

BODY: CABINET

DATE: 21st October 2009

SUBJECT: Medium Term Financial Strategy 2009-2013

REPORT OF: Chief Finance Officer

Ward(s): All

Purpose: To set out an overarching sustainable financial strategy to support the Council's strategic priorities and plans over the next three years.

Contact: Alan Osborne, Chief Finance Officer,
Tel 01323 415149 or internally on ext 5149

Recommendations: Members are asked to:

- i) Approve the medium term financial strategy 2009-13.
- ii) Agree the balance of assumptions made in the strategy.
- iii) Agree the aim of sustainable finance as set out in 2.3
- iv) Agree the challenge to be set in determining the Councils corporate and service planning process for 2010/13.
- v) Request that officers develop a system of priority based budgeting for 2010/11 onwards to be used to deliver the challenge.
- vi) Request that the emerging budget proposals for 2010/11 be brought to Cabinet in December prior to detailed consultation.
- vii) Agree that as part of the Service and Financial Planning process that any requests for future use of earmarked reserves are approved in the service and financial plans.

1.0 Introduction

- 1.1 The Councils Medium Term Financial Strategy is a Rolling 3 year Strategy that takes into account:
- The external financial environment
 - The overall financial demand of services
 - The Councils existing and projected financial resources
 - The political priorities and stated aims
 - Financial sustainability
- 1.2 The strategy was last approved in February alongside the 2009/10 budget and is updated at least annually.

- 1.3 In common with all councils the medium term outlook is very challenging and in order to protect services an ambitious ongoing programme of efficiencies is key to success.
- 1.4 The Government set out a target of 3% efficiencies (around £550,000 for Eastbourne) in 2009/10. The Government has since increased the target for local authorities to 4% (£750,000) from 2010/11.
- 1.5 However in order to achieve sustainability the Council is likely to need to meet a minimum of 6% over the next three years and the strategy suggests a "stretch target" of around 8% in order to achieve this.
- 1.6 With such a target the Council has already embarked on a radical programme under the DRIVE programme, full year budgeted savings of over £1m have already been identified in 2009/10.

2.0 Sustainable Finance

- 2.1 The basic legal definition of a balanced budget is that planned expenditure can be met from income and reserves.
- 2.2 Whilst that definition is the legal minimum, it does not provide for sustainability if reserves are used in the long term to resource any differences between ongoing expenditure commitments and ongoing incoming resources.
- 2.3 Therefore it is proposed that over the cycle of the MTFs ongoing expenditure must be financed from ongoing resources with only non recurring investments being met from any surplus reserves.
- 2.4 The original 2009/10 budget was set using £650,000 of non recurring income sources and £290,000 of reserves, principally as a result of an injection of some £2.5m of refunds of VAT from HM Revenue and Customs.
- 2.5 The Capital Programme also has an effect on the Councils revenue finances as any investments that cannot be met from grants, contributions, capital receipts or straight revenue funding need to be met from borrowing. This has to be repaid with interest from revenue over time.
- 2.6 The Council has recently taken on additional borrowing in the Housing Revenue Account in order to meet the decent homes standard. This borrowing is supported by the housing subsidy system and therefore has no long term impact on the Council's General Fund Revenue Account.
- 2.7 The General Fund does have some historic debt of £8m which is fully financed by way of interest charges and the Minimum Revenue Provision (MRP) of £320,000 per annum.
- 2.8 It is up to Councils to set their own MRP and balances of Capital Receipts and Contributions can be offset to reduce this liability in the short term, although this only provides for short term relief against the cost of capital.

2.9 Capital investment can be used as “invest to save” therefore borrowing is an important tool in the overall financial strategy where savings exceed the cost of capital.

3.0 The National Financial Outlook

3.1 It is well publicised that the economy is currently in recession and Councils are not immune from its effects. In addition the state of public finances dictates that a squeeze on public expenditure is inevitable over the life of this strategy.

3.2 The current low interest rates severely reduce the income to councils who generate investment income due to positive cash flow and reserve balances.

3.3 The Government continues to target an inflationary rate of 2% using its preferred method of Consumer Price Index (CPI)

3.4 As part of its comprehensive spending review the Government has already announced the last year of a three year settlement with local government for 2010/11. The pressure to reduce settlements in the following three years is extremely high.

3.5 Service demands on Councils are increasing with demographic and recession causal effects.

3.6 Funding for initiatives such as the Local Authority Business Growth Incentive Scheme (LABGI) has already been reduced over the last year.

3.7 Public sector pay has come under severe pressure with the latest offer to employees in Local Government being 1%. The offer to Chief Officers is 0%.

3.8 The Government has launched a consultation on the future of council housing provision (The Housing Revenue Account) a draft response is included elsewhere on this agenda. It is unlikely that any radical change will take place until well into the cycle of this MTFS.

3.9 The Government has started a consultation on increasing the amount that local government employees contribute to their pensions. Any increases in the short term however are likely to have little effect on the existing employers contributions.

4.0 The strategy commentary and main assumptions

4.1 Issues arising from 2008/9

The Foundation of any sound financial plan is a stable budget to outturn position. The 2008/9 outturn, whilst containing the normal ups and downs was a positive result in that the overall variance on normal activities (£300,000 favourable) was well within tolerance.

4.2 Emerging Issues in 2009/10

In 2009/10 the position has two major challenges:

- The recession and in particular its effect on income levels and service demands
- The ambitious timing of savings targets that were set in February

At the 6 month stage the Council has a provisional outturn of around £500,000 adverse. Work to reduce this projected deficit is underway and the longer term savings from the initiatives in 2009/10 are looking promising.

The only savings that will need to be rolled forward to 2010/11 are the savings of £100,000 per annum that would arise from Trust status.

4.3 Inflation on goods and services

The Government has a long term commitment to retain an inflation rate of 2% per annum (CPI) and therefore the strategy assumes that will be the prevailing rate of its 3 year life.

The Council, in common with most, does not add inflation each year to its supplies and services budgets as this would add some £600,000 per annum.

Instead, it assumes a level of continuous improvement in procurement allowing for only contract inflation to be applied at a cost of some £240,000 per annum.

In the case of any pockets of high inflation (e.g. energy, insurance) a growth bid is made in the service and financial plans to the extent that these cannot be contained by other mechanisms.

4.4 Pay inflation

One of the major costs in a District Council is the cost of its employees. This accounts for some £16m for the Council as a whole.

The current economic climate has some relief in this respect to the Council as during the last MTFS rises of 3% per annum were expected.

The new strategy assumes the following rates based on the economic assumptions:

2010/11 – 1%
2011/12 – 1.5%
2012/13 – 2%

4.5 Pension costs

The increase in the Council's increase to employer contributions to the East Sussex Pension scheme is currently capped at 1% over 3 years (0.33% per annum increase) This expires in March 2011.

The next triennial revaluation of the fund is to take place in March 2010 which will set rates effective from April 2011. The cap for increases in employer contributions over the period is expected to be 2%.

Therefore the strategy assumes a rise of 0.66% per annum for the years 2011-2013.

4.6 Fees and charges

The Council currently receives income from fees and charges for its services of £12m.

The previous MTFS sought to maximise these amounts wherever possible.

In the wake of the recession, the new strategy recommends that whilst the Council will strive to charge for individual services at a rate concurrent with the standard of service, the Council wide effect of increases will amount to no overall gain in income in the first year.

It is assumed that for the years 2011 to 2013, income will grow by 1 and 2% respectively.

Individual service and financial plans will still strive to achieve some increases where it is felt appropriate and achievable.

4.7 Interest Rates

In reaction to the severe drop in interest rates in 2008/9 the Council had to reduce its target for net investment income by £350,000 in 2009/10. This represents approximately £100,000 per basis percentage point.

There are differing forecasts in the future profile of interest rates which are largely dependent on the recovery and inflationary pressures in the economy. Most analysts now predict that there will be a very slow recovery and rates will be only going to increase modestly in 2010/11.

The Council's treasury management advisers (Sector Ltd) are forecasting steadily rising rates that will take until the end of 2011/12 to get to 2008 levels. Other analysts predict a longer recession and therefore a longer timescale for interest rate rises.

The strategy assumes no increase in overall yield from interest rate rises over the life of the MTFS with any surpluses used instead to finance capital expenditure (see 4.11 below) This can be retested as each year's budget is set.

4.8 Council Tax Base

The Council has declared an audited Collection Fund deficit of £797,000 as at 31.03.09.

The deficit is set to rise to around £1.5m by 31.03.10 as the council tax base for 2009/10 was set on the same erroneous method.

Eastbourne's share of this cash deficit will be in the order of £200,000 and can only be offset partially by increased collection performance in 2009/10.

Whilst performance is currently holding up well, the strategy assumes that a one off deficit of £200,000 will be recovered in 2010/11. This will be declared formally in January 2010.

Once rebased to a more accurate level, the recession dictates that in common with most other areas a flat tax base should be assumed for the next three years.

4.9 Government Grant

The Council currently receives £10.3m of revenue support which is set to rise by 1% to £10.4m in 2010/11.

From 2011 there is a new three comprehensive spending review due, so in the absence of any announcements in the autumn or spring budget debates, the Council will not learn what settlement is due for 2011-2013 until December 2010.

The national picture is extremely challenging and the most extreme view is that grant may be cut by around 10%. Clearly this could not happen without any effect on services.

The strategy now assumes a cash freeze over the life of the MTFs.

4.10 Unavoidable Growth

Every year due to service demand, legislation or other factors the Council needs to recognise an element of unplanned growth. With good budget monitoring and rigorous financial it can be reduced to a minimum and dealt with by compensating savings and or contingency budgets.

In 2009/10 there are two main areas of the budget that will require permanent adjustment.

- Land Charges – change in legal regime that requires Councils to achieve a break even position (Councils have traditionally made a surplus on land charges) - £35,000
- Cost of added years given previously. The Council no longer awards added years, but where employees over 50 choose to take a lower redundancy payment they can opt for some added years - £65,000

Looking at previous years and comparing with similar authorities it seems

reasonable to assume a level of £100,000 of unavoidable growth in any one year.

The detailed budget and service planning processes would identify any particular needs in future.

4.11 Revenue cost of Capital

An adjustment of some £700,000 was made to reduce income from investments in the setting of the 2009/10 budget. Assumed rates were reduced from 4% in 2008 to the current 0.5%. This cost the Council some £350,000 per annum in lost interest.

In addition the Council had not previously been making any provision to repay its general fund debt (£8m) therefore from 2009/10 a Minimum Revenue Provision (MRP) was included (4% of the capital financing requirement) at a cost of £320,000 per annum.

Most analysts predict only a very slow increase in rates in 2009/10, and although there is the possibility that increased investment income could be budgeted to make a contribution to the net revenue budget, the strategy includes the option instead to finance further capital either direct from revenue or by making provision to finance further borrowing.

The table below shows the potential capital investment that could be derived from an future increase in rates.

The table assumes repayments over 25 years and a long term average investment return of 4%.

Invest to save schemes could be financed in addition to this where the saving is 8% or greater as a proportion of the initial investment. (4% capital 4% interest)

Increase in Interest Rate	Additional Revenue (£'000)	Amount of Capital Available (£'000)
1%	100	1,250
2%	200	2,500
3%	300	3,500
4%	400	5,000

4.11 The Cabinet has indicated that it would like to continue the migration of resources from non priority areas to priority areas over the life of the MTFs.

A target of £200,000 per annum has previously been set by Cabinet as a desirable annual shift and is modelled in **Appendix 5**.

4.12 Savings

Taking all known factors and assumptions as outlined above the Council would face the scenarios depending on the size of the efficiency programme as shown in **Appendix 3**.

A basic level of savings of not less than £1.1m (6%) of new recurring savings per annum is required for this strategy.

In order to allow for further service development and to act as a stretch target a programme of approximately 8% or £1.5m per annum of new recurring savings is recommended.

Recurring savings that have already been identified are:

£'000

- 100 - Trust Status (B/f from 2009/10)
- 250 - Accommodation (Effective from 1.10.10)
- 200 - Waste Partnership (Effective from 1.4.10)

Together with these at least £700,000 of new savings needs to be identified as part of the service and financial plans for 2010/11 along with options for 2011/13.

4.13 The Housing Revenue Account (HRA)

The HRA is ring fenced from the General Fund although should it fall into deficit then it would have to be subsidised by the General Fund.

Transactions between the HRA and the General Fund comprise three main elements:

- Interest on the HRA balance paid to the HRA
- Debt charges paid by the HRA to the General Fund
- Recharges from the General Fund to the HRA for support services

For the purposes of this strategy it is assumed that there is no change to the existing overall level of transactions between the accounts.

It should be noted however that there are two developments underway:

- A review of the recharging for support services
- An efficiency programme specifically for the HRA in order to maintain a sustainable 30 year business plan

Should services provided by the Council to Eastbourne Homes be lost, an equal and opposite saving in the affected area should be made.

5.0 Reserves

5.1 The Council has four main reserves:

Revenue

- General Fund – As a contingency and working capital
- Strategic change – Set up in 2008/9 to support DRIVE
- Other Earmarked Reserves –For specific projects including carry forwards

Capital

- Usable Capital Receipts – for future capital schemes

In addition the Council holds funds on behalf of others e.g. section 106 contributions.

5.2 The audited 2009/10 accounts show balances available as general fund to be £4.5m, the Cabinet in July considered this to be the starting point for the new MTFS.

5.3 The previous MTFS recommended a minimum general fund reserve of at least £1m.

5.4 The recommended level of general reserves to support a more diverse strategy with ambitious savings targets and an uncertain economic outlook would appear to be in the range £1.5m to £2m.

For the purposes of this strategy a minimum level of reserves is set at £2m initially. This will be reviewed annually as each budget is set.

5.5 The strategic Change fund was established in 2008/9 in order to facilitate the release of ongoing savings. This reserve is a key enabler for change and therefore it is recommended that it is reviewed and potentially replenished over time.

5.6 Other earmarked reserves along with approved carry forwards (£1.043m from 2008/9 to 2009/10) exist to support particular projects.

It is recommended as part of the service and financial planning for 2010/11 that use of these reserves is tested against current priorities, preserving only balances held on behalf of third parties and ring fenced grants.

This would require any requests for carry forward to be approved in the plans ahead of the year that they would be spent.

6.0 Priority Based Budgeting

6.1 As the Council moves forward with its change and efficiency programmes it is essential that it makes decisions on priorities and non priorities using a structured methodology.

6.2 It is therefore proposed to develop a standard methodology to be used in service and financial plans that enables Cabinet to decide on the levels of service that it would accept with levels of reduced investment.

7.0 Main Risks

The main risks in this strategy and strategy to manage are included at **appendix 1.**

8.0 Consultation

- 8.1 Consultation on the MTFS will be undertaken with Scrutiny at the finance event on 2 November.
- 8.2 At its September meeting the Cabinet agreed to launch a consultation on priorities following this meeting, a separate report on this agenda is included.
- 8.3 It is a requirement to consult with the Business Community over the detailed budget proposals that will emerge from this strategy.
- 8.4 The Joint staff Committee has requested a specific consultation, this was started in September following the last Cabinet.

9.0 Conclusions

- 9.1 In order to provide sustainable finances the Council will need to make efficiency savings or service alterations to the order of £1.2-£1.5m per annum over the life of this MTFS. These are summarised in **Appendix 2** and shown in more detail in **Appendices 3-6**.
- 9.2 Due to the scale of the challenge the programme of change will require more radical measures for savings that often have a lead in period of 1 to 2 years, therefore the service and financial plans need to look over a longer timeframe and use a scenario based approach so that the best decisions can be made for services and sustainability.

Alan Osborne
Chief Finance Officer

Background Papers:

The Background Papers used in compiling this report were as follows:

Budget 2009-10

Cabinet Reports: – Finance Matters 27 May, 8th July 2009 and 2nd September 2009 -MTFS and Budget Setting February 2009.

Audit Committee- Final Accounts- 22 June 2009 and 24 September.

To inspect or obtain copies of background papers please refer to the contact officer listed above.

Risk	Contained in Strategy	Appendix 1 Other Potential Mitigation
Income Reduction	<ul style="list-style-type: none"> • Some recession hit income budgets adjusted in 2009/10 • No growth assumed in overall income targets in 2010/11 rising by only 1% and 2% in 2011/12 and 2012/13 respectively 	<ul style="list-style-type: none"> • Service and Financial Plans to test possible income generation activities and price sensitivity • Managers given freedom to set prices in accordance with service levels and market conditions • New sources of income explored in Plans • Service reviews where reduced activity taking place
Government Support Being Reduced	<ul style="list-style-type: none"> • Assumption for cash frozen grant over life of MTFS 	<ul style="list-style-type: none"> • Service alterations to a modified level • Change assumptions in budget setting • Update MTFS if uncontainable
Benefits Performance	<ul style="list-style-type: none"> • Base budget adjustment in 2009/10 • Specific Reserve set aside for approx 1% financial adjustment to Housing Benefit Claim • Short term funding from DWP (£140k) to recognise caseload increase 	<ul style="list-style-type: none"> • Service Review (reported separately) • Mobilise resources from other areas if performance hit by staffing shortages • Relieve service with one off resources to avoid performance drop
Efficiencies not being delivered	<ul style="list-style-type: none"> • A stretch target to ensure elimination of optimism bias causing a corporate problem • Strategic Change Fund to support invest to save • Capital Invest to save principles 	<ul style="list-style-type: none"> • Use compensating savings in short term • Increase and manage a higher vacancy factor • Plan resources and timetable corporately with external challenge
Savings Initiatives "Overload"	<ul style="list-style-type: none"> • Spread of challenge over three years 	<ul style="list-style-type: none"> • Test Corporate Plan for resource distribution, concentrate on largest and most achievable savings

Appendix 2

Appendix	Efficiency Plan	Efficiency Savings %	Amount of new savings per annum recurring £'000	Amount available for recurring service growth from year 1.	Amount available for non recurring service investment (above minimum £2m general reserve) £'000
3	"Do Nothing	0	0	0	Nil -(Negative reserves)
4	Government Target	4	750	0	200 -over 3 years
5	Eastbourne Plan	6	1125	200	1200 -over 3 years
6	Eastbourne Aspiration	8	1500	500	1500 -over 3 years