduction in expenditure so neutral overall.

7 CAPITAL

In recent years the Council has maintained a significant capital programme. However as a result of the emerging financial pressures and the conclusion of the Pathfinder House and Depot projects the capital programme is now much diminished. The table below shows the value of the capital programme and that whilst it is currently forecast to fall to around £5m p.a., borrowing will accumulate and the consequent impact of interest and repayment on the revenue budget will continue to rise.

Borrowing Costs	2010/11 £000	2011/12 £000	2012/13 £000	2013/14 £000	2014/15 £000
Forecast Capital Spending	9,079	10,842	4,062	5,540	5,202
Accumulated "Borrowing" EOY (net of MRP)	19,663	29,701	32,619	36,884	40,450
Net Interest and Borrowing Costs					
- total	-58	358	1,173	1,621	2,155
- as % of total net revenue spending	0%	2%	5%	8%	11%

8 FORECAST GAP IN FUNDING

Based on the changes explained above, and assuming a 2.5% annual increase in Council Tax from 2012 the forecast gap in our revenue account is a follows.

SHORTFALL	Budget	MTP			
	10/11 £M	11/12 £M	12/13 £M	13/14 £M	14/15 £M
Net Spending before savings	**24.7**	**24.3**	**25.2**	**26.1**	**27.3**
Funded by:					
Government support	-12.9	-11.9	-11.3	-10.7	-10.2
Council Tax	-7.2	-7.3	-7.6	-8.0	-8.5
SHORTFALL	4.5	5.1	6.3	7.4	8.6

Previous forecasts already predicted a substantial funding gap for 2011/2 and beyond. This updated forecast has increased the gap largely due to the predicted fall in central government funding. Whilst this reduction in funding is not yet certain, the gap in our funding is unlikely to be more than £1m higher or lower than currently predicted.

9 FUNDING OPTIONS

9.1 The Council currently raises £7.2m through Council Tax by charging the average band D tax payer £124.17. It is the 20th lowest of the 201 District Councils which have an average of £168 and a maximum of £313.

9.2 Recent policy has been to keep the annual Council Tax increase under the predicted capping level. This has previously been forecast at 5% but fell to 4.5% last year. The change in government and consequent change in capping arrangements may give this Council greater scope to determine its preferred level of taxation after consultation with the public. For each £10 rise in Council Tax the savings target would reduce by £0.6M.

9.3 **Council Tax Constraints**

The Council has a very low Council Tax and this is a fundamental cause of its difficult financial situation. Previous Governments, as part of their economic policy, have restricted Council Tax rises by capping rather than relying on local decision-making and accountability. Thus any authority with a low council tax was effectively caught in a “poverty trap” and could not move towards the average position.

The new Government does not support capping and is proposing to replace it with a scheme where Councils that seek a percentage increase of more than a government predetermined amount (subject to de minimis cash increase levels) must obtain local support through a referendum. This cannot be introduced in time for this year's Council Tax setting.

There have been Government proposals that there should be no Council Tax increases in 2011/12 or 2012/13 with the possibility of extra government support of up to the equivalent of a 2.5% tax rise in the first year.

9.4 **Council Tax Options**
Whilst the Members can set Council Tax at any particular level, three scenarios have been identified to stimulate the debate on the level of increase.

Government preference: This is based on no increase next year, 2.5% in 2012/13 and then 5% per year for the rest of the plan period. It assumes we will get extra funding from the Government next year equivalent to a 2.5% rise and results in a Council Tax level of £4.40 per week (£229 per year) in 2024/25.	
Council Tax	**Savings still required**
No increase in 2011 followed by the maximum increase permitted without requiring a referendum in all subsequent years	£2m p.a. for each of the next 4 years.

Moving to District Council Average: This assumes the Council Tax is increased to the current year's average next year (an 84p per week rise) and then future increases are constrained to 2.5% per year. It also results in a tax level £4.45 per week (£232) in 2024/25.	
Council Tax	**Savings still required**
Immediate increase to the national average, but limited rises thereafter.	£2m of savings required for 2011/2, followed by a further £1m in each of the following three years

Slower increase: Based on a 10% rise next year followed by a rise of about 4.1% per year thereafter. This also results in a level of £4.45 per week (£232) in 2024/25.	
Council Tax	**Savings still required**
£1 per month increase in 2011 followed by 50p per month in subsequent years.	£2m of savings in 2011/2 followed by a further £1.5m in each of the subsequent years.

Annex A provides additional information for each of the above options and Annex B shows the sensitivity of these forecasts to variations in key assumptions.

9.5 **Impact on Savings Requirements**

The November draft budget/MTP report will provide a forecast for the level of savings that can be achieved through efficiencies, including staffing efficiencies, however it is unrealistic to believe that savings of these magnitude can be achieved through efficiencies alone. Members are invited to consider their views on the range of Council Tax increases and hence the extent to which each service should be cut.

10. PROPOSED ACTIONS AND TIMESCALE FOR AGREEING SAVINGS

10.1 It is clear that whatever approach the Council takes to taxation, a significant level of savings must be made. The extent of savings required mean that reductions in staffing are inevitable. With this in mind a voluntary redundancy scheme has already been proposed. Compulsory redundancies are most likely to also be required although the extent will depend upon the balance of tax rises and expenditure reductions determined by Members.

10.2 An indication of key dates in the process is shown below:

September	
9	Forecast considered by Overview & Scrutiny
16	Forecast considered by Cabinet
Mid to late	***COMT forecasts the items and value to be achieved from efficiency saving*** ***Consideration of consultation results.***
27	***Employment Panel adopt updated Redundancy Policy and agree Voluntary Redundancy scheme.***
28	***Voluntary Redundancy scheme advertised to staff.***
29	Forecast considered by Council
October	
12	***Voluntary Redundancy scheme closes for senior staff.***
20	Comprehensive Spending Review Announcement
November	
11	Draft Budget/MTP considered by Overview & Scrutiny
18	Draft Budget/MTP considered by Cabinet
December	
Early	Grant announcement
15	Draft Budget/MTP considered by Council
January	
8	***Voluntary Redundancy scheme closes for other staff.***
February	
10	Final Budget/MTP considered by Overview & Scrutiny
17	Final Budget/MTP considered by Cabinet
23	Final Budget/MTP considered by Council
March	
31	***Decisions made on Voluntary Redundancy requests.***

11 CONCLUSIONS

11.1 Whilst there remains a number of uncertainties, such as the level of reduction in government funding, the size of the Council's current deficit in relation to our now limited revenue reserves and low Council Tax will require the Council to make sizable reductions in the scale of its spending. The level of cuts can be reduced but not eliminated by raising Council Tax.

11.2 The results of the consultation exercises will allow the Cabinet to propose an approach to Council Tax increases and the resultant nature and phasing of service reductions.

11.3 The next 5 months are therefore critical to the Council's future levels of service delivery in many of its services.

11.4 Whatever decisions are taken the Council must make plans to achieve a minimum of £2M of reductions in its net costs next year and also determine where subsequent cuts shall be made.

11.5 Cabinet are required to approve the basis for calculating the Minimum Revenue Provision each year. The recommended basis is shown at Annex C.

12 RECOMMENDATIONS

Cabinet is requested to:

Approve the annuity basis for the calculation of Minimum Revenue Provision as outlined in Annex C.

Recommend this report to Council and highlight the challenges that need to be addressed over the coming five months.

ACCESS TO INFORMATION ACT 1985
Source Documents:
1. Working papers in Financial Services
2. Financial Forecast (September 2009), 2009/10 Outturn, 2010/11 Revenue Budget and the 2011/15 MTP

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ANNEX A

COUNCIL TAX SCENARIOS

OPTION Government Preferred

	Budget	MTP				FORECAST			
	10/11 £M	11/12 £M	12/13 £M	13/14 £M	14/15 £M	15/16 £M	16/17 £M	17/18 £M	18/19 £M
Net Spending before savings	24.7	24.3	25.2	26.1	27.3	28.2	29.3	30.4	31.6
Required Savings	**0.0**	**-1.9**	**-3.8**	**-5.7**	**-7.6**	**-9.5**	**-9.9**	**-10.1**	**-10.5**
Net Spending after savings	**24.7**	**22.4**	**21.4**	**20.4**	**19.7**	**18.7**	**19.4**	**20.3**	**21.1**
Funded by:									
Government support	-12.9	-11.9	-11.3	-10.7	-10.2	-9.7	-9.9	-10.2	-10.4
Council Tax	-7.2	-7.3	-7.6	-8.0	-8.5	-9.0	-9.5	-10.1	-10.7
SHORTFALL Met from Reserves	**-4.5**	**-3.2**	**-2.5**	**-1.7**	**-1.0**	**0.0**	**0.0**	**0.0**	**0.0**
Council Tax	**£124.17**	**£124.17**	**£127.27**	**£133.64**	**£140.32**	**£147.34**	**£154.70**	**£162.44**	**£170.56**
Remaining reserves end of year	11.4	8.2	5.7	4.0	3.0	3.0	3.0	3.0	3.0

OPTION District Average

	Budget	MTP				FORECAST			
	10/11 £M	11/12 £M	12/13 £M	13/14 £M	14/15 £M	15/16 £M	16/17 £M	17/18 £M	18/19 £M
Net Spending before savings	24.7	24.3	25.2	26.1	27.5	28.7	30.0	31.0	32.2
Required Savings	**0.0**	**-1.9**	**-2.9**	**-3.9**	**-4.9**	**-5.9**	**-6.9**	**-7.9**	**-8.9**
Net Spending after savings	**24.7**	**22.4**	**22.3**	**22.2**	**22.6**	**22.8**	**23.1**	**23.1**	**23.3**
Funded by:									
Government support	-12.9	-11.7	-11.3	-10.7	-10.2	-9.7	-9.9	-10.2	-10.4
Council Tax	-7.2	-9.9	-10.3	-10.6	-11.0	-11.3	-11.7	-12.1	-12.5
SHORTFALL Met from Reserves	**-4.5**	**-0.8**	**-0.7**	**-0.9**	**-1.4**	**-1.8**	**-1.5**	**-0.9**	**-0.4**
Council Tax	**£124.17**	**£168.00**	**£172.20**	**£176.51**	**£180.92**	**£185.44**	**£190.08**	**£194.83**	**£199.70**
Remaining reserves end of year	11.4	10.6	9.9	9.0	7.6	5.8	4.2	3.4	3.0

OPTION Slower Increase

	Budget	MTP				FORECAST			
	10/11 £M	11/12 £M	12/13 £M	13/14 £M	14/15 £M	15/16 £M	16/17 £M	17/18 £M	18/19 £M
Net Spending before savings	24.7	24.3	25.2	26.1	27.4	28.4	29.5	30.5	31.8
Met from Savings	**0.0**	**-1.9**	**-3.4**	**-5.0**	**-6.6**	**-8.0**	**-9.3**	**-9.6**	**-10.0**
Net Spending after savings	**24.7**	**22.4**	**21.8**	**21.1**	**20.8**	**20.4**	**20.2**	**20.9**	**21.8**
Funded by:									
Government support	-12.9	-11.7	-11.3	-10.7	-10.2	-9.7	-9.9	-10.2	-10.4
Council Tax	-7.2	-8.1	-8.5	-8.9	-9.3	-9.8	-10.3	-10.8	-11.3
SHORTFALL Met from Reserves	**-4.5**	**-2.6**	**-2.0**	**-1.5**	**-1.3**	**-0.9**	**0.0**	**0.0**	**0.0**
Council Tax	£124.17	£136.59	£142.25	£148.14	£154.29	£160.68	£167.34	£174.28	£181.50
Remaining reserves end of year	11.4	8.7	6.7	5.2	3.9	3.0	3.0	3.0	3.0

ANNEX B

FINANCIAL PLAN - SENSITIVITY AND RISKS

The financial forecast model has been used to demonstrate the impact that the following variations would result in. The values indicate the annual amount that would need to be added or deducted from the savings target at that time, ***assuming that any intermediate years had been covered by temporary savings***.

	Extra savings needed (+) ##:	
	2015/16 £M	2024/25 £M
0.5% less pay award in 2011/12 and 2012/13	**-0.3**	**-0.4**
0.5% extra pay award every year	**+0.7**	**+3.0**
2% extra reduction in Government Grant per year for 5 years (35% cut rather than 25% cut)	**+1.0**	**+1.2**
5% loss in Leisure Centre fees and charges	**+0.3**	**+0.4**
0.85% increase in spending every year to cover cost of increased population. There is no provision for demographic growth in the forecast.	**+0.9**	**+3.4**
Pension Fund contributions increase after 2014/15 at 1% every year.	**+0.2**	**+2.7**

Outturn prices for relevant year.

Inflation, other than pay, is fairly neutral as long as it is possible to quickly increase fees and charges in line with it.

Other Potential Variations
(*items more likely to be favourable are in bold italics)*

- A net loss through changes to the grant formula when Concessionary Fares transfer to the County in April.
- ***Introduction of reward grant for housing growth.***
- ***NI increase impact reduced by changes to thresholds.***
- Increase in interest rates.
- Future capital programmes have items with shorter asset lives resulting in higher revenue cost for repaying borrowing.
- Most budgets are based on 97.5% of salary due to the expectation of savings from staff turnover. A temporary adjustment was made to reduce this in last year's MTP until 2013/14. Given that turnover will reduce because of significant cuts in the public service the salary budget may have to become more nearly fully funded.
- ***Remote possibility of further one-off VAT refunds or receiving compound rather than simple interest on these and the refunds already agreed.***
- The potential for costs relating to "orphan" contaminated land sites.
- A "double dip" to the recession.
- Difficulty delivering the savings already identified or the spending targets inherent in this plan.
- High priority service developments not already in the MTP and any unavoidable spending requirements not referred to in this report emerging.
- Repayment of past land charge fees.

ANNUAL MINIMUM REVENUE PROVISION POLICY 2010/11

When a Council finances capital expenditure from borrowing, the resulting costs are charged to the Council Taxpayers over the whole life of the asset so that those who benefit from the asset share the cost. There are two elements to the cost – the interest on the borrowing is charged in the year it is payable, whilst the money to repay the sum borrowed is charged as a “minimum revenue provision” (MRP) to the revenue account each year, starting with the year after the borrowing takes place. Once money is in the MRP it can only be used for repaying borrowing.

The Department for Communities and Local Government (DCLG) has issued guidance on what constitutes prudent provision and this requires the Council to determine an approach and publish this each year.

There are three options for the calculation of the MRP :

Equal annual installments

This is the easiest and simplest approach but the combination of the equal installments of principal and the reducing interest makes the cost high to start with but then reducing year by year.

Depreciation basis

The Depreciation basis is the most complex. It starts by mirroring the equal annual installments method but also requires adjustments every time the life of an asset is varied.

Annuity basis

By setting the rate for the annuity equal to the expected long term borrowing rate the cost is the same for each year like a conventional mortgage. It is only marginally more work than the equal installments approach. This is the basis agreed for 2009/10.

The Annuity basis is, by far, the most equitable approach and it is therefore proposed that it continues to be the Council’s MRP policy.

ANNEX D