REPORT TO:	**FINANCE & MANAGEMENT COMMITTEE**	**AGENDA ITEM: 7**
DATE OF MEETING:	**10th SEPTEMBER 2009**	**CATEGORY: RECOMMENDED**
REPORT FROM:	**DIRECTOR OF CORPORATE SERVICES**	**OPEN**
MEMBERS' CONTACT POINT:	**KEVIN STACKHOUSE (595811)**	**DOC:** u/ks/MTFP/mid year review/September 09
SUBJECT:	**A REVIEW of the COUNCIL'S MEDIUM TERM FINANCIAL PLAN 2009 to 2015**	**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 2015 (as summarised in Appendix 1) is considered and approved.

1.2 That on-going provision is made towards the cost of Green Bank Leisure Centre as detailed in the report.

1.3 That provision is made to cover for the loss of external funding for 2 established posts as detailed in the report.

1.4 That the updated capital investment and financing programme to 2015 (as detailed in Appendix 5) is considered and approved.

1.5 That the updated financial projection on the Housing Revenue Account to 2019 (as detailed in Appendix 6) is considered and approved.

1.6 That all current base budgets are scrutinised as closely as ever during the 2010/11 budget-round and a programme of cashable efficiency savings be compiled to meet the budget deficit.

1.7 That any further capital spending beyond 2009/10 (except for that detailed in Appendix 5) is not committed until future income streams are certain.

1.8 That the Budget and Financial Planning Timetable for 2010/11 (as detailed in Appendix 7) is approved.

2.0 Purpose of Report

2.1 In accordance with the Council's Financial Strategy, the report reviews and updates the Council's Medium Term Financial Plan (MTFP) and associated budget projections. It considers both revenue spending and capital investment on the General Fund and Housing Revenue Accounts.

2.2 It effectively updates the Council's medium term financial position following the out-turn from 2008/09, together with changes since the 2009/10 budget-round. It is intended to set an indicative position ahead of the 2010/11 budget-round.

Aims of the Council's Financial Planning Framework

2.3 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. It includes setting a minimum level of general reserves that are required at the end of every financial planning period.

2.4 This helps the council to focus on the resources that it will have available 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.

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

- General Fund Revenue Account – Section 3 and Appendices 1 to 4
- Capital Investment and Financing – Section 4 and Appendix 5
- Housing Revenue Account (HRA) – Section 5 and Appendix 6
- Budget and Financial Planning Timetable 2010/11 – Appendix 7

3.0 GENERAL FUND REVENUE ACCOUNT

Background

3.1 Back in 2007, the Council changed its financial planning period from 3 to 5 years. This was in response to the Budget Statement in February 2007 by the Council's Chief Finance Officer, who highlighted the need to look further forward.

3.2 At that time, the 3-year plan highlighted the continuing draw down of general reserves to finance expenditure and the need to move towards a balanced budget over the longer-term. Therefore, the MTFP was extended to cover 5-years.

The Position Entering this Review

3.3 Following the budget round for 2009/10, the projected 5-year balance showed a general reserve of approximately £590,000 as at March 2014. This was below the minimum target balance of £1m as determined in the Financial Strategy.

3.4 A more favourable final account for 2008/09 (as reported to Committee on 25th June 2009) showed an increase in reserves of approximately £250,000. This was after providing the financing (£100,000) for capital works at Midway Fishponds.

3.5 Assuming that all other factors remained unchanged, this would have projected the reserve balance to over £800,000 (£590k + £250k) by March 2014, clearly a much healthier position and much nearer the strategic target of £1m.

3.6 The Council has done much work in recent years to reduce what is effectively an underlying budget deficit in the longer-term. The MTFP produced during the 2009/10 budget-round, showed this deficit decreasing from over £1/2m in 2008/09 to approximately £180,000 by 2013/14.

3.7 As regularly reported over the last 12 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 loss of income from short-term investments and planning.

3.8 However, the beneficial impact of the new national concessionary travel scheme from April 2008 effectively provided a buffer against this. The MTFP considered during the 2009/10 budget round assumed a recovery in the economic position during 2010 with the full impact of a recovery taking effect during 2011/12.

3.9 As highlighted above, this was projected to leave an underlying budget deficit based on predicted spending and assumptions at that time (i.e. in January 2009) of £180,000 by 2013/14, with reserve balances of over £800,000 (following the out-turn).

Updated Projection

3.10 The projection has now been updated and rolled forward to include 2014/15. This will be used to inform the Council's spending proposals ahead of the 2010/11 budget-round.

3.11 It takes account in particular, of the on-going impact of the current global economic situation and other known variations, such as lower inflation, especially its likely impact on public sector pay awards. The overall projection is summarised in **Appendix 1**.

3.12 **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.**

3.13 This then provides an opportunity to take proper and planned remedial action. In addition, it should be used as the basis for building detailed budget plans for 2010/11 and beyond. The main assumptions included in the projection are as follows:

- A continuation of current service provision adjusted only for previously known and approved variations.
- Annual pay awards, increments and pension increases.
- Lower rates of inflation, especially over the next 2 years.
- Annual increases in overall fees and charges.
- An annual increase in council tax of 2.5% per year.
- Lower increases in the level of general government grant.
- An on-going provision to meet capital expenditure commitments as a safeguard against insufficient capital resources being generated in the future.

3.14 The projection (in Appendix 1) shows a **negative** general reserve balance at 31st March 2015 of £970,000, with an underlying budget deficit of approximately £318,000 by 2014/15.

3.15 Clearly, this would leave the Council in an unsustainable position in the longer-term. A more detailed analysis of this projection and the underlying assumptions is provided later in the report.

3.16 In summary, the main reasons for the worsening position from that previously projected are listed below (figures are cumulative over the life of the MTFP).

- A further year's budget deficit (as above) - £318,000
- A continuing loss of interest from short-term investments - £645,000.
- Anticipated reductions in general government grant arising from the 2010 Comprehensive Public Sector Spending Review (CSR 10) - £450,000.
- A likely need to continue subsidising the Council's main leisure centre beyond 2011 - £250,000.
- A provision to cover for the loss of external funding for 2 established posts - £225,000.

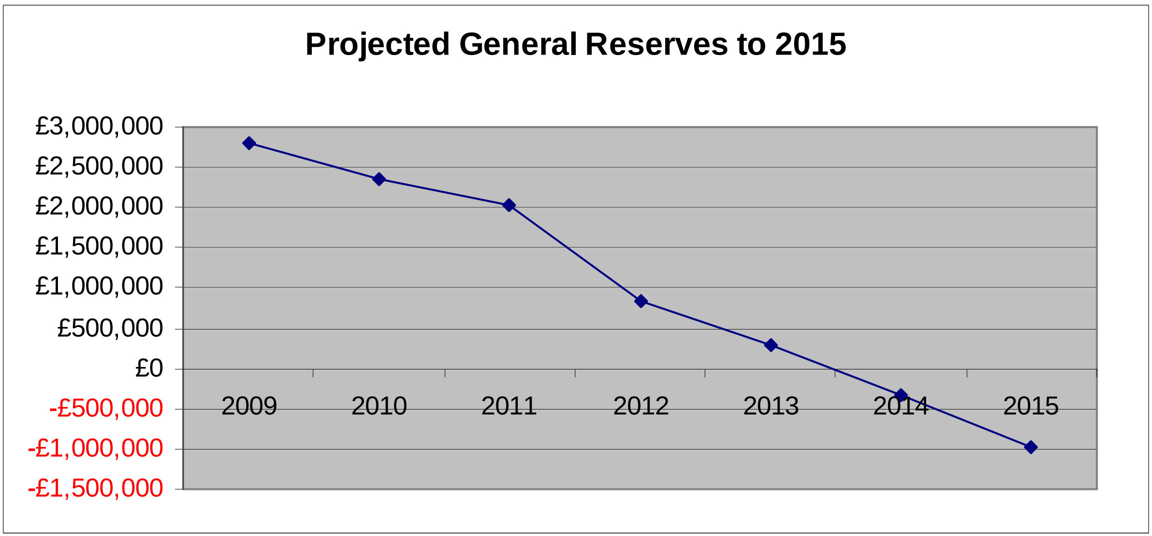
- A provision for an increase in external audit fees for grant claims following revised auditing requirements - £190,000.

- An increase in the provision to provide capital funding from revenue to protect future commitments should insufficient resources be generated - £180,000.

3.17 These amounts seem extremely large, but are cumulative totals over 5 to 6 years. Together, the above items reduce projected reserves over the next 5-years by approximately £2.3m. Infact, the overall situation could show a much poorer position.

3.18 However, it is anticipated that public sector pay awards will be much lower than previously projected in 2009/10 and 2010/11 and this helps to offset to some extent, the above reductions.

3.19 The overall impact on the Council's projected reserves to 2015, together with a summary of the projection, is shown in the following graph and table.



Note – the minimum level as determined in the Financial Strategy is +£1m.

SUMMARY OF PROJECTED BUDGET DEFICIT to 2015

Year	Projected Net Expenditure £'000	Projected Financing £'000	Budget Deficit/ £'000
2009/10 (Budget)	11,866	11,861	5
2009/10 (Estimated)	12,411	11,958	453
2010/11	12,155	12,110	45
2011/12	12,799	12,350	449
2012/13	12,855	12,615	240
2013/14	13,142	12,882	260
2014/15	13,473	13,155	318

The Need to Review Current Spending

3.20 Based on this projection, the Council will need to continue to review its current base budget. Resources are required to gain a balanced budget in the longer-term and to meet capital commitments.

3.21 Some provisions continue to be made for future pension increases and the interim costs associated with the current pay and grading review.

3.22 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.

3.23 These may arise from the new Corporate Plan, together with public expectations identified in the recently published Place Survey for South Derbyshire.

The Council's Efficiency Programme

3.24 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.

3.25 Only efficiencies banked to-date have been included in the projection. These include procurement savings made over the last 12 months, together with the longer-term savings accruing from the streamlining of senior management, corporate services, central printing and planning services in recent years.

3.26 The latest efficiency statement reported to Committee (**Appendix 4**) identifies cumulative efficiency savings of approximately £1.2m by 2015 under CSR 07. Much of this has as already been included in the MTFP.

3.27 An additional £25,000 per year may be attained if as expected, the savings made on stationery and protective clothing in 2008/09 can be sustained over the planning period. This would generate approximately £150,000 between 2009 and 2015.

3.28 In addition, other cashable gains may be made, for example through the proposed Corporate Services Partnering Project and the full introduction of the new "purchase to pay" process.

3.29 This efficiency statement is effectively part of the MTFP. In accordance with the Financial Strategy, further gains will be built in once achieved with known amounts.

In Summary

3.30 The detail that follows highlights continuing uncertainty on many external factors. However, given this projection, the Council cannot afford to wait for a significant recovery in the economic situation nor an increase in government grant, even though the District remains one of the fastest growing areas in the UK.

3.31 Due to pressure on the public finances at a national level and expectations for low council tax increases especially in the current climate, access to traditional funding streams may be severely limited.

3.32 Although these would have a beneficial impact on the Council's financial position, their timing, amount and on-going nature remains very unclear.

3.33 It should be noted that a longer-term view is being considered. The Council's level of general reserves is currently healthy and should remain so to 2011/12.

3.34 However, the situation is now projected to become more critical than earlier reported and it is the extent that reserves are being drawn down on an on-going basis that provides a much different picture by 2015.

Main Assumptions and Risks

3.35 As always, the projection aims to be realistic but prudent. Clearly, it should be viewed with a certain degree of caution. However, it should also be used as a gauge of the Council's future financial position and be in focus when spending decisions are being taken.

3.36 Every effort is made to take account of known spending pressures, although some are less predictable, for example, the impact of the next revaluation of the Pension Fund. Therefore, every effort is made to provide a prudent estimate for these known variations. The main assumptions, risks and sensitivity analysis associated with the projection are outlined in the following sections. The main factors considered are:

- Inflation
- Public Sector Pay Awards
- Pensions
- Planning, Building Regulations and Land Charges Income
- Interest Rates and Return on Short-term Investments
- Concessionary Travel Costs
- CSR 10 and Government Grant
- Council Tax and Property Growth
- Provision for further Revenue Contributions to Capital
- Fixed Term and Externally Funded Posts
- Leisure Centre Provision
- Swadlincote Woodlands
- 2010 Rating Revaluation

Base Budget

3.37 The current base budget (Net Expenditure on Services) has been projected forward based on current service provision only, being maintained. This has been adjusted for known and approved variations. The detail supporting this (**Appendix 2**) shows a summary breakdown of net expenditure by cost type.

Inflation

3.38 This has been applied only to those cost types where it is likely that inflation will apply. These are mainly for pay, fuel, energy, licences, maintenance and contracts. Many budgets for supplies, services and expenses continue to be cash limited at current levels into the future.

3.39 The relevant inflation factors used are detailed in **Appendix 3**. Although inflation is calculated at cost type level, in accordance with the Financial Strategy it is held as a central provision in the MTFP rather than allocated across service heads.

Inflation Rates

3.40 Generally, inflation is measured in 3 main ways:

- Retail Prices Index (RPI)
- Consumer Price Index (CPI) – effectively RPI less housing costs
- Gross Domestic Product (GDP) Deflator – a measure of longer-term inflation

3.41 All 3 measures are historically low. In fact, the RPI has been negative since March 2009 and currently stands at –1.4% (as at July 2009). This reflects the continuing fall in house price, mortgages and related costs.

3.42 Although the UK has officially been in recession for some months, the CPI had been above the Bank of England’s target rate of 2% since October 2007. In June 2009, it fell below this and currently stands at 1.8% (as at July 2009).

3.43 Although prices for fuel and energy continue to rise, this has been offset by lower costs of food and clothing.

3.44 Excluding pay, the CPI measure is a better indicator on which to measure potential inflationary effects in the short-term. This is because it takes into account the costs of fuel, energy, maintenance and transport related items.

3.45 These are more relevant to the Council’s spending, although they tend to increase more than the headline and average figure.

3.46 The GDP indicator has recently been revised down by the Government to 1% for 2009/10 and 1.5% for 2010/11. It remains at 2.5% thereafter.

3.47 Except for pay inflation, which is the largest expenditure item, no other changes are proposed to other inflation factors at this stage for forecasting purposes. A longer-term rate for 2011/12 onwards of 2.5% has still been assumed.

Sensitivity of Inflation

3.48 Using the inflation provision projected in 2014/15 of £363,000, as an example, this is broken down as follows:

- Pay inflation + £330,000
- Other costs + £171,000
- Fees and Charges - £138,000

3.49 For every 1% shift in inflation on other costs, together with that on fees and charges, equates to approximately £70,000 and £55,000 respectively.

3.50 There are numerous expenditure categories that makes up this total and these figures assume that every category is subject to that 1% variation, when in reality there may be ups and downs within. It is considered that these provisions are prudently based.

Estimated Pay Inflation

3.51 This is the main inflationary change since the last review. An increase of 3% per year had previously been included on what is the Council's biggest expenditure item.

3.52 At present, there are clear signals that the Government is looking to limit public sector pay increases. Indeed, the employers have recently offered an increase of 1% for 2009/10 with some additional increase at the lowest end of the pay scales.

3.53 Therefore, the current inflation factor has been reduced to 1% for 2009/10 and 2% for 2010/11. This saves approximately £1.3m compared to the previous projection between 2009 and 2014 and is a significant factor in helping to offset the adverse variances previously highlighted.

3.54 As a single item in itself, this is an extremely sensitive factor in the projection. For example, just a ½% point difference (up or down) in 1 year equates to approximately £1/4m cumulatively over 5-years in the projection.

Pensions

3.55 The Actuary for the County's Pension Scheme will undertake a triennial review in 2010. In anticipation of the Council's liabilities increasing, this plan continues to provide for an increase in the Council's pension costs from 20011/12 of £80,000 per year. This equates to an increase of 1% on pensionable pay.

3.56 Due to the current state of the financial markets and in particular falling asset values and rising liabilities due to greater life expectancies increasing, the longer-term deficit on the Fund is likely to grow. Initial indications on the effect of recent changes from additional employee contributions and the dampening of future benefits do not seem to be offsetting the increasing liabilities.

3.57 However, it is considered that the actual impact on the Council will depend upon how much the Government is willing to ask public sector employers and ultimately taxpayers, to contribute to pensions, especially in the current economic climate.

Income from Planning Fees, Building Regulations and Land Charges

3.58 It has been regularly reported over the last two years how the continuing reduction in this income stream has adversely affected the Council's financial situation. The current base budget for income is £916,000 for 2009/10, above the actual for 2008/09 of £860,000.

3.59 Initial indications from actual and projected income so far in 2009/10, suggest that the base budget may not be achieved overall. In particular, income from building regulations continues to slide downwards and it will depend on whether any further major planning applications are received in addition to the one already received.

3.60 These may be needed just to balance the budget for 2009/10 and future income is reliant upon an improvement in the economic situation.

Projecting Income Levels

3.61 This continues to be more difficult to strike a balance between being realistic and prudent. The following table shows actual income over the last 5 years, the current base budget and the projections over this planning period.

Analysis of income from planning applications, building regulations and land charges	Planning Fees £	Building Regs. £	Land Charges £	Total £
Actual 2004/05	501,700	348,130	238,665	1,088,495
Actual 2005/06	612,198	370,232	229,826	1,212,256
Actual 2006/07	677,366	338,055	227,812	1,243,233
Actual 2007/08	573,747	297,089	192,798	1,063,634
Actual 2008/09	517,485	236,242	106,375	860,102
Base Budget 2009/10	531,000	255,000	130,000	916,000
Projection 2010/11	590,000	300,000	180,000	1,070,000
Projection 2011/12	590,000	340,000	220,000	1,150,000
Projection 2012/13	590,000	340,000	220,000	1,150,000
Projection 2013/14	590,000	340,000	220,000	1,150,000
Projection 2014/15	590,000	340,000	220,000	1,150,000

3.62 The projections in the above table remain unchanged from those used in the previous review of the MTFP. They assume an upturn in the economic situation during 2010/11. The strategy of an income target from 2011/12 of approximately £1.15m overall remains in place. This is below previous peaks.

3.63 Due to planned growth in residential and commercial development, it is considered that this target may be exceeded in some years. In principle, this would create additional revenue, but its use will need to be determined at that time depending on the overall financial position.

Reviewing the Position

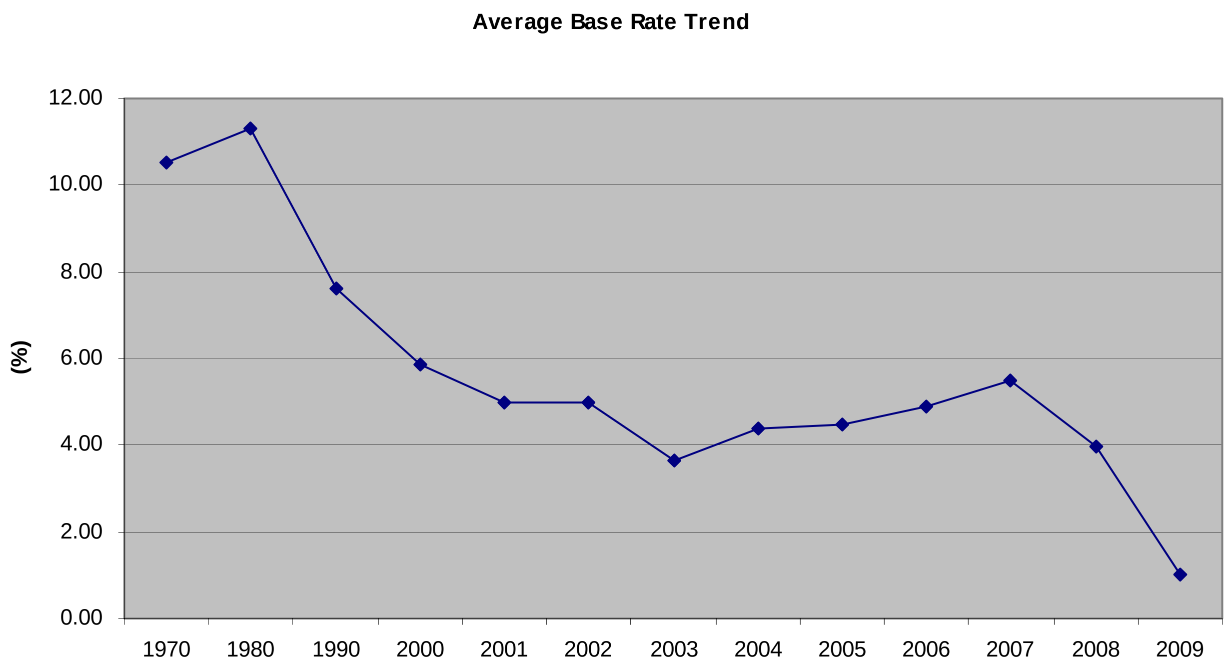
3.64 As usual, the situation and the effect on longer-term projections will be closely monitored on an-going basis and will continue to feature highly in monitoring reports to Committee.

Interest on Short-term Investments

3.65 Similar to the situation with planning income, it has been regularly reported how the continuing volatility in financial markets and the historically low level of interest rates has adversely affected the Council's financial situation. The current base budget for interest is £175,000 for 2009/10.

3.66 Initial indications from actual and projected income so far in 2009/10, suggest that actual income received will be as low as £30,000, a substantial reduction compared to budget.

3.67 With the Bank base rate remaining at ½%, the Council is only currently achieving ¾% average return. Interest rates are at historically low levels and past trends show that average rates move at slow intervals over time. A trend analysis of the Bank base rate is shown in the following graph.



3.68 Between 2001 and 2007, rates were relatively stable on average when the economy was operating more normally. In addition, this period has seen lower rates compared to the previous 20 years. Many commentators believe that this is due to the Bank of England having independent control of setting rates as a means of keeping inflation low.

3.69 Given the level of current rates and using historical trends as a guide, the projected level of future interest income has been substantially revised, reducing projected income from this source by £610,000 between 2009/10 and 2013/14. An analysis of this is summarised in the following table.

Year	Previous Interest Rate Assumed	Revised Interest Rate Assumed	Previous Income Projection (£'000)	Revised Income Projected (£'000)
2009/10	2.80%	0.75%	175	30
2010/11	3.50%	1.50%	200	60
2011/12	4.00%	2.50%	225	100
2012/13	4.50%	3.50%	250	140
2013/14	5.00%	4.00%	250	160
2014/15	N/A	4.75%	N/A	190

3.70 Widely, it is considered that the bank base rate will not get any lower. Therefore, it has been assumed that the average rate will start to increase slowly from the financial year 2010/11 as the economy again picks up, eventually reaching the average level between 2001 and 2007, of 4.75%. This assumes that the Bank of England will continue to control rates over this period.

3.71 The other factor that could change the projection is the average cash balance that is available to invest on a daily basis. These projections assume £4m, which is the current average. This is lower when compared to previous years where the average has been in excess of £6m to £7m in some periods.

3.72 Clearly, this could all change. However, given the current circumstances and taking into account the views of professional commentators, it is considered that these assumptions provide a realistic but prudent forecast of future income.

Sensitivity

3.73 For comparison, if the average rate varies by 1% in a year, this would equate to approximately £40,000 in interest in that year based on the average cash balance of £4m. A £1m difference in the average cash balance equates to £10,000 in interest.

3.74 Although not appearing significant on their own, higher rates and higher cash levels over that projected, which are sustained over a period of time, would have a very beneficial impact again on the Council's overall financial position.

Concessionary Travel Costs

3.75 As previously reported, with effect from April 2008, the Council benefited from a windfall 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.

3.76 However, the MTFP only shows this benefit accruing until March 2011. Based on Government proposals currently out for consultation, this is when it is expected that the responsibility for concessionary travel will pass to first tier authorities - the County Council in our case.

3.77 Consequently, the associated costs and funding will also transfer. There is a lot of uncertainty over how the Government will implement this. Their informal view is that the costs nationally are true and fully funded in total. Therefore, there is likely to be a redistribution of government grant associated with concessionary travel to match up with total costs in each area.

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

3.79 If the grant loss is less, then clearly this helps the overall financial situation and the Council could yet benefit further beyond 2011. However, indicative calculations within the consultation show South Derbyshire being a net loser on redistribution.

3.80 It is expected that the final outcome will come out of CSR 10 where future financial settlements for local authorities will be proposed.

CSR 10 and Government Grant

3.81 The current financial settlement runs until the end of the financial year 2010/11. This has already determined the Council's grant up to that time and the corresponding figures have previously been built into the MTFP; they remain unchanged.

3.82 Beyond that date, the current MTFP had assumed an annual increase of 2% on the 2010/11 base levels. Although this was below previous settlements upto 2008/09, it was considered prudent that a lower level was assumed to reflect the settlements for 2009/10 and 2010/11 of 2.7% and 2.4% respectively.

3.83 In addition, last year, in considering the medium-term financial position at that time, clear signals were already emerging about tighter settlements in the future.

3.84 However, this was balanced against the Council being a growth area and behind on the Government's full funding formula. Therefore, it was considered in 2008/09 that a factor of 2% was prudent for forecasting purposes.

3.85 These underlying principles remain. CSR 10 will report in the autumn of 2010 and this is expected to inform the financial settlement for the 3 years 2011/12, 2012/13 and 2013/14. Given the current economic situation and the pressure on the Nation's finances, it is considered that the settlement for district councils will be even tighter than previously anticipated.

3.86 Therefore, the factor has been reduced from an annual increase of 2%, down to 1% year on year. This reduces projected resources by almost £450,000 by 2013/14. Clearly this shows that as the Council's main single source of revenue, only a 1% swing either way, can make a significant difference to the overall financial position.

Council Tax and Property Growth

3.87 The assumptions here are largely unchanged from the previous projection. It continues to build in a 2.5% annual increase in council tax, after allowing for an average increase in the yearly tax base (new homes coming on stream) of 1.3%. This increase reflected the latest projections for planning purposes.

3.88 Clearly, the economic climate and the number of new houses coming onto the market influence the increase in the tax base. There was a drop compared to that estimated in 2008/09 forcing a revision to on-going assumptions at that time. Current projections are:

- 2009 – 419
- 2010 – 450
- 2011 – 419
- 2012 – 386
- 2013 – 386

3.89 As at August 2009, 380 new properties had come on stream for council tax. Therefore, the projection of 419 is still on course to be met by December 2009 and no further changes are proposed to future years at this stage.

3.90 Based on these figures, for every 1% difference in council tax in one year, this equates to approximately £1/4m over 5-years.

Provision for Revenue Contributions to Capital

3.91 Clearly, this is a significant issue for the General Fund given the overall amounts involved. For the last 2 years, it has become increasingly apparent that the Council may not generate sufficient capital resources to meet commitments from 2010/11 onwards.

3.92 These commitments consist of the repayment of the remaining covenant finance (fully paid by 2011/12), an annual contribution to disabled facility grants (DFGs), together with the purchase of vehicles and plant.

3.93 Due to the one-off windfalls accruing in 2008/09 and 2009/10 from concessionary travel and the reletting of the Council's main industrial site, approximately £1.8m was approved and prudently set-aside as a provision in general reserves, should insufficient capital resources be generated.

3.94 This provision, still remains and now totals just over £2m with a further year being added to the projection. An analysis of this shows:

- Payment of covenants (to 2011/12) - £872,000.
- Annual contributions to DFGs (at 66k per year) - £330,000.
- Vehicle replacements - £800,000.

3.95 If sufficient capital resources are not generated, then revenue contributions will be required from 2010/11. The repayment of covenant finance cannot be met in any other way; the payments need to be made in accordance with the contracted schedule.

3.96 Under the prudential borrowing code, the Council should not be borrowing further to make these repayments. Consequently, they will be a call on revenue if capital resources are not identified.

3.97 The Council's annual contribution to DFGs are discretionary and do not need to be made. However, the Government is still expecting that authorities should match their contribution on a 60/40 basis.

3.98 If this planned investment were cut from 2010/11, then funding for DFGs would be government grant and any external contributions only, with no top up from the Council.

Vehicle Replacements

3.99 The current policy is to purchase vehicles in accordance with a replacement schedule. This is determined and reviewed on a regular basis to meet the needs of the particular service.

3.100 Purchases are made from an Asset Replacement Fund, which is financed by yearly contributions of £225,000 (capital) and £20,000 revenue. Overall replacements are made within these budgetary constraints.

3.101 Actual replacements can vary from year to year and may not always be in accordance with the schedule at that time. For example, in one year, only £50,000 may be used from the Fund, when in the following year £300,000 may be needed, if say, 2 refuse freighters are replaced.

3.102 Therefore, annual contributions smooth the cost over time, keep the Fund topped up and allow for consistent budgeting.

Alternative Methods of Financing

3.103 Outright purchase is still considered to be the best low cost option over time. Clearly however, it requires the capital investment immediately in the asset. Other forms of finance, such as borrowing, hire and leasing are more expensive, but help to spread the cost across a number of years.

3.104 However, the costs can only be spread over the life of each vehicle, which is typically 5 to 7 years, which is not much more than the life of the MTFP. For example, under the prudential borrowing code, the Council cannot borrow for say 25 years to gain the best interest rate. However, current rates are low even over 7 years at between 2.7% and 3.6%.

3.105 To provide some indicative costings for comparison and using a refuse freighter as an example; over 7-years, borrowing would cost approximately £24,000 per year or £168,000 in total, against a purchase price of £140,000.

3.106 Freighters currently cost around £1,000 per week to hire, equating to approximately £364,000 over 7 years. Leasing would cost approximately £220,000 over the same period.

3.107 Given this, if insufficient capital is generated and revenue finance is required, it is still considered that the best option is purchase. In addition, the Council owns the asset and this brings more flexibility and a residual value in some cases, when the asset has been fully utilised by the Council.

3.108 The generation of capital resources is considered later in the report.

Fixed Term Posts

3.109 There are 4 posts on the current establishment which operate under fixed term contracts and which are partly funded by external contributions. These posts are due to expire over this planning period, between March 2010 and January 2012.

3.110 Therefore, funding for these posts has been <u>excluded</u> from the projection at the appropriate point in the financial plan, as no approval exists beyond that date. The total cost of these posts is approximately £130,000 per year.

3.111 In addition, the Council currently contributes to four posts that are subject to external funding through partnership and sponsorship arrangements (Safer South Derbyshire, County Council, private sector, etc.) in Leisure and Community Development. Approval for the Council's contribution (which was extended in 2008) runs out after this year 2009/10.

3.112 During the last 12 months, funding for 2 of these posts has been secured until 2013/14. The total costs associated with the other 2 posts are approximately £65,000 per year (£30,000 in 2010/11).

3.113 These are established posts at the Council and provision has prudently been made should further external funding for these posts not be secured. This is subject to separate recommendation to the report.

Leisure Centre Provision

3.114 The previous projection only allowed increased funding for Green Bank Leisure Centre until 2010/11 (as approved in February 2008). However, given that an alternative leisure facility has still to be identified as a longer-term replacement, again provision for this funding has prudently been extended on an on-going basis. This is also subject to a separate recommendation to the report.

Swadlincote Woodlands

3.115 A proportion of spending (approximately £50,000 per year) for maintaining this site is currently funded by Section 106 monies. This funding is due to run out after the next financial year, 2010/11. The projection continues to assume that the corresponding expenditure will also reduce from that time, i.e. further resources will need to be identified to maintain the current base spending in total.

2010 Rating Revaluation (Business Rates or NNDR)

3.116 The next general rating revaluation for businesses and public buildings comes into effect on 1st April 2010. All non-domestic properties will be assigned new Rateable Values (RVs) based upon rental values and economic circumstances as they were on 1st April 2008, i.e. before the full effects of the current economic situation.

3.117 Although revaluations have been completed, they will not become known until the end of September 2009. In order to comply with legislation, the revaluations across the Country need to be broadly neutral. Therefore, although RVs are likely to increase since last time, the Uniform Business Rate will be reduced nationally to compensate.

3.118 However, there will be “winners and losers” across the country and some transitional arrangements will be put in place. Regional figures indicate that the East Midlands area will overall, be a net gainer.

3.119 The Council’s current business rates liability on its non-domestic buildings (mainly the Civic Offices, Depot and Town Hall) is currently over £200,000 per year. Pending the release of individual values and details of the transitional scheme, no change is currently proposed to this base budget in the projection.

Conclusion

3.120 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.

3.121 However, given all the analysis and consideration of the risks and assumptions, the General Fund still shows an underlying budget deficit and falling level of general reserves.

3.122 Given the projected reduction in general reserves below the minimum level by 2012/13 with a negative balance by 2014, this potentially presents a significant risk to the Council.

3.123 Together with a continuing budget deficit, the uncertainties arising out of the current economic climate, future financial settlements, etc. any additional spending outside of current resources should not be committed.

3.124 These projections indicate that resources of approximately £300,000 per year need to be identified to achieve a balanced budget without the need to call on general reserves. As highlighted, this does not include any resources for new spending.

3.125 If savings or efficiencies of £300,000 were identified from 2010/11 onwards, projected balances would rise to approximately £1/2m (positive) by 2015, although this still falls short of the minimum level of £1m. However, going forward, a balanced budget would have been achieved by then. Clearly, the longer this is left, the more acute the potential issue will become.

3.126 Consequently, it is recommended that a programme of efficiency savings be identified to enable a timely and proper course of action to be implemented before the situation becomes much more critical in practice.

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 the previous section, the Council faces a shortfall in resources to finance its current capital commitments. The updated capital programme including schemes and resources brought forward from 2008/09 is detailed in **Appendix 5**.

4.3 Besides council house improvements (funded by the Government) and the commitments regarding covenants, DFGs and vehicle replacements previously identified, the Council has no service schemes or projects beyond 2009/10.

4.4 It is likely that the Council will continue to be awarded grant for DFGs and the private sector decent homes programme. However, this could put further pressure on the Council to provide some matched funding.

4.5 With the potential impact that this is now having on the General Fund (to meet the potential shortfall) the need to generate resources from the Council's Disposals Policy is as great as ever. The sale of assets considered "surplus to requirements" has generated resources over the last 2 to 3 years.

Projected Disposals

4.6 Except for housing assets where the national pooling regulations apply, these have tended to be fairly small in value. This is an issue for the Council, as from several further disposals currently being progressed, only 2 or 3 will generate a significant non-housing (general) receipt.

4.7 However, in total it is likely that this will not be adequate to fund the £2m required by 2015. The current national pooling arrangements will reduce significantly the proceeds from housing land if the Council pools the required amount to access the “non-pooled” amount for general schemes.

4.8 However, the Government are currently reviewing the pooling arrangements as part of the national review into financing council housing, as highlighted later in the report.

4.9 Clearly, if the Council was to generate say £1m, this would help to alleviate the potential pressure on the General and Capital Investment Accounts, although it may not provide additional resources for new spending.

Council House Sales

4.10 These have in recent years been one of the main sources of capital funding. However, they have declined sharply from a peak of about 120 in 2004/05, to 6 in 2008/09. The current capital programme assumes no income from this source for capital investment over the planning period. No new sales have occurred since February 2009.

Other Capital Reserves

4.11 Besides general capital receipts from land disposals and council house sales, the Council still has two other capital reserves. Firstly, approximately £135,000 is still available and ring-fenced to complete the Sheltered Housing Vision and Standards.

4.12 Secondly, approximately £370,000 remains in the housing capital receipts (windfall reserve). This is currently earmarked as a contingency to support planned maintenance in the HRA (£300,000) together with £70,000 for garage sites.

4.13 None of this £370,000 is currently committed and could be used elsewhere, the only caveat being that it must be spent on housing, Public or Private Sector.

Other Funding Streams

4.14 On the positive side, the Council has an excellent record of generating and levering in external finance to fund capital investment.

4.15 Current external funding is delivering further improvements at Rosliston Forestry Centre, for new play equipment, town centre improvements and to improve community facilities in Hilton. Significant funding for the new Etwall Leisure Centre was generated externally.

4.16 In addition, growth point funding of £1/2m is currently being used to finance a range of projects across the District. This is helping to lever in other sums, for example to deliver the Swadlincote Town Centre Masterplan.

4.17 The Council may benefit from further allocations together with funds arising from the business improvement grant scheme, which is currently under review for 2010/11.

Asset Management

4.18 Furthermore, although the Disposals Policy alone may not generate a sufficient level of resources, the Council may be able to use its significant asset holdings within the District to enable capital investment.

5.0 <u>HOUSING REVENUE ACCOUNT (HRA)</u>

5.1 There is a statutory requirement for the Council to account separately for income and expenditure associated with the maintenance and management of its public housing stock. In accordance with the business planning process for council housing, a 10-year rolling financial projection on the HRA is maintained.

5.2 This can be a complex process as the variables that make up the national subsidy system and the Council’s actual HRA are inter-related.

5.3 The Council uses a financial model developed with an external agency for its projections. The model automatically calculates the longer-term position when any of the variables change.

The Position Entering this Review

5.4 When setting the budget for 2009/10, the overall projection for the HRA continued to highlight an ongoing budget deficit in the longer term of approximately £656,000 by 2018. In addition, the first year that the HRA was projected to fall into deficit was 2011/12, although that was a better position compared to the previous projection in September 2008.

5.5 This was mainly due to changes in rent levels brought about by the Government’s updated rent restructuring policy, together with a further reduction in council house sales, both factors projecting a greater level of rental income.

5.6 The last review highlighted that the HRA could maintain an adequate level of reserves as required by the Council’s Financial Strategy over the 10-year planning period. The forecasted balance was £937,000 (surplus), although it was considered that the on-going budget deficit was the real issue.

5.7 At that time, there was still a lot of uncertainty around future rent levels and in particular concern about the Government’s proposal to increase base rents (before a real terms uplift and formula catch up) on average by 5% from April 2009. This factor being the level of inflation measured by RPI as it stood at September 2008.

5.8 The subsidy settlement for 2009/10 effectively delayed rent convergence further, with no definitive date set. Although the proposed increase would benefit the overall HRA, individual tenants were facing fairly significant increases (compared to inflation) in the future.

5.9 In February 2008, the Council considered a rent increase averaging 6.28% for 2009/10 in accordance with the Government's rent restructuring policy. Due to concern about the relatively high level, the approved increase was set lower at 4.9%.

5.10 It was noted that this would worsen the projected deficit and bring forward the first year to 2010/11. In addition, the longer-term viability of the HRA was still very much questionable and this was still being compounded by the uncertainties within the current funding system. However, a national review of financing council housing was imminent at that stage.

Revised National Guideline

5.11 Subsequently, during March 2009, the Government announced a reduction in the average national guideline rent increase from 6.2% to 3.1%. This was in recognition of the economic situation.

5.12 Effectively, this provided authorities with an option of implementing the revised guideline with lost rent being compensated through the subsidy system. Consequently, after consideration, the Council approved a 3.1% increase for 2009/10 in April 2009 and this has been implemented.

5.13 Broadly, this was projected to revert the HRA back to the original forecasted position reported in February 2009. This was due to the subsidy system reimbursing lower rent levels with all other items remaining unchanged, including formula rents.

Budget Out-turn 2008/09

5.14 This highlighted an improved position to that estimated, with reserve balances showing approximately £2.7m as at 31st March 2009. This was approximately £50,000 more than estimated due to the HRA virtually achieving a break-even position for 2008/09 (compared to a budgeted deficit of £50,000).

5.15 This was due to increases in income from rents and Supporting People contributions with a reduction in repairs and maintenance expenditure.

5.16 There were additional costs in management and sheltered services due mainly to the development of the Careline Service (approved earlier in the year), although these costs (as estimated) were more than offset by additional income generated.

5.17 On the negative side, there was an extra cost to the HRA in 2008/09, i.e. the negative subsidy payment of £2.96m was approximately £135,000 higher than estimated.

5.18 This was due to the Government lowering the interest rate upon which they reimbursed the HRA's (assumed) capital charges to reflect prevailing interest rates.

Updated Projection

5.19 The projection has now been updated to take account of the revised rent increase for 2009/10 (at 3.1%) and the on-going effects of the out-turn for 2008/09. This is summarised in **Appendix 6**.

5.20 Similar to the General Fund projection, some revision has been made to reflect the current economic situation, in particular on future rent increases, the interest rate used for capital charges and council house sales. Provision continues to be made for future pension increases and the pay and grading review.

Overall Position Updated

5.21 The overall position is that the projected <u>cumulative deficit</u> by 2019 is approximately £293,000. This has changed compared to the previous projection, which highlighted a credit balance of £937,800.

5.22 Sufficient balances of £1/2m, as required by the Financial Strategy, are still projected until 2016/17.

5.23 The yearly deficit in the later years is fairly similar to the previous projection and is still projected to rise to over £600,000 by 2018/19. Clearly, without any major external changes, this would need addressing much sooner than that year.

5.24 In addition, the first year of deficit is now in this financial year, i.e. 2009/10. This is due to the effect of interest rates on capital charges as highlighted above. Although in broad terms, there is not a significant change when considering the 10-year period overall, there continues to be significant volatility within this. To some extent, there are linkages between the different variables.

Overall Analysis of the Change

5.25 Effectively, just over £1.2m has been taken out of the 10-year projection since January 2009 (i.e. a £937k surplus to a £293k deficit). This is summarised in the following table:

Analysis of Change in Projection (10-year figures)	£'000
Reduction in rental income	4,474
Deficit in 2018/19	626
Offset by lower payment to the National Pool	-2,437
Lower inflation factors on expenditure, and	-1,162
Reduction in capital charges	-271
Total Overall Change	**1,230**

Reduction in Rental Income

5.26 This is manly due to the lower rent increase set for 2009/10 and the knock on effect for 2010/11. Average increases for these years are 3.1% (as set) and 4% respectively. Previously 6.2% and 6% had been assumed.

5.27 From 2011/12 onwards, an average yearly increase of 4% has been assumed. This is 2.5% inflation, +0.5% real terms increase + 1% to achieve rent harmonisation. This is unchanged from that previously.

5.28 It should be noted that the reduction in rent is largely offset by a lower payment to the National Pool (to reflect lower rental income) in accordance with the current subsidy system.

Other Stock Reductions

5.29 In addition, the projection has taken out the 30 units to be transferred as part of the Extra Care Project. However, the amount of council house sales has been reduced from 85 to 40 over the next 10 years.

Overall Reduction in Payment to the National Pool (£2.4m)

5.30 The reduction in assumed rent amounts to approximately £4.4m over 10 years. This is offset by projected inflation being lower on management and maintenance allowances of £1.2m and on capital charges, due to lower interest rates, of £0.8m.

Risk, Assumptions and Options

5.31 Similar to the General Fund, any projection should be viewed with a certain degree of caution, especially one spanning 10-years. Although every effort has been made to take into account known spending pressures, some are less predictable. In addition, the previous paragraphs demonstrate the volatility that external factors can have on the overall situation.

5.32 The projection continues to assume the continuation of the existing subsidy system, for which the Government has proposed changes, currently subject to consultation. These are discussed briefly later in this section.

5.33 However, 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.

Housing Subsidy

5.34 The HRA continues to be in "negative subsidy." Consequently, the Council currently makes a net payment to the national pool of approximately £3m. This equates to around 32% of rental income. Based on these projections, this will rise to over £4.8m by 2019, 36% of income.

5.35 It has been widely reported and is accepted that the current national system is out-dated for financing today's housing service at a local level.

5.36 The volatility of the system from year to year can have a significant impact on the HRA which makes the even medium-term planning much more difficult. In addition, the negative subsidy payment is virtually the largest expenditure item in the Council's HRA.

Reviewing the Subsidy System

5.37 During December 2007, the Government announced a review of the HRA subsidy system and the future financing of council housing. The Government published their findings and proposals in a consultation paper in July, inviting comments and feedback by 27th October 2009.

5.38 Basically, the main proposal is to replace the current system with a devolved, self financing system where each housing authority will be able to maintain all income (revenue and capital) generated locally to provide services. This will be in exchange for a one-off allocation of the share of national housing debt.

5.39 Depending on whether agreement is reached between authorities, primary legislation may be needed to enact any changes. Therefore, a new system may not be operational until 2012/13 at the earliest.

5.40 The proposals are currently being considered and liaison is taking place with other authorities and the relevant professional bodies. This will be reported to the next round of Committees in early October in order that a response can be made to the Government before the consultation ends.

Management Costs

5.41 The previous projection built in inflation on the current base costs of 3%. In accordance with inflation factors outlined in the General Fund section, in particular that relating to public sector pay over the next 2 years, this has now been reduced to 2.5% (on average) per year.

5.42 To demonstrate the sensitivity of this variable, the ½% reduction on its own, improved the overall position by £650,000 to 2018.

Housing Repairs

5.43 This budget is always subject to demand and actual expenditure can fluctuate from year to year. There has been an underspending in each of the last 3-years compared to budget.

5.44 It is considered that this might be partly due to the investment the Council has put into planned maintenance over recent years leading to a pattern of fewer responsive repairs. However, milder winters would most likely have contributed more to this.

5.45 The projection continues to assume an annual increase of 4.5% to reflect higher than average inflation in the building industry. Based on this, spending is projected to rise from approximately £3m in 2009/10 to just over £4.5m by 2019.

5.46 On these figures, a 1% variance in the inflation rate each year amounts to approximately £1.8m over 10-years, clearly a substantial difference.

Stock Condition Survey

5.47 This is being undertaken during 2009/10 and will indicate future levels of investment to maintain properties at decent home standards. It is likely that this will show a likely need to increase spending on repairs and improvements to maintain decent home standards. The outcome will need to be reflected in future projections.

Inflation Provision

5.48 Similar to the General Fund, the overall provision for inflation in the HRA, including that for repairs, will be held centrally. In accordance with the Financial Strategy, it will only be applied when pay and price increases have known to have impacted.

Rent Restructuring and Future Rent Levels

5.49 There remains uncertainty around the definitive date set for completing rent restructuring. During 2008/09, the Government delayed full rent convergence until 2016/17, a further 5 years than originally planned. The principle was to avoid hefty rent rises for tenants.

5.50 This was the case for South Derbyshire as generally, actual rents were below formula rents. Whilst this would help to smooth increases for individual tenants over a longer period, overall, the financial position on the HRA worsened as this reduced the amount of rent compared to previous projections.

5.51 The Government calculates the formula rent based on the rate of inflation in the previous September. However as highlighted previously, the original national average increase of 6.2% for 2009/10 (based on an inflation rate of 5%) was subsequently reduced to 3.1% to reflect current economic conditions.

5.52 This projection continues to assume an average increase every year of 4% in line with Government projections.

5.53 However, this could change depending on the inflation rate each September and whether the Government wish to deviate away from this to recognise economic conditions.

5.54 On these projections, the Council's rent convergence date is 2023/24. This is because the actual average rent locally is £59.91. The equivalent formula rent is £68.12 some 12% above the actual and this difference is effectively being phased in between now and 2024.

5.55 All other factors remaining equal, the actual increase each year is very sensitive. For example, a 1% increase upwards (an average of 5% per year) would effectively sustain the HRA in the long-term and it would operate in surplus.

5.56 Conversely, a 1% decrease (an average of 3% per year) would worsen the longer-term position to a point where the HRA would be in deficit by 2015. Whilst the current rent policy remains at a national level, the higher the rent increase each year, the more beneficial it becomes for the overall HRA.

Housing Debt and Interest Rates

5.57 The HRA operates with an historic notional debt of £9m. This is the amount of debt the national system assumes that the Council still has outstanding for housing. The subsidy system provides funding for this debt based on the cost of borrowing (known technically as the consolidated rate of interest or CRI). Effectively, this nets down the payment to the national pool.

5.58 This is the only item in the subsidy settlement than can subsequently change by the year-end, depending on the level of interest rates. This became more sensitive during 2008/09 when the original CRI was reduced by 1.5%. On the notional debt of £9m, this increased the payment to the national pool by £135,000 compared to that estimated.

5.59 The current low level of interest rates has been built into these projections in accordance with that used for the General Fund. This has a shorter-term effect in the HRA as it is assumed that by 2013/14, interest rates will reflect previous levels of CRI.

5.60 However, this has still reduced resources compared to the previous projection by £800,000 in this period. This is the reason why the HRA is now projected to fall into deficit in 2009/10.

Overall Summary

5.61 The above sections again demonstrate the sensitivity of each variable. Historically, more than one variable usually changes from year to year and in some cases are inter-related.

5.62 Perhaps the main point to note is that as long as the current system remains, volatility will continue between years. Unless there are higher and sustained rent rises on average in future years, the HRA will eventually operate with an increasing budget deficit, together with an increasing payment to the national pool.

5.63 The impact of the Government’s proposals on the Council to significantly change the national funding situation is currently being considered and will be reported to the next round of Committees in October.

6.0 <u>Financial Implications</u>

6.1 As detailed in the report

7.0 <u>Corporate Implications</u>

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 <u>Community Implications</u>

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

9.0 <u>Background Papers</u>

9.1 Previous Committee papers between 2008 and 2010, together with the Council's current MTFP. Links at:

http://cmis.south-derbys.gov.uk/CmisWebPublic/CommitteeDetails.aspx?committeeID=30

http://cmis.south-derbys.gov.uk/CmisWebPublic/CommitteeDetails.aspx?committeeID=220

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