Report to: **Executive**

Date: **1 November 2005**

Report of: **Director of Finance and Corporate Services**

Subject: **Review of the Medium Term Financial Strategy/Plans**

Ward: **All**

1. Purpose of the Report

1.1 The consider amendments to the medium term financial strategy for subsequent submission to council for approval.

1.2 To agree measures to sustain the Council's future budget position.

2. Consultation

2.1 The Management Team has considered the report.

3. Background

3.1 The Council's medium term financial strategy was approved in February 2003 with resultant financial plans covering the period 2003/4 to 2005/6.

3.2 The current strategy which is set out in appendix 1, focuses on ensuring that resources are used effectively to meet the Council's vision and objectives as set out in the East Durham Community Strategy 2003 to 2010 and the Council's Corporate Plan.

3.3 Current year budgets are subjected to rigorous monitoring throughout the financial year and it has been practice to formally review the strategy and financial plans during the annual budget process.

3.4 The medium term approach has enabled the council to identify and manage budget pressures ahead of the annual cycles however given developments in terms of grant distribution, council tax review, value for money and the efficiency agenda it is appropriate to review the position now taking into account emerging cost pressures.

4. Medium Term Financial Strategy - Purpose.

4.1 As stated above although the strategy covers 3-year periods it is reviewed annually and is invaluable in the budget planning processes.

4.2 Whilst the aim of the strategy is to ensure that resources are directed into priority areas it should also shape the future financial direction of the Council outlining the financial pressures facing the council.

4.3 Medium term financial planning will never be exact mainly due to uncertainties in the grant position, which accounts for around 70% of our funding. Significant shifts in grant allocation coupled with a council tax capping regime can have major effects on planning primarily due to lack of flexibility. The prudential borrowing regime is often cited as giving more flexibility to Councils but this again is closely linked to affordability and certainly should not be used as a solution to long-term revenue issues. Key to financial stability is to effectively manage the base budget and this has to be done by identifying efficiencies and realigning budgets/resources to meet priority growth.

4.4 It is important to build upon the existing financial strategy to meet our priorities and ensure we are delivering value for money by directing resources effectively. In saying that we must be aware of and manage external pressures otherwise our relatively stable position will deteriorate.

5. Key Issues

5.1 Some of the key issues, which may influence the strategy, are set out below.

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5.2 Members may recall the last review of the system in 2003/4 when the Council did relatively well despite foregoing grant because the settlement exceeded the ceiling. Unfortunately since then we have received floor increases of around 2.5% to 2.9%, which, neither cover cost pressures, nor the growth required to meet national and local priorities. That part of the grant formula applicable to district councils is the Environmental Protective and Cultural element unfortunately it is still the poor relation as far as funding is concerned as the government prioritises Education and Social Services as areas of greater need. A major issue is whether or not the Treasury withdraws the one off injection of funding in last years settlement designed to offset potential council tax.

5.3 In terms of the formula members will recall that apart from population changes the grant formula was frozen. However we have recently received the consultation papers, which I will be forwarding to members shortly but without going into detail some options favour District Councils. In terms of population in contrast with previous years I understand there has been a slight increase, which will benefit the council. Whilst this seems like good news it is of course dependent on the overall pot of money made available to local government and this is influenced by the national fiscal position.

5.4 From last April the Local Authority Business Growth Incentive Scheme was introduced whereby local authorities have the opportunity to retain a proportion of business rates income where the business rates base has increased. Increases in the base are of course mainly due to new business start-ups. Whilst rough estimates reveal that we will benefit when we look at the scheme in isolation we are uncertain of the impact of the scheme on the national pool, which of course is redistributed to all authorities. This could of course have an overall adverse effect on grant, which is made up of revenue support grant and a contribution from the national business rates pool. Again we must wait for final figures, which make forecasting difficult.

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5.5 It is important to keep abreast of the economic climate as events throughout the world impact on global financial markets, which in turn impacts nationally and locally.

- The rate of inflation (excluding mortgages) is around 2.5% and is rising. This impacts on wage negotiations and in turn on-costs such as pensions.

- Whilst inflation is measured on a basket of goods and services, as energy users we are more directly affected by specific surges in cost. World oil prices are currently at record levels and this will impact on our overall energy costs but more specifically the price we pay for petrol and diesel to run our vehicles, machinery and plant.

- When inflation increases the Bank of England tends to use interest rates as a means of control however this is a sensitive area. Currently interest rates are fairly settled at around 4.5%. but this is relatively low. Low interest rates reduces investment returns but conversely may give opportunities to reduce the cost of borrowing. At the moment investment income amounts to around £1m mainly as a result of reduced borrowing and improved reserves, clearly the position has to be carefully managed, as this is a significant source of income. If interest rates fell 0.5% investment income could reduce by around £100,000. In terms of the future outlook we need to ensure this income is managed because inevitably it will fall as reserves decline and borrowing rises.

- In terms of pension costs falls in stock market returns and increased life expectancy are the main reasons for increased pension contributions employer pension costs as authorities grapple with funding deficits. Although we have seen significant increases in the market over the last 18months it has contributed little to the deficit situation, life expectancy being the major factor. As stated in the budget report pension costs will increase by around 3% over the next 2 years around £150k per annum. The Government, employers and the trade unions are currently reviewing the local government pension scheme.

- Finally insurance costs can also be affected by events outside our influence. Whilst funding and premium costs have been managed very effectively over the period they have to be carefully monitored.

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5.6 In June of this year the Council adopted a Trading and Charging Policy in accordance with good procurement practice. Trading is a freedom given to excellent authorities by the government and whilst I do not wish to explore options at this stage it could be considered in future if situations arise. However it is worth exploring charges for discretionary services particularly in relation to neighbouring councils.

5.7 Although income opportunities may be limited compared to some authorities councils charges are nevertheless important and should be reviewed by each service in line with our policy and become part of the budget setting process.

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5.8 Despite mainstreaming a significant number of posts over the last 2 years this remains a difficulty when external funding streams come to an end.

5.9 The strategy must require directorates to report where new initiatives are funded externally to ensure the financial implications and exit strategies are clearly set out and therefore managed.

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5.10 Prudential borrowing was introduced in April 2004 allowing local authorities freedom to borrow for capital expenditure. This of course differed from the previous regime in that we could only borrow with permission. This was known as supported borrowing where the government picked up the borrowing costs. Prudential borrowing is not supported and we would bear the cost of principal and interest repayments. If we use the freedom for unsupported borrowing we must meet a number of tests, it must be prudent, affordable, taking account of the impact on rents or council taxes, and must be sustainable in the longer term. Clearly the medium term strategy must take account of the effects of any proposed prudential borrowing in the financial planning process.

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5.11 Members will recall that a review by Sir Peter Gershon led to local government being set an efficiency target of £6.45bn. His recommendations were incorporated in the government's 2004 Spending Review with the objective to identify savings/efficiencies of 2.5% per annum for redirection into frontline services. The areas targeted for efficiencies are procurement, corporate support services, transactional services and productive time.

5.12 Linked to the review, under the CPA, authorities will be assessed by the Audit Commission on how well resources are managed. Within that assessment authorities will be expected to reflect efficiency plans within budget processes. The strategy should reflect the need to identify efficiencies.

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5.13 The development of the arms length arrangements will have an impact on the general fund particularly in the review of service level agreements and accommodation. We need to keep abreast of developments in this area.

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5.14 From April 2006 a free concessionary fares scheme will be introduced, unfortunately even at this stage there is uncertainty as to how and whether council's will receive the full cost of implementing the scheme. The issue is contained in the grant consultation paper, which will be brought to members shortly.

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To deliver this strategy the government has provided capital grant, however the maintenance of the new systems will impact on the revenue budgets until we benefit from more efficient working and savings emanating from that.

6. Medium Term Financial Plan – Revised Position

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6.1 The monitoring report for the first quarter indicated a potential under-spend of around £440,000. Whilst we have seen additional expenditure coming forward in the year I nevertheless expect the under-spend to be in excess of £500,000 and I have reflected that position in the forecasts. On that basis the unfettered balance at the end of the financial year will be around £2.8m after the use of reserves of £1.5m.

6.2 Clearly the level of reserves is a sound position but we still have an underlying problem in the base budget, which has to be addressed. Last year the gap was just over £300k and already members have agreed growth of over £400,000 for 2006/7 in respect of the increase in street wardens. Continued mainstreaming of externally funded posts in addition to issues around East Durham Homes will increase that figure.

6.3 It is possible that NRF may be available for this service for 2006/7 following the withdrawal of partners nevertheless in the medium term funding has to be available.

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6.4 The medium term position was determined on the basis of the assumptions set out in appendices 2 to 2/2.

6.5 Appendix 3 sets out the updated summarised position, which includes known growth of £440,000 and an additional contingency of £250,000, which is speculative at this stage.

6.6 The projections for 2006/7 and 2007/8 are based on the following assumptions: -

- Savings from staff turnover will increase by £50,000 to £250,000.
- Externally funded posts (street wardens) - full mainstreaming costs brought

forward to 2006/7.
- Mainstreaming costs of other posts and other growth estimated at £250,000 – contingency only.
- External support remains unchanged – 2.5% increase.
- Council tax increases are factored in at 3% for the moment around the rate of inflation.
- If trends in the collection of council tax continue I will be able to reduce the Bad debts provision by a further £300,000, which releases a further £100,000 to the general fund.

6.7 The net effect of the above will leave a budget shortfall of just under £1.2m for 2006/7, which clearly has to be bridged. To do that and continue progress we need to build efficiencies (cashable and non cashable) into our processes. In considering the position I'm aware that there is around £600k in budgets, which will help address the gap and these are itemized below and therefore cannot be used in the exercise, savings must be in addition to these.

	£k
• Miscellaneous contingency items – one offs no longer required.	150
• Cheshire Waste contract buy out releases contract value from Budget 2006/7onwards.	87
• Reduction in Leisure Centre management fee.	88
• Efficiencies identified:-	
Increased benefit subsidy due to increased accuracy	75
Savings in loan charges 2005/6 &2006/7 only	200

6.8 Given the above we are currently looking at a budget deficit of around £600k, around 2.5% of net budget.

7. Financial Strategy – 2006/7 onwards

7.1 Key to tackling the budget shortfall is to ensure actions are sustainable. Unfortunately we are in a position where we have little idea of grant proposals for next year and this is further complicated by the review of the system and other issues outlined in paragraph 6.

7.2 In saying that we have good monitoring systems in place and resources are spent in line with priorities, which is very important. The budget process is embedded and financial issues are tackled in a calm and measured way corporately.

7.3 Having identified the gap it would be very easy to take a cost cutting approach to bring the budget in line however in our experience that would lead to cuts in services and would store up more problems in future. In my view we have sufficient balances to manage the process as we stand at the moment and we should take a more measured approach to the issue making sustainable budget reductions and developing a systematic approach to the problem.

7.4 Having identified a shortfall of just under £1.2m for 2006/7 you can see based on what we know that the deficit has more or less stabilised at just over £1.3m for 2007/8. This indicates that if we bridge the gap we should be close to a balanced budget. In view of this we should set ourselves a savings target of £800k over the next two budget cycles. By then the grant system should be a little clearer and should give some stability allowing us to forecast more accurately.

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7.5 Significant under-spends especially over the last 2 years suggests some capacity in current budgets. Even though a large element was of a one off nature, given the level of balances we need to instill a little risk into the process. We have seen significant IT investment, procurement is advancing and we are investing £1.5m from reserves into service performance, capacity and efficiencies generally. This is a significant investment and we should expect some returns in future. In view of this I would suggest that we set a minimum target for savings of £400k, or 2.7% of budget for 2006/7 across all budgets, should that be exceeded then the excess will count towards the overall target of £800k over two budget cycles.

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7.6 Over the last few years we have injected significant growth into budgets whilst keeping taxes low. However we need to do more in the light of government funding issues and the need to improve services.

7.7 Recent CPA guidelines give significant weighting to use of resources and in particular value for money. Looking back over the last 6 months the government, the IdeA, the Audit Commission and the Gershon review have all brought initiatives around spending reviews, grant changes, and the efficiency agenda. In essence it all signals a need to get more out of our resources in terms of high performance, satisfied communities, low costs and finance growth from within existing budgets.

7.8 At the moment we adopt certain processes to tackle the efficiency/value for money issues and they have served us well: -

- Service planning, which is currently being reviewed.
- Service reviews
- Best value reviews
- Procurement and IT investment

7.9 However what is becoming clear from the use of resources assessments, particularly value for money, is that we need a robust and systematic approach. To achieve that we have to regularly examine and compare our services in terms of cost, performance and outcomes to demonstrate value for money. From that process we need to produce efficiencies, cashable and non cashable. This is not new but we need to plan ahead and ensure we can evidence the efficiencies.

7.10 For 2006/7 as part of the service planning process heads of service will be required to bring forward efficiencies. In addition the management team will bring forward for members consideration a systematic approach whereby the Council can satisfy itself that it is delivering and improving value for money across all services.

8. Conclusion

8.1 Although the above may present a daunting task corporately it is achievable. The council has a culture of corporate working and this coupled with an inclusive budget process and increasing knowledge arising from regular monitoring reporting puts us in a strong position. In contrast with the past, our financial standing is relatively strong and should difficulties occur they could be managed confidently.

8.2 Regarding value for money we have systems such as service and best value reviews to challenge the ways in which services are performing and financed but these are lengthy processes. We need to challenge value for money issues more regularly by developing a systematic approach involving the scrutiny process. Once procedures are embedded we can satisfy ourselves that we are achieving value for money across all services.

9. Implications

9.1 **Policy**

There are policy implications, which will be reported to council in due course.

9.2 **Legal**

None.

9.3 **Financial**

The financial implications are set out in the report.

9.4 **Risk**

A risk assessment has been undertaken and controls are in place to manage those risks.

9.5 **Communication**

None.

9.6 **Corporate Plan and Priorities**

The proposals reinforce the Council's approach to managing our resources in line with council priorities.

9.7 **Performance Management and Scrutiny**

None.

9.8 **E Government**

None

9.9 **Procurement**

None.

9.10 **Equality and Diversity**

None

10. Recommendations

10.1 To agree and recommend the following amendments to the medium term financial strategy to council.

- Charges to be reviewed by each service in line with the trading and charging policy and become part of the budget setting process.
- Where new initiatives are to be funded externally a report will be made to Executive to ensure the full future financial implications are considered and exit strategies are clearly set out and therefore managed.
- That future efficiency plans are included in future budget processes.

10.2 In terms of medium term planning: -

- To agree a budget reduction target of £800k by 2007/8 with a minimum £400k achieved for the 2006/7 budget.
- That the management team brings forward a system to regularly review and improve value for money at the Council.

Background documents referred to in preparing this report

Monthly Monitoring Reports to Executive
ODPM - Grant Settlement Figures – 16/11/2004
Report to an Extraordinary Meeting of the Council on 25/02/2005 – Budget setting

THB/mtfsreviewseptember2005=
19th September2005

MEDIUM TERM FINANCIAL STRATEGY

The Strategy

The strategy will provide an overarching framework in which to develop medium to long term financial plans.

1. That broadly the council maximises spend in line with the changes to the Spending Formula (FSS) and taking account of the council tax policy.

2. That resources are directed towards the priorities identified by the Council

3. That in considering council taxes that cognisance is taken of the socio- economic problems of the area and the impact of, high council tax increases on taxpayers on low incomes, the low level of wealth and indeed the low tax base of the area.

4. That the Director of Finance and Corporate Services monitors the plan taking into account the key issues facing the Council.

5. That bids for future growth be initially considered from existing budgets and thereafter each case to be considered on it=s merits against other priorities of the council.

6. That through various bodies the Council continues to campaign for a better deal for the Council and deprived areas.

Operational Framework

The operational framework is the day-to-day parameters for delivering the strategy. The framework will be subject to regular review.

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Within the strategy=the Council will maintain a prudent balance of, ,1.5m to meet unforeseen or unavoidable items of expenditure which may occur.

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Reserves in excess of the prudent balance to be used to pump prime initiatives as agreed by the Council and to stabilise the base budget in the short term until the budget is fully integrated with the council=s corporate plans.

Such an approach will take pressure off the base budget and enable future revenue savings initiatives to be financed in the short term. Monies for Electronic Service Delivery being a good example.

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That the Council maximises borrowing to enhance the Capital Programme therefore providing investment in the area. As a general rule the Council should not borrow to fund revenue expenditure.

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It is proposed that the current policy for the use of capital receipts be continued on the basis that they are pooled and that usage is considered on a corporate basis.

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In considering charges members should be provided with the following information:-

Current Year Charge	X
Proposed Charge	X
Percentage Increase	X
Estimated Additional Income	X
Income as a % of expenditure	X
Subsidy /Surplus per user (if applicable)	X
Reason for Subsidy (if applicable)	X
Analysis of the impact of the charge	X

APPENDIX 2

MEDIUM TERM FINANCIAL STRATEGY - KEY ISSUES FACING THE COUNCIL

$ Pension Increases

$ Insurance costs

$ Transfer of costs from HRA to General fund as East Durham Homes develops.

$ Improving Performance

$ Procurement/Gershon efficiencies

$ Meeting the Decent Homes Standard

$ Mainstreaming Street Wardens to tackle Anti Social Behaviour.

$ Best Value reviews of: -Housing, Repairs and Maintenance,

$ Environmental Services and support services

$ Engaging the Community – further government initiative.

$ Financial Implications of external funding regimes

$ E Government/Accessibility of Services

$ Premises /Disabled Discrimination Act (DDA)

$ Demand on Capital resources – Decent Homes/DDA/Egovt/Leisure Centres

$ Supporting People

$ Social Inclusion/young People/Elderly/Equality

$ Human Resource Issues around Capacity/Performance Management/Change Culture and Training

$ Potential Externalisation of Services

$ Waste Recycling

$ Central Government changes to Services

$ Government changes to grant system and the impact of the Gershon Efficiency Strategies.

$ Civic Premises – Disabled Discrimination Act

APPENDIX 2/1

BUDGET ASSUMPTIONS

VARIABLES		2005/6	2006/7	2007/8
Salaries and Wage Increases		2.7%	2.95%	2.95%
National Insurance		+1%	+1%	+1%
General Inflation		Zero	Zero	Zero
Insurance increases		Zero	10%	10%
Contract Payments		3.0%	3.0%	3.0%
Pension Costs		+1.8%	+1.8%	Zero
Council Tax Benefits		4.5%	4.5%	4.5%
Rent Allowances		5.0%	5.0%	5.0%
Council Tax Increases		2.9%	3.0%	3.0%
Formula Grant		2.8%	2.5%	2.5%
Interest Rates		4.5	4.5	4.5

CRITERIA USED TO DETERMINE GROWTH

Although the criteria will no doubt be subject to future change for 2005/6 the following was used to prioritise growth.

- Identified priorities of the Council/Corporate Objectives.
- Quality of Life - Sustainability of Services.
- Commitments already made by the Council.
- Best Value Improvement Plans.

S E Government Initiatives (IEG 2/3/4)

- Improvement of Best Value Indicators.
- Self financed growth.
- Issues from the Comprehensive Performance Assessment.
- Statutory Obligations.

For 2005/6 a large element of growth was approved during the 2004/5 financial year.