
REPORT TO THE MEETING OF THE EXECUTIVE 4 NOVEMBER 2009

PORTFOLIO: FINANCE & RESOURCES

**REPORT FROM HEAD OF FINANCE, AUDIT & PERFORMANCE
MANAGEMENT**

SUBJECT: MEDIUM TERM FINANCIAL STRATEGY (MTFS)

1 DECISION BEING RECOMMENDED

- 1.1 To note the mid year review of the 2009/10 budget which sets the context for the 2010/11 budget process.
- 1.2 To note the current assumptions being used for the medium term financial planning.
- 1.3 To indicate to officers any specific issues that need to be picked up as part of the budget process for discussion and consideration as part of the November Budget Awayday.

2 REASON/S FOR RECOMMENDATION

- 2.1 To provide the Council with a starting point for the preparation of the Medium Term Financial Strategy (MTFS) for 2010/11 onwards and the framework within which the Council's budget and Council tax for 2010/11 will be set. It provides a context for those deliberations and provides a range of background information.
- 2.2 The report is structured to consider the following:-
 - Timetable for budget process
 - Current MTFS agreed for 2009/10 onwards
 - Mid year review of 2009/10 budgets
 - Discussion of the assumptions underlying the MTFS
 - Possible Council Tax increases
 - Income
 - Current Savings Target

3 TIMETABLE FOR BUDGET PROCESS

- 3.1 The key dates for preparing and approving the budget for 2010/11 and the MTFS for the period 2010/11 to 2014/15 are:-

Activity	Date
Draft Divisional Plans completed	2 October
Report to Executive – MTFS set the scene & mid year review	4 November
Proposed Joint SMT/Executive	13 November
Member Awayday	28 November
Report to Review Committee – MTFS assumptions & draft budget book	8 December
NNDR Consultation – final meeting	21 December
Proposed Joint SMT/Executive	7 January
Member Awayday	16 January
Council – Budget	26 January
Council – Council Tax setting / Key Policies and Actions	16 February
Revised Corporate Plan	24 March (Executive) 27 April (Council)

- 3.2 The detailed programme of actions for preparing the budgets will be monitored by the Portfolio Holder for Finance and Resources.

4 CURRENT MTFS AGREED FOR 2009/10 ONWARDS

- 4.1 The aim of the MTFS is to demonstrate that the Council can set a balanced budget over the medium term to fund its spending plans by maintaining general fund balance level above a target level by the end of the 5 years. The target level is a Minimum Recommended Level of General Fund balance based on a risk assessment to ensure that the Council has sufficient balances to provide a safety net against future uncertainties in expenditure and income.
- 4.2 In January, the Council agreed the budget for 2009/10 and the MTFS covering the period 2009/10 to 2013/14. The 5 year MTFS includes an annual savings target which represents the forecast budget gap. A budget gap of £780,000 was identified for 2009/10 which was set as a target for savings. It was recognised that this would be done through a combination of the financial results from 2008/09, changes in financial assumptions and estimates for 2009/10, and savings identified by detailed review of service budgets.
- 4.3 In July, the Executive received a report on the progress in addressing this gap and identifying savings. The savings were identified for 2009/10 and also ongoing from 2010/11 onwards and are summarised below:-

	2009/10 -	Ongoing
Contract Arrangements	£38,000	£38,000

	2009/10 -	Ongoing
Council Tax Discounts	£15,000	£15,000
Efficiencies	£10,500	£26,500
External Funding	£36,000	£36,000
Income	£4,000	£4,000
Capital Programme	£44,000	£44,000
Procurement	£128,000	£140,000
Salaries	£82,000	£181,000
Subscriptions	£10,000	£36,000
Transactions	£10,000	£34,000
Total	£377,500	£554,500

- 4.4 During the 2009/10 budget process, a number of bids for additional funding were not progressed because of the financial pressures but it was agreed that these would be reviewed during 2009/10. A summary of these bids and current status is shown below:-

Item	Original Budget Request	Current Position
Meet Climate Change Strategy and Action Plan	£32,000	The Council is entering into a Service Level Agreement with Essex County Council to deliver the Climate Change Agenda as agreed by the Portfolio Holder for the Environment. This was funded by re-prioritising activities as part of the re-structuring of Environmental Services. A budget will be required to fund environmental initiatives.
Increase the value of Taxi Vouchers	£30,000	There was a £39,000 underspend for 2008/09 and with the expansion of the free bus pass scheme, the officer view is that the current provision is adequate
Meet national indicator for biodiversity	£5,000	No action has been taken to date in respect of this Indicator but the budget is still considered necessary.
Enforcement Officer – permanent post	£35,000	Agreed by Executive in July 2009 that post would be funded by savings identified from other posts. Now on the permanent establishment Interviews have been arranged for 11 November.

Item	Original Budget Request	Current Position
Waste Collection Authority – partnership post	£4,000	No longer required.
Chairman of the Council – increased budget for civic duties	£2,000	Managing Activities within current budget parameters

5 MID YEAR REVIEW OF 2009/10

5.1 A separate report to this meeting gives the detailed forecasts for the 2009/10 budgets, including the reasons for changes. In summary the main changes which increase overall net expenditure are:-

- Parking income, including season tickets, is forecast to be £85,000 below budget.
- Investment income is forecast to be £100,000 below budget
- Income from charges for bulky waste is forecast to be £110,000 below budget
- Court cost income is forecast to be £47,000 below budget

5.2 The changes to estimates that reduce overall net expenditure are:-

- Recycling income is £275,000 above budget
- Concessionary Fares expenditure is £80,000 lower
- Inflation linked increases lower than forecast by £70,000

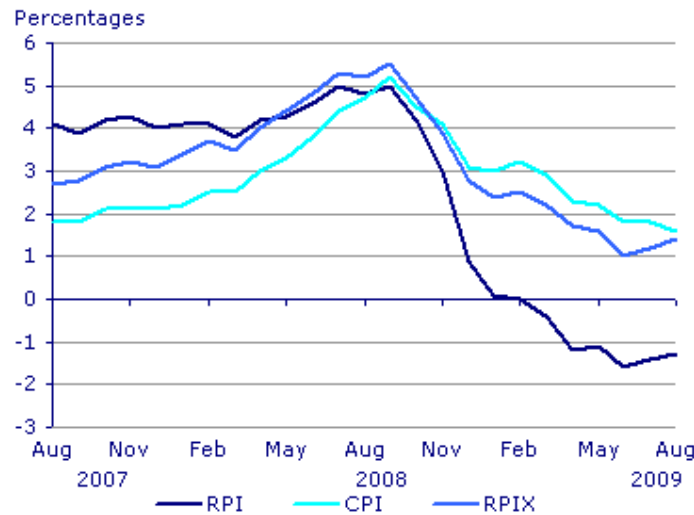
5.3 At this stage, revised net expenditure for 2009/10 is in line with the original estimate of £13.1m

6 ASSUMPTIONS UNDERLYING THE MTFS

Inflation

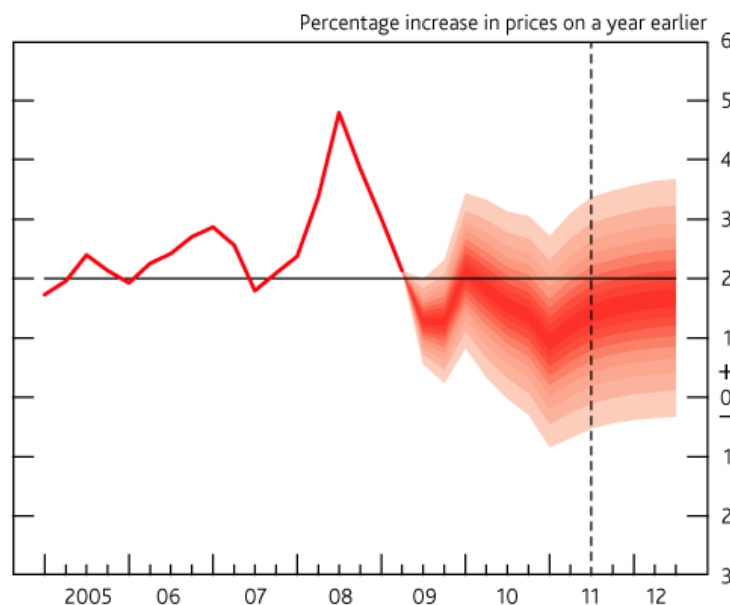
6.1 The Council has outsourced a number of services which means that about £4.8m of expenditure is contracted out and the terms of the contracts allow for an annual increase based on retail price indices. Salaries account for £7m of the Council's expenditure and the current cost of living rise for 2009/10 has been agreed at 1% for officers up to and including Grade SM2 and 0% for officers above that grade.

- 6.2 Since the beginning of 2009, the rate of inflation measured by either the Consumer Price Index (CPI - the Government's preferred measure) or RPIX (Retail Price Index, excluding mortgage payments - used for the majority of our contracts) has fallen with a slight increase in August 2009, as shown below:-



Source: Office of National Statistics – 15 September 2009

- 6.3 The Bank of England's last Inflation Report for August 2009 forecasts CPI as falling below the 2% target in the short term (during 2009), remaining low in the medium term with a higher likelihood of it remaining below the target in the medium term. However, as can be seen from their forecast chart, the forecasts do have an error range of +/- 2%.



- 6.4 Other forecasters' projections are for inflation to remain between 1.5% to 2% up to the end of September 2012.
- 6.5 With regard to cost of living pay rises for the public sector, there has been much debate at the recent party conferences and in local government media about expectations for pay rises for 2010/11. It is likely that in the current economic climate, there will be pressure to limit pay rises next year.
- 6.6 At the current time, the MTFS will be based on inflation between 1.5% to 2%. The risk is that inflation is higher than forecast, particularly at the time of setting annual contract price increases. For contracts, each 0.5% change in inflation is equivalent to about £30,000 and for salaries, each 0.5% is equivalent to about £35,000.

Investment Income

- 6.7 Although investment income is no longer a major source of income for the Council, the MTFS needs to include some assumptions about the expectations for interest rates.
- 6.8 The latest forecasts from the Council's treasury management advisors, Sector, is for bank rate to rise as follows:-

Year	Quarter	Forecast Base Rate
2010/11	Q1	0.50%
	Q2	0.75%
	Q3	1.25%
	Q4	1.75%
2011/12	Q1	2.50%
	Q2	3.00%
	Q3	3.75%
	Q4	4.00%
2012/13	Q1	4.25%
	Q2	4.50%
	Q3	4.50%
	Q4	4.50%

- 6.9 The rate that the Council earns on investments varies from between 0.25 to 1.3 percentage points higher than the current bank rate, ie while the bank rate has been 0.5%, investment returns have varied between 0.75% to 1.8%. On that basis, the average forecast return for the next 3 financial years is:

	Range of return	Average return	Estimated Interest
2010/11	0.5% - 3.05%	1.8%	190,000
2011/12	2.5% - 5.3%	4%	426,000
2012/13	4.25% - 5.8%	5%	530,000

- 6.10 These forecasts have been built into the MTFS at this stage, but will be reviewed as forecasts are updated. The risk is that interest rates do not rise as quickly as forecast and each 0.5 percentage point error in assumptions is equivalent to £53,000.

Pensions

- 6.11 The Council belongs to the Essex Local Government Pension Scheme (LGPS) which is revalued every 3 years, with the last revaluation coming into effect in April 2008. The contribution to the Pension Fund only changes at the time of these triennial revaluations. The last revaluation resulted in only a minor overall change as the increase in employer's contributions was set off against a reduction in the contribution to the pension fund deficiency. However, the recent economic situation is likely to have a major impact on pension funds because of the fall in value of investments, including property and the drop in dividend payments, particularly from banking shares. The Government is consulting on changes to the LGPS and if the proposals are incorporated into legislation, this will affect the next revaluation.
- 6.12 Essex County Pensions will provide an interim valuation later this year which will give some indications of the changes in income and liabilities and the effect this will have on the 2010 revaluation. Because of the complexity of the assumptions and actuarial methods used in the revaluations, it is impossible to give any accurate estimates and the interim valuation will only give an indication of what might happen at the 2010 formal valuation. However, Essex County Pensions have issued some very informal confidential advice about what may happen from 2011/12 onwards. On the basis of this advice, the provision in the MTFS will be increased.

Government Funding

- 6.13 Government grant funding is fixed for 2008/09 to 2010/11 with increases of 3.12%, 2.17% and 2.15% each year. The current MTFS assumed grant funding after 2010/11 of 2.2%. This assumption was based on the current 3 year grant allocation and also medium term inflation forecasts at the time. It is still not clear how Government will respond to the need to reduce the country's debt burden and in particular the implications for public spending on local authorities. It is highly likely that any announcement on local authority funding will be delayed until after a general election and that the priority areas will remain health and education. It is therefore considered prudent to reduce the assumptions on government grant for 2011/12 onwards to 1% per annum.
- 6.14 The risk is that the Council will receive a zero increase or even a reduction in Government grant. Each change in grant of 1% is equivalent to £51,000 in 2011/12. Scenarios of various reductions in Government grant from 2011/12 will be modelled and the implications considered as part of the process for preparing the MTFS for 2010/11 onwards.

Council Tax

- 6.15 The current MTFS assumes annual council tax rises of 4.9%. During the course of the budget preparation process, various scenarios of different council tax rises will be presented for member consideration. The final agreement of the rise for 2010/11 will take place at the Council meeting on 26 January 2010.

Fees and Charges

- 6.16 The majority of discretionary charges will be increased in line with inflation assumptions.
- 6.17 Parking tariffs will be reviewed as part of the budget process for 2010/11.

Capital Programme

- 6.18 The Capital Programme is prepared in line with the Council's Capital Strategy, which will be revised and presented for approval by Council in December.

7 RISK IMPLICATIONS

- 7.1 The risks associated with individual assumptions are detailed in the body of the report and a risk assessment of the current risks to the Council's financial planning is attached as Appendix A.
- 7.2 The preparation of the Council's budget is project managed by the Senior Accountant and will be monitored by the Portfolio Holder for Finance and Resources. At this stage, there are no significant risks which would prevent the Council from setting a balanced budget for 2010/11.

8 RESOURCE IMPLICATIONS

- 8.1 Delivering the savings or additional income identified in this report is essential to maintaining a balanced budget and ensuring that the Council is well placed to finance current and future spending plans.

I confirm that the above recommendation does not depart from Council policy and that appropriate consideration has been given to any budgetary and legal implications.

SMT Lead Officer Signature: _____

Head of Finance, Audit & Performance Management

Background Papers:

None

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If you would like this report in large print, braille or another language please contact 01702 546366.

Appendix A

MTFS – RISK ASSESSMENT AS AT OCTOBER 2009

Risk	Consideration	Action
Adequacy of inflation or interest rate provisions in budgets.	Nearly 50% of the Council' gross expenditure is related to salaries which are nationally agreed and outside the control of the Council.	Inflation is built into MTFS. Scenario analysis of various assumptions to test sensitivity of MTFS to changes in inflation Review inflation forecasts regularly during budget process.
Effects of Capital Finance	Capital cashflows can be difficult to predict as historically they have been from right to buy sales and the Council has now transferred its housing stock. If the Council were not able to finance capital expenditure, it would have to be met from revenue, however, capital balances are relatively healthy.	Part of consideration for level of reserves but no amount required
Investment Income and uncertainty of interest rate assumptions	There is a risk that the Bank of England will reduce interest rates to zero or investments rates will fall further. Current forecasts based on bank rate of 0.5% for 2010/11 and increases from Q2 2010/11 onwards. Each 0.5 percentage point error in assumptions is equivalent to £53,000. Forecast returns – 2010/11 = 1.8%, 2011/12 = 4%	Part of consideration for level of reserves but no amount required. Review interest rate forecasts regularly during budget process.

Appendix A

Risk	Consideration	Action
Debt Collection and Uncertainty of Income	If there were to be a significant increase in bad debts or a sudden reduction in income, this would impact on revenue balances.	Fall in income for planning, building control and land charges built into estimates with recovery from 2011/12 onwards Monitoring of performance against budget
Reductions in Government Funding	Increase fixed for 2010/11 as part of 2007 Comprehensive Spending Review. Grant for 2011/12 unlikely to be announced before General Election.	Reduce assumption to 1% per annum Scenario analysis of various assumptions including reductions to test sensitivity of MTFS to changes in assumptions.
Reduction in Grants	Grants are used to fund one off expenditure items and not part of core estimates	No financial action. Impact is that action plans may not be completed, if dependent upon grant income.
Unpredictable and demand-led expenditure	This would be managed through robust budgetary control during the year and the budget setting process. However, as budgets become tighter, flexibility to accommodate the unexpected reduces and mandatory demand led items represent unavoidable expenditure that has to be financed.	Include in calculation of Minimum Recommended Level of Reserves
Emergency Expenditure	Resulting from unforeseen events. Although the Council has comprehensive insurance cover, there may be incidents which are not covered or where Government assistance is only partial. In the event of such an incident, significant costs may have to be met from revenue reserves.	Include in calculation of Minimum Recommended Level of Reserves

Appendix A

Risk	Consideration	Action
Management of Change	Local Authorities need to have available resources to manage change (eg retraining, accommodation). The lack of such resources can stifle effective management and/or result in other important services being adversely affected.	To be met from existing budgets.
Underachievement of Efficiency Targets	Apart from the risk of not achieving nationally set efficiency savings, the MTFS includes cashable savings. If these are not achieved, Revenue reserves would have to be used to balance the budget.	Include in calculation of Minimum Recommended Level of Reserves
Standards Board	Estimated that an authority of our size may have as many as one investigation per month which could require investigative services. No historical experience to base estimates on	Not to be included in MTFS and costs will be covered by the £10,000 contingency budget
Property Searches	Introduction of cost recovery charges only. Further challenges to level of fees from Personal Search Companies.	Monitor developments during budget process. May require amendment to estimated income.
Pitt Review	No assessment of cost implications yet completed for district authorities. Implications are being considered on a county wide basis.	Monitor developments during budget process.
Pension	Revaluation in 2010 which will affect deficit payment from 2011/12 onwards. Current payment is £720,000.	Monitor developments during budget process and increase provision in line with ECC advice