REPORT TO:	**FINANCE & MANAGEMENT COMMITTEE**	**AGENDA ITEM: 7**
DATE OF MEETING:	**21st OCTOBER 2010**	**CATEGORY: RECOMMENDED**
REPORT FROM:	**DIRECTOR OF CORPORATE SERVICES**	**OPEN**
MEMBERS' CONTACT POINT:	**KEVIN STACKHOUSE (595811)** kevin.stackhouse@south-derbys.gov.uk	**DOC:** u/ks/MTFP/mid year review/October 10
SUBJECT:	**A REVIEW of the COUNCIL'S MEDIUM TERM FINANCIAL PLAN 2010 to 2016**	**REF:**
WARD (S) AFFECTED:	**ALL**	**TERMS OF REFERENCE: FM 08**

1.0 Recommendations

1.1 That the updated financial projection on the General Fund to 2016 as detailed in **Appendix 2** is considered and approved.

1.2 That the potential affects of various Revenue Support Grant Settlements from 2011/12 as modelled in the Report be considered and noted.

1.3 That base budgets for Transport, Grounds Maintenance, Waste Collection and Recycling, together with Street Cleansing are robustly scrutinised during the 2011/12 budget round.

1.4 That the updated capital investment and financing programme to 2016 as detailed in **Appendix 3** is considered and approved.

1.5 That the updated financial projection on the Housing Revenue Account to 2020 as detailed in **Appendix 4** is considered and approved.

1.6 That the Budget and Financial Planning Timetable for 2011/12 (as detailed in **Appendix 5**) is approved.

1.7 That an updated report on the outcomes of CSR 10 and its effects upon the Council's Medium Term Financial Plan is presented to the Committee on 2nd December 2010.

2.0 Purpose of Report

2.1 In accordance with the Council's Financial Strategy (at http://www.south-derbys.gov.uk/council_and_democracy/council_budgets_spending/budget_and_financial_strategy/default.asp) the report reviews and updates the Council's Medium Term Financial Plan (MTFP).

2.2 This includes a review of associated budget projections, risks and assumptions based on various scenarios. It considers both revenue spending and capital investment on the General Fund and Housing Revenue Accounts.

2.3 The report effectively updates the Council's medium term financial position following the reported out-turn for 2009/10, together with changes since the 2010/11 budget-round. It is intended to set an indicative position ahead of the forthcoming 2011/12 budget-round and in particular, the outcomes from the Comprehensive Spending Review (CSR 10).

2.4 The main aim is to gauge in overall terms, the Council's updated financial position ahead of what is almost certainly to be a challenging time financially for the Council over the next planning period.

Aims of the Council's Financial Planning Framework

2.5 A key factor within the Council's overall Financial Strategy is medium term financial planning. This is to achieve a sound and sustainable financial position in accordance with the Corporate Plan objective of achieving "value for money."

2.6 The main target within the Financial Strategy is to achieve a minimum level of general reserves by the end of every financial planning period. This is based on a Medium Term Financial Plan (MTFP) which sets out a financial projection and commentary on the key spending areas across the Council.

2.7 The main focus of the projection is to estimate the Council's future financial position. It should not be used as an indication of impending financial difficulties, but is an early warning sign of the financial challenges that lie ahead in future years. This then provides an opportunity to take proper and planned remedial action. In addition, it is used as the basis for building detailed budget plans each year.

2.8 It also helps the Council to focus on the resources that it will have available during and at the end of each period. In addition, it helps to identify where resources and spending are changing in the medium term to enable action to be taken at an early stage to prevent any loss of financial stability.

2.9 Clearly, the projections are based on a series of assumptions (some of which are interlinked) based on an analysis of interest rates, inflation, together with the national economic situation and central government policy. These do change which can affect the MTFP and consequently the Council's spending plans.

2.10 The report is split into 4 main parts, as follows:

- General Fund Revenue Account – Section 3 and Appendices 1 and 2
- Capital Investment and Financing – Section 4 and Appendix 3
- Housing Revenue Account (HRA) – Section 5 and Appendix 4
- Budget and Financial Planning Timetable 2011/12 – Appendix 5

2.11 Each section starts with a review of the current position, updates the financial projections for known changes and reviews key assumptions in order to provide a revised position ahead of the 2011/12 budget round and in particular, the outcomes from CSR 10.

3.0 GENERAL FUND REVENUE ACCOUNT

Background

3.1 Apart from Council Housing, day-to-day income and expenditure on services is accounted for through the General Fund. The net expenditure is financed from Government Grant and Council Tax, with any shortfall being financed from the Council's Reserves.

3.2 In accordance with the Financial Strategy, a 5-year planning period, on a rolling basis, has been adopted for the General Fund.

The Position Entering this Review

3.3 The General Fund position was last reviewed in February 2010 as part of setting the detailed budget and council tax level for 2010/11. This showed that based on spending plans and after allowing for certain cost pressures in the future, the medium-term financial projection highlighted a continuing budget deficit on a an annual basis to 2014/15. This is summarised in **Table 1**, below.

Table 1 – General Fund Projection (as at February 2010)

YEAR	BUDGET DEFICIT £	CAPITAL PROVISION £	BALANCE OF RESERVES £
2009/10	- 453,264	0	+ 2,347,746
2010/11	- 501,090	0	+ 1,846,655
2011/12	- 581,991	- 465,000	+ 799,664
2012/13	- 346,589	-225,000	+228,075
2013/14	- 382,876	- 310,000	-464,801
2014/15	-302,163	- 250,000	-1,016,964

3.4 The budget deficits for 2009/10 and 2010/11 are being financed by drawing down general reserves which are currently at a relatively high level, compared to the minimum amount required of £1m. However, projections in February clearly showed that this strategy of drawing down reserves could not be sustained beyond 2011/12, without falling below the £1m limit.

Critical Year 2011/12

3.5 Table 1 show that the critical year was 2011/12. Projections highlighted that this was the point when general reserves would fall below the safe and approved minimum level of £1m.

3.6 To correct this position, the Council resolved to identify cashable savings of approximately **£375,000 per year** in order to meet the longer-term budget deficit and to protect the minimum level of general reserves. These savings would need to be in place **by October 2010**.

The Need to Identify Capital Resources

3.7 **Table 1** does however show that the longer-term budget deficit was projected to reduce over the 5-years. This was due to cashable savings already achieved as part of the Council's procurement and service improvement programme.

3.8 However, as previously reported, the deteriorating financial position is being exacerbated by the need to generate resources to meet outstanding capital commitments of **£1.25m.** These commitments are effectively unavoidable as they relate to the final covenant repayments and to replace vehicles.

3.9 If resources were not generated, then this would effectively increase the annual budget deficit as they would need to be financed from the General Fund in the absence of any other options. As **Table 1** shows, this would leave general reserves substantially below the approved minimum level by 2012/13.

Proposed Actions

3.10 When setting the Budget for 2010/11, it was noted that actions already in place should generate resources to help remedy the situation and maintain the Council's finances on a sound and stable footing.

3.11 The issue was that the associated savings were by no means guaranteed at that stage. It was acknowledged that they were subject to either on-going project work, or negotiations with partners. The areas involved were

- Restructure of Community Services
- Corporate Services Partnering Project, including the development of a Business Centre
- On-going efficiency programme through procurement and business improvement
- Head of Service reviews
- Etwall Leisure Centre – additional partner contributions
- Disposal of Surplus Assets

On-going Issues

3.12 The Council has done much work in recent years to reduce what is effectively an underlying budget deficit in the longer-term. As regularly reported over the last 18 months, the effect of the downturn in the global economy, together with volatility in financial markets, severely affected the Council's financial position, mainly through reduced income from short-term investments and planning.

3.13 These reductions have been proportionately greater than any corresponding reductions in cost. Although this situation appears to have stabilised, there are still no clear signs of when the economic situation will improve. It is considered that this would beneficially assist the Council's financial position as a growth area.

3.14 However, the Council is now facing a potential reduction in general government grant as part of the National Comprehensive Spending Review (CSR 10). This is discussed in more detail later in the report.

Progress to-date on Action Areas

3.15 During the first half of the financial year 2010/11, several project areas identified in the previous budget round, have been completed as part of the commitment to generate sufficient savings by October 2010. The key areas have been reported to the Committee in detail and are summarised below.

- Restructure of the Community Services Directorate which will save approximately £677,000 to 2015.
- Restructure of Legal Services through a partnership arrangement which will save approximately £156,000 to 2015.
- Corporate Services Partnering Project which will save approximately £900,000 over the next 7-years on the core services transferred, together with guaranteed savings of a further £800,000 through improved income collection, procurement and service transformation in retained services.

Updated Projection

3.16 The projection has now been updated and rolled forward to include 2015/16 in accordance with the 5-year planning period. At this stage, it only takes account of known and approved changes since February 2010, and is effectively a revised starting point.

3.17 It includes the effects of the key projects highlighted above, together with the 2009/10 out-turn as reported to the Committee on 29th June 2010. Further modelling and sensitivity analysis around this projection is detailed later in the report.

3.18 The overall projection is detailed in **Appendix 1** and summarised in **Table 2**, below.

Table 2 – Updated Projection as at October 2010

YEAR	BUDGET DEFICIT £	CAPITAL PROVISION £	BALANCE OF RESERVES £
2010/11	-336,523	0	2,649,923
2011/12	-434,435	-465,000	1,750,489
2012/13	-151,229	-225,000	1,374,259
2013/14	-130,777	-310,000	933,482
2014/15	-44,840	-250,000	638,642
2015/16	93,331	-250,000	481,972

3.19 The updated projection at this stage shows the on-going budget deficit almost eliminated by 2014/15 at approximately £44,000, with a budget **surplus** by 2015/16. The deficit increases in 2011/12 due to the one-off cost of the District Elections in May 2011 (this projection continues to make a provision of £100,000 to cover associated costs).

3.20 However beyond this, the deficit begins to fall much more sharply due to the on-going effects of the 3 restructure/partnership projects highlighted previously. In addition, the interim costs of the pay and grading review (depending on the timing of implementation) also reduce from 2012/13.

3.21 As reported in June, the net effect of the improved out-turn position in 2009/10, increased general reserves by £421,000, clearly improving the starting position ahead of this review.

3.22 Consequently, general reserves effectively stay above the minimum level of £1m until March 2014, where they would fall to approximately £933,000. If the capital provision could be met, clearly this would improve the financial position markedly.

3.23 It should be noted that the capital requirement continues beyond 2014/15. Although all covenant commitments would have been met by then, vehicles would still need to be replaced and currently £250,000 (£1/4m) per year is required as a contribution to the Replacement Fund.

3.24 However, based on current spending profiles and associated assumptions, by 2015/16, the General Fund would be in surplus and would effectively be in a position to start contributing to the vehicle replacements direct if other capital resources could be identified in the interim period.

3.25 It is stressed again, that this is based on assumptions used in February and these will need to be reviewed. However not withstanding this, actions undertaken have clearly improved significantly the overall financial position in the medium-term.

3.26 The main changes to the bottom line between February and October 2010 are summarised in **Table 3**, below.

Table 3: Changes to the Financial Projection Following Approved Actions

Cumulative 5-year effect	£
Projected 5-year Balance @ March 2015 (as it stood in February 2010) – Table 1	-1,016,964
Community Services Restructure (as per Committee approval)	677,687
Legal Services Restructure (as per Committee approval)	156,900
Corporate Services Partnering (to 2014/15 only)	363,805
Increase in Balances B/fwd @ 1/4/2010 following 09/10 out-turn	421,214
Delay in Pay and Grading (2014/15 provision put back)	36,000
2015/16 - additional year added to rolling plan (£250,000 - £93,331) – Table 2	-156,669
Revised Projected Balance @ March 2016	**481,973**

Key Assumptions

3.27 The main assumptions included in this projection (as approved in February 2010) are shown in **Table 4** below.

Table 4: Key Assumptions included in the Current Projection

Variable	10/11	11/12	12/13	13/14	14/15
Increase in General Government Grant	2.4% (actual)	0%	0%	0%	2%
Provision for Pay Inflation	1.25%	1.25%	2%	3%	3%
Provision for General Inflation	2.25%	1.50%	2.5%	2.75%	2.75%
Increase in Fees and Charges	2.25%	1.50%	2.5%	2.75%	2.75%
Increase in Properties Liable to Council Tax (new build)	450	419	386	386	400
Indicative increase in Council Tax Rate	2.5%	2.5%	2.5%	2.5%	2.5%

3.28 The increases in grant and inflation were based on indicators and predictions prior to the change of Government in May 2010. Given the Coalition Government's strategy and proposals from their June budget announcement, these will need to be reviewed and updated to reflect their priorities and assumptions.

Income from Planning Fees

3.29 In addition, the projection also includes future estimates of income from planning, building regulations and land charges - significant income streams for the Council. Current estimates are detailed in **Table 5**, below.

Table 5: Significant Income Streams included in the Current Projection

Analysis of income from planning applications, building regulations and land charges	Planning Fees £	Building Regs £	Land Charges £	Total £
Estimate 2009/10	531,000	255,000	130,000	916,000
Actual 2009/10	677,070	232,875	134,023	1,043,968
Estimate 2010/11	531,000	210,000	125,000	866,000
Forecast 2011/12	590,000	340,000	130,000	1,060,000
Forecast 2012/13	590,000	340,000	130,000	1,060,000
Forecast 2013/14	590,000	340,000	130,000	1,060,000
Forecast 2014/15	590,000	340,000	130,000	1,060,000

3.30 The forecasts are currently based on an upturn in the current economic climate during 2011/12, in particular from planning fees and building regulations, where there are forecasted increases in overall income levels.

3.31 As previously reported, it is considered that income levels from land charges will not increase due to the nature of the market and national changes to the pricing mechanism. Indeed, latest information suggests that income could in fact reduce and again this is detailed later in the report.

Income from Short Term Investments and Bank Deposits

3.32 The following interest rates and income estimates are included in the current projection.

Table 6: Projected Interest Rates and Receipts within the Current Projection

Year	Interest Received	Average Interest Rate
2010/11	£60,000	1.50%
2011/12	£100,000	2.50%
2012/13	£140,000	3.50%
2013/14	£160,000	4.00%
2014/15	£190,000	4.75%

3.33 The average rate currently being earned on deposits is 0.75%, compared to an anticipated 1.5% for 2010/11. In addition, there is still no clear sign when interest rates will increase and it is likely that interest received will now be below the estimates in 2010/11 and 2011/12 and this is reviewed later in the report alongside interest payable.

Pensions

3.34 The projection assumes an increase in employer's contributions of 1% of pensionable pay from 1st April 2011. The Pension Fund is currently subject to a triennial actuarial review, the results of which are due shortly.

The National Position

3.35 The Committee will be aware that during the summer the Coalition Government has been undertaking a review of public expenditure. It is widely expected that many areas of local authority spending, will see a reduction in central government support from April 2011.

3.36 The Comprehensive Spending Review (CSR 10) is due to report on 20th October 2010 and a verbal update will be provided at the meeting. However, it is anticipated that only global departmental figures will be published at this stage and grant allocations for individual authorities will be released later in the year.

3.37 As part of this review, it is expected that authorities will be given some new "guidance" on setting future council tax levels.

3.38 In addition, the national situation regarding employee pay awards has not been formally resolved.

3.39 The Government's June budget review based its projections on a pay freeze for a majority of local government workers in 2011/12 and 2012/13. In addition, the Local Government Employers have offered no increase for the current year, 2010/11. Annual awards are of course subject to national negotiation and as the greatest cost this is a critical issue for the Council's MTFP.

3.40 In addition, with pension funds across the country likely to show further deficits following a review of current actuarial valuations, some action may be required nationally to limit any further liabilities on council budgets.

A Review of Key Assumptions, Risks and Other Financial Issues

3.41 **Tables 2 and 3** (above) summarised the Council's revised financial projection following the effect of known and planned changes.

3.42 The next sections of the report, review this projection based on updated information and analysis. Consequently, it proposes a further financial projection following a prudent review of the key assumptions and risks included in the MTFP. The areas reviewed are:

- Pay awards
- Inflation (on income and expenditure where it is applied)
- Interest payable and receivable
- Income from Land Charges
- Housing and Planning Delivery Grant
- Insurance Premiums

3.43 This revised analysis is intended to provide a MTFP and projected financial position ahead of the detailed grant settlement, council tax increase and pension contributions, for which more detailed and mainly external information is awaited.

Pay Awards

3.44 As previously highlighted, the Council has allowed for increases on pay in its forward projections, although nationally, it appears that there will be a strong move towards implementing pay freezes for 2010/11, 11/12 and 12/13.

3.45 Against this and with continuing forecasts for the UK economy, the MTFP provisions of 1.25% for 10/11 and 11/12, together with 2% for 12/13 and 3% per year thereafter, appear prudent. However, current levels of inflation are above these percentage levels.

3.46 It is proposed that a provision is now made of ½% for the next 3 years, (2010/11 to 2012/13 inclusive) and then 2 ½% per year thereafter.

3.47 The ½% increase (or 1.5% over 3-years) is intended to cover any increases for the lowest paid as set out in the Government's June Budget. The longer-term provision of 2 ½% is based on the latest forecasts of longer-term inflation as measured by the GDP National Deflator.

3.48 Pay, including on-costs such as allowances, together with employer's national insurance and pension contributions are the largest cost to the Council (estimated at £10.5m on the General Fund for 2010/11). Consequently, this is a sensitive variable. For example, a ½% change in one year, equates to approximately £52,500 per year or in excess of £1/4m over 5-years.

3.49 Building in the revised inflation provisions into the current model, <u>increases</u> balances at 2015/16 by approximately £1.9m. This includes around £150,000 due to the cancellation of a proposed 1% increase in employer's national insurance from April 2011; this had been planned by the previous Government in December 2009.

Pay and Grading Review

3.50 At its meeting on 16th February 2010, the Committee agreed in principle to provide additional resources for implementing pay and grading. These additional resources were to be found from the difference between the actual pay award for 2010/11 and the amount that the Council had provided for in the MTFP, assuming that this was lower.

3.51 As highlighted earlier, the amount originally provided was 1.25% and it is proposed to reduce this to 0.5%. However, for 2010/11 only, the original provision for pay will be maintained to reflect the resolution of the Committee in February.

3.52 This then increases the base budget for employee costs in 2010/11 with a cumulative effect over the period 2011/12 to 2015/16 equating to £472,000.

General Inflation

3.53 In accordance with the Financial Strategy, inflation is not automatically applied to all cost heads and a provision is made where it is considered unavoidable.

3.54 This mainly applies to items such as fuel, energy/utility costs, repairs/maintenance and contracted supplies/services. Allowances are also set for concurrent expenses paid to parish councils together with grants to voluntary bodies.

3.55 Most budget heads are in fact cash limited and in particular those relating to office and other overhead expenses. Allowance is made for increases in fees and charges where the Council has discretion to do so.

3.56 Total inflation is held and controlled as a separate contingency in the MTFP along with the provision for pay awards. It is only allocated to budgets once an inflationary increase or allowance is either approved or known to have impacted upon a base budget.

3.57 As highlighted earlier in the report, provision for inflation has been allowed at 2.25%, 1.5% and 2.5% for 10/11, 11/12, and 12/13 respectively, with a longer-term rate of 2.75% beyond this. These indices were based on HM Treasury's forecast of longer-term inflation as measured by the GDP National Deflator, as at December 2009.

3.58 As part of the June 2010 Budget, the Treasury amended their forecasts of the GDP index to the following:

- 2010/11 – 3% (up from 2 ¼%)
- 2011/12 – 2% (up from 1 ½%)
- 2012/13 – 2 ¼% (down from 2 ½%)
- 2013/14 onwards – 2 ½% (down from 2 ¾%)

3.59 Although the longer-term rate has been revised down slightly, the short-term rate has been increased to reflect current and actual inflation rates, the GDP acting as an overall average. Building in these indices into the financial model <u>decreases</u> resources by approximately £140,000 over the life of the projection to 2015/16.

3.60 An analysis of the updated inflation/growth provision (including pay) is summarised in **Table 7**, below.

Table 7 – Analysis of Overall Inflation Provision

	2010/11 £'000	2011/12 £'000	2012/13 £'000	2013/14 £'000	2014/15 £'000	2015/16 £'000
Pay	131	54	55	262	269	276
Other Costs	84	75	87	105	108	111
Fees and Charges	0	(120)	(138)	(142)	(156)	(160)
Growth	22	56	68	69	69	70
TOTAL	237	65	72	292	288	297

<u>Note</u>

Inflation applicable to fees and charges has been included direct in the base budget for 2010/11 following a review of fees and charges during the previous budget round.

3.61 The provision for growth includes the phased increase for concurrent expenses paid to parish councils (as approved by the Committee in January 2010) together with anticipated costs in future years due to the growth of the District. These remain unchanged from the MTFP approved in February.

3.62 Due to the recent transfer of Corporate Services to the new service provider, the inflation analysis in Table 7 will change, i.e. the provision for pay will be effectively transferred to "Other Costs." This is because direct staff costs will reduce, with contractual costs increasing.

3.63 However, as the yearly indexation on the base service fee is mainly tied to annual pay awards, the overall effect is likely to be minimal.

Fees and Charges

3.64 The level of increase for fees and charges may present a risk. Year on year, it may not be possible to generate the increase on each and every charge made.

In accordance with the Council's Charging Policy, the level of fees and charges is reviewed on an annual basis during the budget round, with an average increase across each service area being used as a target.

Interest Payable and Receivable

3.65 The current MTFP was based on the assumption that the Bank of England Base Rate would increase during 2010/11, with an average rate over the year of 1.5%. Clearly, the Rate continues to remain unchanged at 0.5% and it is widely considered that it will remain at this level until the early part of 2011.

3.66 The Council is currently earning 0.75% on its short-term investments and bank deposits and this is unlikely to improve by March 2011. The MTFP is based on a longer-term average rate by 2014/15 of 4.75%.

3.67 The longer-term rate may be prudent as many commentators agree that the Bank Rate will need to increase, and too much higher levels, to combat inflation and to prevent further distortions in economic activity; it is the timing that remains unclear.

3.68 However, in the interim, it appears that the average rate in the MTFP over the next 2-years is now unrealistic. Therefore, it is proposed to use a lower average rate for 2010/11 and 2011/12, as follows:

- 2010/11 – 0.75% (compared to 1.5%)
- 2011/12 – 1.75% (compared to 2.5%)

3.69 Feeding this into the financial model <u>decreases</u> resources by approximately £48,000 over the life of the projection to 2015/16. This amount is perhaps not as great as expected, but clearly we are only dealing with low rates of interest and the longer-term rate of 4.75% remains unchanged.

3.70 In addition, although interest is lower (compared to the previous projection) this is offset to some extent through lower interest payments on transferred debt and also in the amount the General Fund pays over to the Housing Revenue Account (HRA).

3.71 The projection assumes a lower average cash and reserve balance, dropping from £4m in 2010/11 to £3m by 2015/16.

Land Charges

3.72 As previously reported, the Committee will be aware of an on-going issue around whether local authorities are able to charge for providing data on environmental information as part of a land/property search. With effect from 17th August, the Government revoked the current statutory fee of £22, effectively to conform to a European Directive.

3.73 Based on this Directive, the UK Government consider that a majority of information contained in local authority property records is likely to be “environment information” and that under information regulations, it should be made available free of charge.

3.74 The Council’s total budget of £125,000 for income from land charges for 2010/11 includes an amount of approximately £25,000 for income from personal searches. Given the revocation of the statutory fee, it is considered prudent that this amount is taken out of the overall budget from 2010/11 onwards.

3.75 In addition, the Directive is retrospective and could mean that the charges and income received for personal searches dating back to 2005 (when the Directive was implemented) will be recoverable. In the period covering January 2005 to 30th July 2010, the Council has received total income of just over £100,000.

3.76 Clearly this is a national issue, not least on the basis that a major income stream for local authorities is being reduced. The Local Government Association (LGA) continues to lobby the Coalition Government on behalf of local authorities, not only from a financial viewpoint, but also on more practical/technical implications on accessing information.

3.77 In the meantime, it is considered prudent that the MTFP allows for a provision of £100,000 covering any claims for refunds by individuals and private search companies who have been charged since 2005.

3.78 <u>However, this should not be taken that any refunds are necessarily due.</u> The Council will need to look closely at any claims and considers that it is the responsibility of companies and individuals to demonstrate and provide evidence that money is owed. In this respect, definitive guidance is required to be provided at a national level.

3.79 The LGA consider that there is still a case to argue, including that there should be compensation for local authorities who have only implemented fees set by statute.

3.80 A separate elsewhere on the Agenda of this Committee considers this issue in more detail, including options to change the fee charging structure from 1st November.

Housing and Planning Delivery Grant (HPDG)

3.81 As previously reported, the Coalition Government announced earlier in the year that there will be no allocation of HPDG in 2010/11. This grant has been awarded in the past to support local authorities in their strategic housing and planning roles.

3.82 The Council has an earmarked reserve set-aside from which it draws down financing to meet expenditure each year, including staffing costs. The reserve is topped up each year from Government allocations. As at 31st March 2010, the HPDG Reserve amounted to £511,000.

3.83 It is not clear whether HPDG or a replacement will be awarded in future years. The Government has announced that it is its intention to provide resources based on the number of new properties built in the area.

3.84 Clearly, as a growth area, this would benefit the Council. However, it is not clear whether this will be new money or form part of the General Revenue Support Grant. It is likely that this will be determined as part of CSR 10.

3.85 Based on committed and planned spending, the current HPDG reserve of £511,000 will run out in 2012/13. This prevents an issue for the MTFP in that approximately £180,000 (per year) of staffing and other costs are funded from this Reserve. This is in addition to any other spending pressures (including planning inquiries) that HPDG has helped fund in previous years.

3.86 It should be noted that the staff costs are mainstreamed posts and are included in the 5-year financial plan. The issue is that the Reserve has been used to fund costs in addition to Revenue Support Grant and the Council Tax. Effectively, on-going HPDG has been assumed in the MTFP.

3.87 Given the likely pressure on the forthcoming grant settlement for local government, it is considered prudent that the £180,000 is reduced from 2013/14 pending the grant situation later in the year.

Insurance Premiums

3.88 At its meeting on 9th September, the Committee approved a contract, following a tendering exercise, for its insurance premiums over the next 5-years. This will generate a saving of approximately £20,000 per year on the General Fund and this has been reflected in the updated MTFP.

Updated Projection

3.89 The overall effect of the above changes to the financial projection is detailed in **Appendix 2**, with a summary in **Table 8**, below.

Table 8: Revised Projection as at October 2010 (Following Updated Analysis)

YEAR	BUDGET DEFICIT (-) / SURPLUS £	Capital Provision £	BALANCE OF RESERVES £
2010/11	-378,282	0	2,608,164
2011/12	-486,625	-465,000	1,656,539
2012/13	83,472	-225,000	1,515,011
2013/14	-42,491	-310,000	1,162,520
2014/15	99,696	-250,000	1,012,217
2015/16	280,237	-250,000	1,042,454

3.90 **Table 8** shows that the level of balances would still be around the recommended minimum level of £1m by 2015/16. Clearly the biggest variable is the assumption regarding lower pay awards, in particular over the next 3-years, as highlighted earlier in the report.

3.91 <u>However, to reiterate, at this stage, this is before any effect of a potential reduction in Government Grant is taken into account and this still assumes an annual increase in council tax of 2.5%. This is effectively the starting point based on the most up to date information and analysis pending CSR 10.</u>

CSR 10

3.92 It is widely considered based on headline information from the Coalition Government, that departmental spending as it affects the grant allocation of this Council, will be cut from current levels. In fact, more recently, Ministers have said that cuts are “inevitable” if the Government is to meet its over-riding priority of reducing the UK’s Budget Deficit.

Government Spending

3.93 Government figures show that it has to find £86bn nationally to meet the projected budget deficit over the next 6-years. Of this £66bn (around ¾) is to come from budget cuts. The Treasury has asked all Government Departments to produce saving plans modelled on cuts of between 25% and 40%.

3.94 The Government expect that the average cut per department will be 25%. However, some spending areas like Health are to be protected and this will mean that other departments could be facing cuts of 30%.

3.95 This will most likely apply to the Department for Communities and Local Government (DCLG) from which the Council receives its main revenue support grant. DCLG’s annual budget is £33.6bn, of which 25% is approximately £8.4bn.

3.96 Cuts already announced by the DCLG have already saved £2bn through reducing specific grants (such as the HPDG), closing regional government offices and development agencies, together with the disbandment of the Audit Commission.

3.97 More recently, the DCLG has apparently agreed a cut in its housing and regeneration budget with the Treasury, resources which do not impact directly upon local authorities.

3.98 Some further cuts in central government are likely and it remains to be seen just how great the reduction is, that is finally passed on directly to district councils.

3.99 In addition, the Council receives funding from the Department for Works and Pensions (DWP). Its budget is £9bn per year, of which 25% equates to around £2.25bn. The Treasury is expecting large savings in this area from benefit reform in particular.

3.100 This could also have a knock-on effect to the Council who pay and administer benefits locally and receive a grant of £1/2m to fund costs.

Revenue Support Grant (RSG) and Redistributed Business Rates

3.101 The general grant (or Formula Grant as it is known) from central government is in fact mainly business rates income that is pooled nationally as opposed to revenue support. The proportion of business rates (or NNDR) has in recent years been increasing to become the greatest share and currently makes up ¾ of the overall Formula Grant across local authorities.

3.102 The Council's general grant for 2010/11 of approximately £7.3m is split 0.9m RSG and £6.4m NNDR. This is an issue for the Government in that under legislation, all income pooled nationally from NNDR has to be returned to local authorities in some form.

3.103 If overall Formula Grant is cut to such a large extent, this may mean that a proportion of NNDR proceeds nationally are "lost," i.e. the total collected may be more than the Government are willing to provide in resources to local authorities.

3.104 If a cut of 25% in overall resources was to be implemented, this would mean that the Government would need to address the NNDR issue. It is considered that this would put pressure on specific grants such as those previously awarded for HPDG, etc. In addition, general or Formula Grant may then be entirely made up of redistributed business rates in this settlement.

Illustrative Effects on the Council

3.105 The Council currently receives a general government grant of approximately £7.3m to fund general fund expenditure. The MTFP as revised in **Table 8** above assumes no increase in this level of grant over the next 3-years.

3.106 Clearly now, this assumption appears optimistic. Therefore, to gauge the potential affects of a reduction, the revised position as shown in **Table 8** has been modelled on the basis of real term reductions in grant of 5%, 10% and 25% spread evenly over the next 5-years. The results are summarised in **Tables 9 to 11**, below.

Table 9: A 5% Reduction

YEAR	BUDGET DEFICIT (-) / SURPLUS £	Capital Provision £	BALANCE OF RESERVES £
2010/11	-378,282	0	2,608,164
2011/12	-559,764	-465,000	1,583,401
2012/13	-62,074	-225,000	1,296,326
2013/14	-259,721	-310,000	726,605
2014/15	-334,777	-250,000	141,828
2015/16	-373,697	-250,000	-481,869

Table 10: A 10% Reduction

YEAR	BUDGET DEFICIT (-) / SURPLUS £	Capital Provision £	BALANCE OF RESERVES £
2010/11	-378,282	0	2,608,164
2011/12	-632,902	-465,000	1,510,262
2012/13	-206,158	-225,000	1,079,104
2013/14	-472,606	-310,000	296,498
2014/15	-614,371	-250,000	-567,874
2015/16	-717,956	-250,000	-1,535,830

Table 11: A 25% Reduction

YEAR	BUDGET DEFICIT (-) / SURPLUS £	Capital Provision £	BALANCE OF RESERVES £
2010/11	-378,282	0	2,608,164
2011/12	-852,319	-465,000	1,290,845
2012/13	-629,632	-225,000	436,213
2013/14	-1,085,634	-310,000	-959,421
2014/15	-1,403,261	-250,000	-2,612,681
2015/16	-1,669,784	-250,000	-4,532,465

3.107 Clearly, the very worst case scenario of a 25% cut would make the Council's current spending level completely unviable. A more "moderate" cut of 10% would eventually lead to a substantial budget deficit in the longer-term of approximately £700,000, although the reserve balance would stay above the £1m minimum level until 2012/13.

3.108 Even a 5% cut would reduce balances to virtually zero by 2014/15, with an annual budget deficit of nearly £400,000. This would effectively put the Council's General Fund back into a negative position it was facing 18 months ago and offset all of the efficiencies made to-date.

3.109 Clearly, a 5% reduction is at the lower end compared to global figures being highlighted for the local authority sector. Anything higher would mean that the Council would seriously need to consider its spending before 2012/13.

Council Tax

3.110 As part of CSR 10, it is expected that "guidance/direction" will be issued to local authorities on future council tax levels. The Coalition Government have indicated that they expect a council tax freeze for the next years, i.e. 2011/12 and 2012/13.

3.111 They have also indicated that may look to provide “incentives” to councils who freeze increases in line with their expectations.

3.112 Again, for illustration, if a freeze is applied alongside (say) the “moderate” grant scenario of a 10% reduction (Table 10 above) the effect is shown in **Table 12**, below.

Table 12: A 10% Reduction in Grant
And a Council Tax Freeze in 2011/12 and 2012/13

YEAR	BUDGET DEFICIT (-) / SURPLUS £	Capital Provision £	BALANCE OF RESERVES £
2010/11	-378,282	0	2,608,164
2011/12	-751,576	-465,000	1,391,588
2012/13	-449,659	-225,000	716,929
2013/14	-725,204	-310,000	-318,275
2014/15	-876,369	-250,000	-1,444,645
2015/16	-989,666	-250,000	-2,684,310

3.113 The table shows that a council tax freeze alongside a “moderate” grant reduction would worsen the financial position much quicker. Reserve balances would fall below £1m before 2012/13 with a much higher longer-term budget deficit.

National Concessionary Travel Scheme

3.114 As previously reported, with effect from April 2008, the Council benefited from a reduction in costs arising from the new National Bus Pass Scheme. In Derbyshire, this forced a reallocation of costs to represent a fairer share based on actual usage compared to eligible population, from which South Derbyshire gained.

3.115 However, the MTFP only shows this benefit accruing until March 2011. With effect from April 2011, the responsibility for concessionary travel will pass to first tier authorities - the County Council in our case.

3.116 Consequently, the associated costs and funding will also transfer, although the mechanism for doing this is still to be confirmed. However, there will be a redistribution of government grant associated with concessionary travel to match up with total costs in each area.

3.117 Although South Derbyshire will not meet the cost, it will also lose grant, and the net position (£840,000) has been maintained in the MTFP. This effectively reflects the higher costs of the scheme prior to 2008.

3.118 If the grant “loss” is less than £840,000, then clearly this helps the overall financial situation, although there is a risk that the Council could even be a net loser on redistribution based on some draft exemplifications issue by the

DCLG. This is a further issue where the final proposals will form part of CSR 10.

The Need to Review Current Spending and Other Issues

3.119 Given the expected effect of CSR 10 on the updated MTFP as analysed in the report, the Council will need to continue to robustly review its current base budget to safeguard reserves and ultimately current service provision.

3.120 It is likely that resources will still be required to gain a balanced budget in the longer-term and to meet capital commitments (an update on capital is provided in Section 4). However, the magnitude will not be known until later in the current budget round.

3.121 Some provisions continue to be made for pension increases, the interim costs associated with the outstanding pay and grading review, together with district growth, mainly refuse collection and street cleansing.

3.122 In addition, resources (as yet uncommitted) still remain for additional support to the voluntary sector (£100,000) and the statutory Place Survey (£20,000 every 2-years) which has recently been abolished. Clearly, tight control of the inflation/growth contingency pot could also help to increase available resources.

3.123 However, it is important to highlight that this projection does not allow for any new resources to meet service improvements that the Council may wish to focus on over the next few years. In addition, no specific resources have been identified to replace the Section 106 financing (£50,000 per year) for maintaining Swadlincote Woodlands.

Spending Trend

3.124 The Council does have a history of spending overall within budget which is prudent but it should not be assumed that this will continue. However, certain areas should come under close scrutiny where there have been recent trends in under spending to determine whether the base budget can be reduced.

3.125 For example, savings (compared to budget) were reported for 2009/10 in Transport (£88K), Grounds Maintenance (£52k), Recycling (£48k) and Street Cleansing (£47k).

3.126 A proportion of these savings may not be on-going and some budgets are demand led. In addition, several of the spending areas are being reviewed as part of the efficiency/service review projects highlighted below.

3.127 However, in the meantime, the base budget should come under closer scrutiny in these areas. Therefore, it is strongly recommended that they do so as part of the 2011/12 budget round with a view to reducing current spending.

The Council’s Efficiency Programme and Service Reviews

3.128 Clearly, this will increase the pressure even further for the Council’s on-going efficiency programme (mainly through procurement and service reviews) to deliver resources to achieve a balanced budget and for re-investment to meet emerging priorities.

3.129 In accordance with the Financial Strategy, only efficiencies banked to-date have been included in the projection, including those highlighted earlier in this report.

3.130 In accordance with the Council’s Procurement Strategy, additional project work currently being progressed is follows:

- Re-tendering the Contract for Leisure Facilities, where it is planned to let a contract with effect from April 2011.

- Tendering for Grounds/Parks Maintenance Services where it is planned to let a contract with effect from November 2011.

- Joint working in Waste/Recycling, where a detailed business case is being progressed for consideration by the Council in January 2011.

3.131 When savings are known and guaranteed, these will be built into the MTFP.

Corporate Services Partnership

3.132 In addition to the reduction in service costs transferred which are now included in the MTFP, the service provider has guaranteed minimum cashable savings of approximately £800,000 over the next 5 years to 2016. These savings will be delivered through improved income collection, transformation in procurement and retained services.

3.133 Although specific areas have been earmarked, detailed service improvement plans to deliver the financial savings are currently being formulated. These will need to be approved by the Council. The savings will be phased, mainly over the next 5-years, but again, will only be built into the MTFP once known and guaranteed.

Minimum Level of Balances

3.134 The previous sections clearly highlight that the Council faces many financial risks and variables, several of which are quite exceptional. Therefore, it needs to be prudent in ensuring that it maintains an adequate level of general reserves on its General Fund to act as a contingency.

3.135 The Local Government Act 2003, places the emphasis on each local authority to determine its minimum level of reserves, based on advice from the authority’s Section 151 (Chief Finance) Officer. This will depend on local circumstances and the minimum level should be reviewed on a regular basis.

3.136 Based on this, the Council's minimum level as set out in the Financial Strategy is **£1m** on the General Fund. This level is calculated based on an assessment of the major financial risks facing the Council including major income streams, inflation and interest rates, all of which are detailed in previous sections of the report.

3.137 Good practice suggests that the minimum level should be between **5**% and **10**% of net revenue expenditure. Based on the net revenue expenditure on the General Fund for 2010/11 of approximately £12.5m, £1m is **8**%; by 2015/16, £1m will be around **7.5**%.

Conclusion – General Fund

3.138 Clearly, there are a lot of variables that can come into play in formulating the projection. Overall, the projection is considered to be realistic, but prudent based on known information at this point in time.

3.139 Clearly the biggest issue for the Council now is the detailed results of CSR 10, in particular future grant levels and how concessionary travel will affect the settlement.

3.140 The Council currently has a good level of unallocated general reserves and with actions implemented from the efficiency programme over the last 2 years, this has maintained a relatively sound financial position, at least in the short term.

3.141 Therefore, unless there is a more significant cut of 25% as shown earlier in **Table 11**, the Council will still have a general fund reserve balance of over £1m in March 2012.

3.142 This will at least provide some time for the Council to implement current project work and to put in place further measures ahead of the 2012/13 budget round to meet the budget deficit. However, the sooner cashable savings are made, the less reliance will need to be made on these reserve balances allowing them to be used elsewhere rather than financing a budget deficit.

3.143 Whatever, a tough financial climate is forecast and it is anticipated that the Council will need to challenge current spending and service delivery more robustly.

4.0 CAPITAL INVESTMENT and FINANCING

4.1 The Council is guided under a National Prudential Code of Practice to set a 5-year capital investment programme. Clearly, this has to be based on assumptions about likely resources to be available and potential commitments facing the Council over this period.

4.2 As previously reported and highlighted in Section 3, the Council faces a shortfall in resources to finance its current capital commitments and provision has been made in General Fund Reserves as a contingency.

4.3 These commitments relate to the final covenant repayments (which will have all expired by 2011/12) and the replacement of vehicles and plant. The covenants are subject to legal agreements, the repayment schedule is fixed and they cannot be readily re-financed.

4.4 Vehicle replacements are in the form of annual contributions to the Asset Replacement Reserve from which vehicles and plant are purchased in accordance with a replacement schedule; replacements vary from year to year.

4.5 Annual contributions even out costs between years, whilst keeping adequate funds in the reserve to provide flexibility and to meet all requirements over time. Replacements can be delayed and sometimes this is the case.

4.6 However, this can impact on service delivery and needs to be balanced against increased repair and maintenance by extending the use of refuse freighters for example, beyond their normal useful life.

4.7 Vehicles can be leased, hired, rented or the cost met through borrowing. However, these are still ultimately revenue costs and direct purchase is still considered to be the most cost effective method; it also provides benefits from ownership of the asset.

4.8 The latest capital programme is detailed in **Appendix 3** and is the detailed version of that reported to the Committee in September.

4.9 Effectively, this only includes schemes that are now externally funded, i.e. for disabled facility grants and private sector housing investment (funded by Government Grant) together with some major improvements funded through Growth Point Allocations.

4.10 There are currently no substantive schemes beyond 2010/11 and clearly the Council has no resources. In addition, similar to the General Fund, the prognosis for external grant allocations is not good.

4.11 Future allocations for Disabled Facility Grants (DFGs) and for investment in private sector housing are part of CSR 10. It is likely that other funding sources previously secured by the Council from Growth Point, Business Development Grant and Leisure Pots will be severely cut in future years as part of CSR 10, limiting any further investment.

4.12 The Council can continue to use its Major Repairs Allowance for Council House improvements provided through the separately financed housing subsidy system. However, as previously reported to Committee, the future financing of local housing is currently being reviewed and this is detailed in **Section 5**.

4.13 Development contributions secured as part of planning agreements may still fund leisure, recreational and community facilities. This is an on-going programme and depends on the nature of and what is negotiated for, each development.

The Key Issue and Proposed Actions

4.14 However, the key issue of financing covenants and vehicles to 2015/16 remains, with **£1.5m** required. In setting the MTFP and budget in February 2010, some key regeneration projects were identified which would enable the Council to use surplus assets to generate resources.

4.15 The main project is the relocation of the main works depot in Darklands Road, which on completion, will net a substantial capital receipt (subject to commercial negotiations). The project is moving forward as planned and it is anticipated that the Council will receive the net receipt around January/February 2012.

4.16 If that receipt is generated in that timescale (subject to how much CSR 10 affects the Council) this will clearly relieve financial pressure on the General Fund and may provide some resources for investment.

4.17 Other key land sales which have previously been approved by the Committee are currently being progressed. Resources (subject to planning and contractual agreements) are expected in 2012/13.

4.18 In the meantime, receipts from the smaller land sales and some council house sales continue to trickle through. However, these are minor in the overall context of resources required and are also subject to Government Pooling under Capital Accounting Regulations.

4.19 However, they have been used to top up Disabled Facility Grants and to progress the Sheltered Housing Vision.

VAT Windfall

4.20 On a positive note, the Council has recently been successful in securing a fairly substantial refund of VAT. Based on a European Directive, HM Revenues and Customs (HMRC) were found not to have implemented the VAT treatment of sports facility admissions correctly into UK law.

4.21 On the basis of further case law passed in 2009 which made this incorrect treatment retrospective, the Council made a claim for a refund in VAT dating back to the period **1977 to 1995**.

4.22 In accordance with the European Directive, the claim was based on a refund of all VAT charged to users of leisure facilities for sporting services, sports courses and where tuition fees were charged in this period.

4.23 These services should not have incurred VAT. However, the Council had charged VAT (in accordance with HMRC's prevailing guidance) and paid it over in its agency capacity to HMRC.

4.24 After research and compilation of evidence to meet HMRC requirements, the Council submitted 2 claims, for £143,000 to cover sporting services and a separate claim for £123,000 covering sports courses and tuition fees.

4.25 The first claim was settled in August 2010 and totalled £139,844 with interest added of £124,000, making a total of approximately £263,000.

4.26 The second claim has yet to be settled although HMRC have indicated that it will do so, albeit lower than the first claim. However, it is anticipated (but not certain) that it will be paid before March 2011. It is estimated that the settlement (including interest) will be approximately £150,000.

4.27 In total, the Council could receive a total "windfall" of over £**400,000**. Clearly, this is a substantial amount and there are no restrictions on its use. As it is a one-off resource, it is recommended that it is used to finance the outstanding capital commitments in 2011/12. This would effectively make the

4.28 However, this will depend on the outcome of CSR 10 and in the meantime it will be set-aside pending the spending review and the effects upon the Council.

4.29 The amount received to-date of £263,000 has in fact been adjusted in the Council's accounts for 2009/10 as a post balance sheet event. This was reported to the Audit Committee on 29th September and effectively, the Council's general reserves have been increased by £263,000 as at 31st March 2010.

5.0 HOUSING REVENUE ACCOUNT (HRA)

5.1 Under the Local Government and Housing Act of 1989, local authorities are required to account separately for the income and expenditure associated with council housing. Accounting regulations specify what can be charged to the Housing Revenue Account (HRA). This is designed to ensure that costs associated with the provision of council housing are financed separately to all other costs of the Council.

5.2 The Council is also required to maintain a rolling 10-year business and financial plan to ensure that the service is sustainable in the longer-term. The HRA cannot operate in deficit and must maintain a minimum level of general reserves as a contingency. For South Derbyshire, this minimum level is currently an approved £1/2m.

The Position Entering this Review

5.3 When setting the HRA budget for 2010/11 back in February, the updated 10-year financial projection at that time, continued to show that the HRA would become unsustainable in the longer-term, i.e. would fall below the £1/2m level.

5.4 The HRA has been operating with an underlying budget deficit, but has in recent years spent within and below its base budget. This has allowed HRA general reserves to remain at a relatively high level and these have been drawn down to finance the annual deficit. However, similar to the General Fund, using reserves to finance a budget deficit in the longer-term is not sustainable.

5.5 The HRA's position is exacerbated through the uncertainties associated with the national subsidy system, together with rent restructuring policy, and in particular how much is paid to the Government Pool in "negative subsidy." Changes on an annual basis impact upon the financial projection and make forward planning much more difficult.

5.6 The approved budget for 2010/11 was set with an estimated deficit for the year of £439,664, to be financed from HRA reserves. The reserve balance was estimated at just under £1.9m by 31st March 2011.

5.7 The 10-year projection forecast that reserves would fall below the minimum level of £1/2m by 2015/16 based on financing this underlying deficit. The previous projection (October 2009) was forecasting 2016/17.

5.8 At its meeting on 4th February 2010, the Housing and Community Services Committee noted that a detailed review of the HRA's Business Plan would be undertaken during 2010/11 with the aim of finding budget savings. This review has not yet been undertaken, although the initial meeting of the project group is due shortly.

5.9 The review had been put on hold pending the outcome of the Coalition Government's response to the "self financing" consultation. The Government have stated that details of a new system will be reported as part of CSR 10.

Budget Out-turn 2009/10

5.10 The final accounts for the HRA were reported to the Committee in June. The deficit for the year was just £76,380 compared to that estimated of £411,579, i.e. a reduction of £335,199.

5.11 Most of this reduction had been anticipated during the year. The main reasons for the better position were that repairs, maintenance and management costs were contained in the base budget without the provision for inflation being called upon, together with increased income from the Telecare Service and Supporting People contributions.

5.12 Consequently, the level of HRA reserves stood at £2.65m as at 31st March 2010, compared to an estimate of £2.32m.

Changes to Housing Subsidy 2009/10

5.13 Following the out-turn and the accounts being approved, the Government notified local authorities of a change to the interest rate used for completing the housing subsidy grant claim for 2009/10. The rate was reduced from 2.25% to 1.13%. This interest rate is applied to the assumed (or notional) level of debt the HRA carries in the subsidy system, i.e. £9.4m.

5.14 Clearly, the Council has no actual debt outstanding, but the subsidy system recognises that there are on-going capital financing costs associated with the Council's housing stock. The HRA out-turn for 2009/10 was reported on the basis of 2.25%.

5.15 The reduction to 1.13% (i.e.1.12%) has reduced the amount of capital charges netted off the overall negative subsidy payment by approximately £100,000. This will be adjusted in 2010/11 and will effectively mean that the HRA will need to increase its payment in 2010/11 and finance it from the increased level of balances reported in June.

Updated Projection

5.16 The projection has been updated to reflect the better out-turn for 2009/10 and the subsequent change to subsidy as detailed above. In addition, the projection has been reviewed to take account of:

- Latest stock numbers
- Minor changes to 2010/11 subsidy allowances
- Rent convergence and actual rent levels
- Interest rates and inflation

Stock Numbers

5.17 The only change made is that the stock brought forward into 2010/11 has been adjusted down by 7 to reflect the actual figure as it stood at the end of 2009/10. The difference is due to more council house sales (3) and decommissioned properties (4) as part of the Extra Care Project.

5.18 Although the difference of 7 is not significant, it takes approximately £200,000 of resources out of the HRA over 10 years. This is due to the loss of rent income and subsidy allowances, although the actual management and maintenance costs in the HRA have remained unchanged.

5.19 The projection continues to assume that stock numbers reduce by 5 per year from 2011/12.

Changes to 2010/11 Subsidy Allowances

5.20 The final allowances for management and maintenance were changed slightly when the final subsidy determination was issued in March 2010. These have made very minor differences over the 10 years.

Interest Rates

5.21 This relates to the on-going effect of the interest rate reduction in 2009/10 detailed earlier. This reduced the amount of capital financing reimbursed in subsidy. To reflect interest rates remaining low, similar to that modelled on the General Fund, the following changes to future estimates have been made:

- 2010/11 – 1.75%, down from 2.25%
- 2011/12 – 2.50%, down from 3.50%
- 2012/13 – 4.50%, down from 5.00%
- 2013/14 – 5.00%, down from 5.50%
- 2014/15 onwards – 5.75%, down from 6.50%.

5.22 Based on the notional debt of £9.4m, lower interest rates have overall, a detrimental affect on HRA resources. Amending the rates above, takes approximately £600,000 out of the HRA compared to the previous projection over 10-years.

Rent Convergence and Actual Rent Levels

5.23 As previously reported, rent convergence, i.e. the period over which the Council’s actual rent will catch up and match the national formula rent, tends to change each year. The budget for 2010/11 assumed rent convergence by 2013/14 in accordance with national guidelines and the rent increase for 2010/11 was set on this basis.

5.24 This is a key variable in the Council’s HRA as rent makes up the most part of income. The Council’s average rent is currently below the national formula by 9.5% (£61.22 compared to £67.68 respectively).

5.25 In principle, the quicker convergence takes place, the greater the benefit to the HRA as the income base increases. For example, convergence by 2013/14 would mean the following increases in <u>average rent</u> over the intervening period.

- 2011/12 – 5.26%
- 2012/13 – 6.10%
- 2013/14 – 6.17%

5.26 In setting the budget for 2010/11, the projection assumed that these increases will occur in order to align with the national position. However, in reality, many South Derbyshire tenants (around 2/3rds) will not converge within this timescale. This is due to caps (set by the Government) that have been placed on increases for individual tenants as protection against large rent rises in previous years.

5.27 This means that many individual rents have fallen further behind. Caps do not allow a rise sufficient each year, to catch up the national formula by the prescribed date.

5.28 As the Council's average rent is still someway below the national formula, this means that overall, the HRA's income base has being lowered compared to national assumptions which are reflected in the Council's negative subsidy payment, i.e. that payment is increased because the system assumes that the national rent is being charged.

5.29 For 2010/11 alone, this will cost the overall HRA approximately £156,000 in "lost" income; this then lowers the base position for future years with a cumulative effect.

5.30 Rent policy at a national level is reviewed and notified to local authorities on an annual basis. Invariably, this changes from year to year depending on the view of affordability taken by the Government. However, it is likely (but not certain) that national rent policy will continue with a cap on individual rent rises and it is not clear whether some general control would be retained within a reformed system.

5.31 However, the projection has been updated based on this assumption, with convergence of all tenants completed by 2016/17, 3 years after what has been assumed nationally. This has a material affect upon the HRA as it reduces income compared to the current projection by approximately £1.25m over the next 6 years.

5.32 The total rent increase each year is shown in **Table 13**, below.

Table 13: Analysis of Rent Increases Assumed over the next 6 years to achieve Convergence

Year	Inflationary Increase	National Real-Terms Increase	Formula Increase	Total Increase
2011/12	2.00%	0.50%	2.04%	4.54%
2012/13	2.25%	0.50%	1.95%	4.70%
2013/14	2.50%	0.50%	1.87%	4.87%
2014/15	2.50%	0.50%	1.78%	4.78%
2015/16	2.50%	0.50%	1.70%	4.70%
2016/17	2.50%	0.50%	0.80%	3.80%

Cost Inflation

5.33 Inflation on repairs and maintenance, together with pay have been reviewed, in particular given the potential affects of very low increases in pay anticipated for the next 3 years. In addition, the knock-on effects of lower repairs and maintenance spending in 2009/10 have also been re-modelled as the base position is lower.

5.34 Provision for pay has been reduced as per the General Fund analysis based on the same strategy. In addition, inflation rates for repairs and maintenance spending have been revised as follows:

- 2010/11 – 1.00%, down from 2.50%
- 2011/12 – 2.00%, down from 2.50%
- 2012/13 – 2.25%, down from 3.50%
- 2013/14 – 2.50%, down from 3.75%
- 2014/15 onwards – 3.50%, down from 3.75%.

5.35 The lower inflation rates reflect the indices used for the General Fund, although the longer-term rate of 3.5% is 1% above the Government's measure of long-term inflation.

5.36 It is appreciated that repairs and maintenance can be a volatile and is a demand led budget, but recent years does show a trend of overall spending within budget. In addition for 2009/10, it was contained within the base budget, i.e. no inflation was called upon from the contingency to meet costs.

5.37 Repairs spending is, along with the employee budget in the HRA, probably the most sensitive variable to changes in cost inflation. Infact current repairs spending is greater than employee costs at approximately £3m compared to £2.5m per year for pay and benefits.

5.38 Based on the revised inflation rates above, this reduces projected spending in the HRA by over £1m over 10-years. This includes the effects of the lower base position.

5.39 As previously reported, the HRA faces a potential shortfall in resources to meet all works and liabilities as identified in the 2009 Stock Condition Survey. Therefore, it would appear prudent to maintain the previous estimated amounts to provide additional resources.

5.40 However, based on this projection overall and the adverse affects of other changes, this is difficult without jeopardising the viability of the HRA much sooner than is currently projected.

The Revised HRA Projection

5.41 Overall the adverse effects of lower interest rates and rent convergence have been offset by lowering inflation provisions for pay and repairs. It should be noted however, that the current base spending position on costs has not been changed, only the inflationary element in forward projections.

5.42 However, the net effect is that the revised projection shows that the HRA falls below the minimum balance level of £1/2m by **2014/15**, i.e. a year earlier than previously forecast. This is detailed in **Appendix 4**.

Overall Summary and Conclusion - HRA

5.43 Similar to the General Fund, any projection should be viewed with a certain degree of caution, especially one spanning 10-years. However, it is not the 10-year time frame that is now important, as the critical year by which the on-going deficit needs to be addressed continues to come forward and is now effectively within 4 years.

5.44 The projection should be used as a gauge of the HRA's future financial position. Although from projection to projection, varying levels of general reserves at the end of 10-years have been highlighted, one issue always remains, that of a growing budget deficit over the planning period.

5.45 The projection continues to assume the continuation of the existing subsidy system and the Council's contribution to the National Pool through its negative subsidy payment will only increase. As long as the current system remains, volatility will continue between years and the longer rent convergence takes place, the greater the adverse affect on the overall HRA.

5.46 This puts pressure on managing costs and at some stage spending will need to be reviewed.

A New System?

5.47 Against this, an announcement regarding details on allowing authorities to become self-financing is now expected as part of CSR 10. This will tie into the introduction of a new Localism Bill later in the year.

5.48 The Council responded positively, but also cautiously to the consultation surrounding this issue, which was reported to the Full Council in July 2010.

5.49 Whether the Council will be able to afford self-financing will depend on the amount of national housing debt that will need to be taken on. If it is implemented, then clearly the financial picture and the HRA will change fairly significantly.

6.0 Financial Implications

6.1 As detailed in the report

7.0 Corporate Implications

7.1 The MTFP assesses the resources and options available to the Council in order for it to deliver its services and priorities set out in its Corporate Plan.

7.2 Clearly, the projections contained in this report highlight a very difficult and uncertain situation over this planning period. This will continue to place pressure upon all service areas to manage resources carefully and to generate efficiencies and external funding wherever possible.

8.0 Community Implications

8.1 Ultimately, the amount of financial resources affects the level and quality of services and facilities provided to the local community.

9.0 Background Papers

9.1 The Council's Financial and Capital Investment Strategies at:

http://www.south-derbys.gov.uk/council_and_democracy/council_budgets_spending/budget_and_financial_strategy/default.asp