EAST HERTS COUNCIL

EXECUTIVE – 4 SEPTEMBER 2012

REPORT BY THE EXECUTIVE MEMBER FOR FINANCE

FINANCIAL STRATEGY AND MEDIUM TERM FINANCIAL PLAN TO 2016/17

WARD(S) AFFECTED: ALL

Purpose/Summary of Report

- To consider revisions to the Financial Strategy including policy on reserves and the proposed planning assumptions to be used to update the Medium Term Financial Plan and to make recommendations to the Council.

RECOMMENDATIONS TO COUNCIL: That:	
(A)	**the proposed Financial Strategy be adopted;**
(B)	**the planning assumptions set out in this report be adopted by the Council as the basis for framing the 2013/14 budget and Medium Term Financial Plan to 2016/17; and**
RECOMMENDATION FOR THE EXECUTIVE	
(C)	**Officers be asked to model a projection of the Council's revenue income and expenditure to 2019/20 on the basis set out at paragraph 3.4 to include sensitivity analysis in respect of government funding, business rate income and the rate of housing development and other key variables.**

1 Background

1.1 This report sets the context for the coming budget round. The Financial Strategy is a statement on the Council's approach to and priorities for the management of the Council's finances and which includes consideration of the minimum and maximum amount of reserves it is appropriate to hold having regard to current and longer term risks.

1.2 Medium term financial planning must make assumptions about the future course of demand and cost pressures on spending and on the factors which affect future income.

1.3 The governments proposals with regard to replacing council tax benefits by local schemes of council tax support and for business rates retention by local authorities transfer significant financial risks to local government along side the opportunities these changes provide.

2.0 Report

This report is in 4 parts

Part 1 looks at the funding changes, identifies the risks and provides some sensitivity analysis around those risks.

Part 2 reviews the Financial Strategy and in particularly the current level of reserves

Part 3 considers government funding in the light of the changes set out in part 1

Part 4 considers pay price and other factors

2.1 Part 1 Changes to funding

Council Tax Support

2.2 The Council is consulting on a proposed scheme of council tax support to replace council tax benefits from 1 April 2013. A report to the Executive on 31 July to agree the draft scheme for consultation is a background paper to this report explaining the change in more detail.

2.3 Currently, the government carries the risk of escalation of the cost of benefits but in future the risk of increasing entitlement to council tax discount will be shared by East Herts, the County Council and the Police Authority pro rata to each authority’s rate of council tax.

2.4 Budget and MTFP assumptions for council tax support are as follows.

2.4.1 The cost of benefits to be awarded by East Herts in 2012/13 is estimated at £7m which will reduce to an estimated £6.65m on implementation of the new scheme of council tax discounts. Allowance needs to be made for some growth in numbers becoming entitled to the new discount.

2.4.2 The switch from a scheme of benefits to a scheme of council tax discount is anticipated to increase take up. There can be expected to be an underlying growth in the number of pensioners entitled to the discount from demographic changes. The number of working age families entitled to the new discount is more volatile and affected by the wider economy and employment. The benefits claimant count grew by 10% in the year to April 2009, 8.2% in the year to April 2010, 2.8 % in the year to April 11 and 2.6% in the year to April 2012.

2.4.3 For the purposes of the MTFP the cost of £6.65m has been increased by 3% to £6.85m for 2013/14. Beyond 2013/14 allowance for further growth of 1% in 2014/15 is proposed but no increase thereafter on an assumption that an improving economy starts to reduce the numbers of working age claimants to offset growth in pensioner claimants.

2.4.4 The share of the cost attributable to East Herts is held as a constant 10.7% (East Herts Council band D tax of £159.13 as a proportion of average total council tax £1486.17). This assumes that East Herts rate of council tax moves in tandem with other preceptors.

2.4.5 Funding from the government for council tax support "will be based on revised forecasts of subsidised council tax benefit expenditure, to be issued in the autumn"[1]. The grant income assumption is that support will be based on a lesser figure than the forecast cost set out above (the 3% growth has not been reflected in the grant assumption) and that East Herts will not be subject to the floors and ceiling provisions which formed part of the consultation as not being an obvious outlier in terms of the cost of discounts relative to the budget.

2.4.6 The government will pay a grant to East Herts as billing authority to be used to offset the impact of the changes on town and parish

[1] Localising Support for Council Tax Funding arrangement consultation DCLG May 2012

council precepts. The assumption is that the grant will be fully applied in this way but that East Herts will not make up any difference if the grant does not adequately cover the impact on town and parish councils.

2.4.7 For 2013/14 the latest estimate is that the discount scheme will reduce council tax income to East Herts by £733k offset by government grant of £675k as noted above these figures will be updated in the autumn. Each 1% increase in the cost of discounts above the estimate will cost £7.3k and will not be offset by an increase in grant.

Retention of Business Rates

2.5 From 1 April 2013 50% of business rates will be retained by local government, the "local share" and 50% paid over to central government as the "central share".

2.5.1 "Transitioning from the current complicated arrangements inevitably means there is a degree of complexity to the set up of the new scheme" [2]

"Businesses will see no change in the way their business rates bills are calculated"[3]

2.5.2 The first quotation above is something of an understatement - proposals for retention of business rates introduce a whole new lexicon to local government finance. That transition is intended to minimise the impact on individual authorities in early years whilst providing incentives to authorities to grow their business rate tax base in future years.

2.5.3 Existing arrangements are that all business rate income is paid over to government and that income is then used along side revenue support grant to fund each authority's formula grant. Formula grant is set by factors which take into account relative needs and council tax resource having no regard to business rates. As such the government carries all the risk that income from business rates falls short (or exceeds) the estimate. In year monitoring and collection of business rates need not feature in budget monitoring and forecasting future business rate income has been unnecessary in producing the medium term financial plan.

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[2] Business Rates Retention technical consultation DCLG July 2012.
[3] A Plain English Guide to Business Rates Retention DCLG July 2012.

2.5.4 From 2013/14 the forecast of business rate income will be one of, if not the most, significant factors in setting the budget and MTFP.

2.5.5 The key features of how the new system will work are

- The government will estimate the national business rate income for 2013/14
- 50% of this sum – the local share - will be apportioned to billing authorities based on their share of national business rate collections over the last 5 years
- Of the sum allocated initially to East Herts 80% will be retained and 20% apportioned to the County Council. These amounts are referred to as the “individual authority business rates base line”
- The government will separately determine a figure referred to as “the base line funding level”. This will be derived from each authority’s share of the local government spending control total.
- If an “individual authority business rate base line” is more than the “base line funding level” the excess is paid over to government (and vice versa where a lesser figure). A payment to the government is a “tariff” a receipt from government is a “top up”.
- The “tariffs” and “top ups” will be indexed in line with each September’s RPI.
- So far all the above are based on estimates and actual collections may vary from these estimates.
- Where collections fall significantly short of the estimate a safety net will apply. The safety net will kick in where a shortfall is between 7.5% and 10% (precise figure yet to be decided) of the estimate.
- To pay for the safety net there will be a levy on those authorities where actual receipts exceed their “individual business rates baseline”. The tariff will work such that the rate of increase in the “base line funding level” does not exceed the rate of increase in the “individual authority business rate base line”

2.5.6 As made clear by the second of the quotations above the Council will not set the business rate. Unless the government amends current policy the rate of tax – the “non-domestic rating multipliers” - will be indexed to each September’s RPI. The timing and offer of transitional relief after revaluations will be determined by the government.

2.5.7 For 2013/14 the government will makes its own estimate of what each authority's income will be. It will then allocate revenue support grant so that authorities in aggregate have funding which equals the predetermined spending control total. Revenue support grant will not be retrospectively adjusted should the government's estimates of business rate yield prove to be incorrect.

2.5.8 At this stage the assumption is that the government will make an accurate assessment of the business rate income for 2013/14. The primary focus of attention is therefore on estimating the share of the national local government control total which will be allocated to East Herts (see Government Funding below). It won't be until the 2013/14 accounts are closed (in June 2014) that we will know whether actual business rate income and the amount retained match the estimate – although in year monitoring will alert to significant variation.

2.5.9 The technical consultation paper set out guidance on budget setting and this will be used to assess the government's forecast in the autumn.

2.6 The proposed MTFP includes a specific contingency item of £200k in each of 2013/14 and 2014/15 to meet forecasting errors and which will revised as more information becomes available.

3 Part 2 The Financial Strategy

3.1 **Essential Reference Paper C** is the current Financial Strategy refreshed at paragraph 3.

3.2 The Financial Strategy and the MTFP have a 5 year focus and for this purpose the Strategy remains sound. However, it may be appropriate to put the next 5 years into the context of longer term trends given suggestions that austerity may be here to 2020 and the Local Government Associations modelling of the funding outlook to 2020.

3.3 If local modelling is to be useful it is necessary to agree some parameters which may be subject to sensitivity analysis. The following are high level statements about pressures and income which the Committee is asked to endorse or recommend amendment.

3.4 The most significant drivers of service and cost pressures for East Herts in the period to 2019/20 are seen to be:

- **Increase in the housing stock** allowing the formation of additional households. Information is available from the reports to the District Planning Panel analysing trends and options.
- **Increase in population**. Information can be derived as above and ONS projections.
- Any **exceptional pay or price inflation**. At this stage these appear unlikely to be significant as does the Council's ability to generate income from charges much above inflation.
- **Interest rate changes** and their impact on investment income.
- **Business growth** in the context of business rates retention.
- The impact of continuing deficit reduction measures on **government funding**.

3.5 A review of the level of reserves has been carried out as at 31 March 2012 based on the draft final accounts (**Essential Reference Paper D** refers). This indicates that reserves are £400k above the ceiling set out in the strategy – largely arising from the 2011/12 under spending being above forecast - and which triggers a requirement that consideration be given to reducing the general reserve. At this stage it is proposed to include a use of reserves in 2013/14 and 2014/15 of £200k per year to fund contingencies in respect of the local government funding changes.

4 Part 3 Government Funding

4.1 The business rates retention scheme set out above will still operate within Spending Control Totals. So, for example in 2013/14 of the national spending control total of £25bn some £11.5bn will be funded from the local share of business rates and £13.5bn from Revenue Support Grant (RSG). Some £0.9bn of the business rate income will be set aside for the GLA transport grant producing a ratio of 10.6 (local share of business rates) to 13.5 (RSG) in support of each Council's allocation within the aggregate local government control total. By reducing the amount of RSG the government will at the aggregate level continue to exert considerable pressure on local authority spending even were authorities to grow the business rate income.

4.2 Government funding is therefore best considered as the future course of the Spending Control Totals and the formulas used to allocate a share of the total to each authority.

4.3 The latest exemplification of formula changes for 2013/14 show them to be at worst neutral for East Herts and at this stage a nil change is assumed.

4.4 Updated spending control totals for 2013/14 and 2014/15 are set out in the technical consultation on business rates retention. **Essential Reference Paper E** is a forecast for East Herts based on those amended totals. The reductions in funding compared to 2012/13 are within the contingency amounts allowed in the MTFP approved in setting the 2012/13 budget in February.

4.5 Unusually, there will no certainty at the start of the year about the amount of funding to be received. The government propose to top slice £2bn from the total to meet the cost of

- The New Homes Bonus
- Capitalisation approvals
- A safety net in respect of retained business rates.

4.6 To the extent any of the £2bn is unused it will be returned to local government and there should be a substantial return in the first 2 years based on the amounts estimated to be needed to cover the 3 items quoted above. The proposed MTFP will assume that these sums are returned – a position to be reviewed prior to finalising the budget. For East Herts it is estimated that the amount returned could be as £230k in 2013/14.

4.7 One aspect of government support which is unclear is how support for housing and council tax benefit administration will be phased out as the Universal Credit is phased and what levels of support, if any, will be provided for the new local scheme of council tax support. At this stage the grant of £674k for 2012/13 is assumed to reduce by 50% over the period to 2014/15. Further reductions may be likely as Universal Credit is increasingly phased in and a review will be made in the autumn in the light of any information from DWP.

4.8 Local Government Spending Control totals for 2015/16 and later years will be set after the next Comprehensive Spending Review due in autumn 2013 although there is speculation a full CSR might be postponed until after the 2015 general election.

4.9 Looking beyond 2015/16 control totals for local government spending depend on the pace of deficit reduction which hinges on the timing and strength of economic recovery. In July the IMF published its review of the UK economy and estimated growth in 2012 at 0.1% and 2013/14 at 1.5%. These forecasts were consistent with the summary of independent forecasts published by the Treasury in July. The independent forecasts have been on a downward trend over the last year (in July 2011 the forecast for growth in 2012 was 2%). The IMF report cautioned that the deficit reduction plans for 2013/14 might need to be reconsidered "if growth does not build momentum". The Bank of England's August inflation report painted a similarly gloomy picture "underlying demand growth is likely to remain muted in the near term".

4.10 The Office of Budget Responsibility will update its forecasts in November and it seems inevitable that the Chancellor's Autumn Statement will again reduce growth forecasts and record higher levels of borrowing pushing back the elimination beyond 2016/17 and so well into the next parliament. The growth figures at **Essential Reference Paper B** appear optimistic and a reduction of 1% point in each year might be expected.

4.11 The assumption in the MTFP is that from 2015/16 RSG will fall such that in aggregate business rate income and RSG will show a cash freeze at the level of 2014/15 representing a real terms reduction of about 2% per year.

5 Part 4 Other Assumptions

5.1 At the date of writing this report the GDP figures for the quarter ended June showed a reduction of 0.7% (GDP is at the level it was in the second quarter of 2006); CPI was at 2.4% and RPI at 2.8% for June 2012 with independent forecasts of further reductions by the 4th quarter of 2012. Local government pay was last increased by 1% from April 2009.

5.2 **Essential Reference Paper B** sets out the proposed assumptions for each of the factors built into the MTFP.

5.3 At this stage planning will assume a nil council tax increase in 2013/14 and increases of 2.5% in subsequent years. These assumptions will be reviewed in the light of the grant settlement.

5.4 The MTFP approved in February anticipated savings in 2013/14 and future years. These savings are retained in the current plan but remain subject to confirmation during this budget round. A schedule of the proposed savings is attached to **Essential Reference Paper F**.

5.5 Provision is made to add to the interest equalisation reserve in 2013/14 taking the reserve to £1.78m. These contributions will depend on achieving the forecast investment income in these years. The forecast for investment income has been increased to reflect the Council's new fixed term deposits and the proposed contributions to the reserve will add to capacity to manage lower returns in 2015/16 and later years.

5.6 At this stage no additional savings beyond current plans are required to 2015/16.

5.7 In 2016/17 the savings requirement is dependent on the level of planning contingency. A smaller planning contingency is reasonable now that the funding reductions from the announced changes to grants are built into the budget and substantial funding is now provided to meet a shortfall in investment income. However the contingency provision is not on a scale to address the sorts of reduction in national funding modelled by the LGA – from £24.2bn in 2014/15 to £17.6bn by 2020.

Capital

5.8 The council had no unused capital receipts at 31 March 2012. Income from receipts may be boosted by the government's initiative to promote further "right to buy". Significant capital development would be at cost to investment income and the policy of capping spending at no more than £1m per year is continued in the forecasts. Invest to save and externally funded projects will be in addition to this £1m.

6 Implications/Consultations

Information on any corporate issues and consultation associated with this report can be found within **Essential Reference Paper 'A'**.

Background Papers

HM Treasury Forecasts for the UK economy No. 303 July 2012

International Monetary Fund Public Information Notice No. 12/81 July 2012
Bank of England Inflation Report May 2012
Office for Budget Responsibility Economic and fiscal outlook March 2012
DCLG Business Rates Retention Technical consultation July 2012

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