

	<p style="text-align: center;">Budget Panel 23 October 2008</p> <p style="text-align: center;">Report from the Director of Finance and Corporate Resources</p>
<p style="text-align: right;">Wards Affected: ALL</p>	
<p>Review of progress on the Medium Term Financial Strategy</p>	

1.0 SUMMARY

- 1.1 The council's medium term financial strategy was set out in the 2008/09 Budget Report and was up-dated in the budget process report to the Executive on 14th July and the budget up-date report to the Executive on 6th October. The October report referred to the potential impact of recent economic events on the budget. Since that report was produced, the economic situation has significantly worsened.
- 1.2 Whilst the fundamental underlying approach in the medium term financial strategy is considered sound and will not change, the consequences of the changes to the economic situation mean that there will need to be a further review of the assumptions within it. It is too early assess what the fall-out of recent economic events will be. At this stage, therefore, this report sets out the current assumptions. A further report will be presented to the Panel at a later stage setting out the changes that need to be made to the medium term financial strategy as a result of the new economic situation.

2.0 RECOMMENDATIONS

The Budget Panel is asked to:

- 2.1 note current assumptions in the medium term financial strategy; and
- 2.2 note that a further report will be provided on the medium term financial strategy once it is clearer what the consequences of the current economic situation are.

3.0 DETAILED CONSIDERATIONS

Background

- 3.1 The council's approach to medium term financial planning has been developed over a number of years. It is based on clarity about the

council's priorities expressed through the Corporate Strategy, ensuring the underlying financial strength of the authority, a risk based approach to budgeting, accurate forecasting of the resource envelope likely to be available, an understanding of the budget pressures facing the council, and the development of an efficiency strategy (now replaced by an improvement and efficiency strategy) aimed at making the most effective use of resources.

- 3.2 Whilst the underlying approach has not changed, current economic conditions mean that there is considerably less certainty about underlying assumptions within the strategy. The consequences of the collapse of the Icelandic banking system and the council's potential exposure to losses as a result of this add to this uncertainty. In addition, the changed economic environment will affect the budget pressures faced by the council and will also require a reassessment of priority needs within the borough.
- 3.3 The result is that the medium term financial strategy will have to be re-assessed as part of the 2009/10 budget making process. It is too early to assess the longer term consequences of the current financial crisis. At this stage therefore this report sets out the assumptions underlying the current medium term financial strategy and the approach to be taken to up-dating the strategy as part of the 2009/10 budget process.

Underlying assumptions in the existing medium term financial strategy

- 3.4 The underlying assumptions in the current medium term financial strategy were up-dated in the budget process report to the Executive in July. These are as follows:
- a. Formula Grant increases by 1.75% in 2009/10 and 1.5% in 2010/11, in line with the three year settlement announced last year, with a further increase of 1% in 2011/12;
 - b. pay increases of 2.5% pa;
 - c. price increases of 2% pa;
 - d. income increases of 2% pa;
 - e. pension fund contributions remain at 2008/09 levels;
 - f. provision for 'inescapable growth' as follows:
 - i. £644k in 2009/10 for commitments in service areas in 2009/10 with a further £658kn in 2010/11 and £45k in 2011/12 (details in Appendix A);
 - ii. £7.5m in central items in 2009/10 with a further £5.6m in 2010/11 and £3.1m in 2011/12 (details in Appendix B);
 - iii. £2m growth provision each year for other 'inescapable growth';
 - g. service priority growth to be funded from increases in Area Based Grant and the revenue element of LAA Performance Reward Grant;
 - h. borrowing to fund the capital programme remains at levels

included within the current capital programme;

- i. 3% savings achieved each year in all service areas other than:
 - i. adult social care, for whom budget pressures associated with increasing levels of care need within the community would be funded from transformation savings;
 - ii. waste management, for whom the focus is on reducing overall waste tonnages and increasing recycling in order to reduce the pressure on the levies budget within central items;
 - iii. children's social care and One Stop Shop who are exempted from the 3% savings target until 'invest to save' funds are repaid;
- j. use of the capital element of Performance Reward Grant to fund 'invest to save' schemes.
- k. a 0.75% increase in the council tax base;
- l. spending each year is in line with budget;
- m. balances remain at £7.5m;
- n. any increase in balances above £7.5m is used for one-off purposes.

3.5 The resulting projected budget gap is set out in Table 1 below:

Table 1 Projected budget gap (July Executive)

Year	Cumulative budget gap assuming:		
	5% council tax rise	2.5% council tax rise	0% council tax rise
	£m	£m	£m
2009/10	2.3	4.8	7.2
2010/11	0.7	5.9	10.9
2011/12	(3.3)	4.8	12.5

3.6 The report to the Executive and the Budget Panel earlier in October presented first stage budget savings and up-dated the budget position. The key factors identified as further potential pressures on the council's medium term financial prospects are as follows:

External pressures:

- a. *Inflation.* The annual increase in the Consumer Price Index (CPI) was 5.2% and the RPI-X was 5.5% in September. The forecasts are that inflation will fall to around 4% by the end of the year and is likely to have fallen below the target level of 2% by this time next year. The increased inflation affects all costs incurred by the council but has a particularly adverse effect where contract costs are linked in to RPI or increases in fuel costs (eg the waste contract). This will have an impact on the council's spending in the

current year but it should not effect assumptions in the medium term financial strategy for future years;

- b. *Economic downturn.* This affects:
- i. income generating areas – land searches, planning income, commercial rents, parking. So far the largest impact has been on land search income which is showing a projected shortfall in the current year of £400k. The current budget assumption is that shortfalls in income will be compensated for by additional income in other areas from reviews of fees and charges. It is not intended to change this assumption at the moment but this remains a risk area for the medium term strategy;
 - ii. demand led services such as temporary accommodation and housing benefits. Levels of homeless applications remain at historically low levels, partly because of preventative action taken by the housing service and partly because of the impact of Local Housing Allowance making it easier for families on benefit to find privately rented accommodation particularly in the south of the borough. However levels of housing benefit applications are increasing and this is a sign that the financial crisis is beginning to have an impact on demand for services in the borough. This is an area that needs to be monitored closely and could result in the need for additional funding from the provision for ‘inescapable growth’.
- c. *Impact on interest rates of turmoil in the financial markets.* Relatively high levels of short term interest rates and low levels of long term interest rates contributed to improvements in the council’s overall capital financing position in the early part of this year. The 0.5% reduction in base rate earlier this month together with expected further falls in short term interest rates will reduce the return on short term investments. In addition, the failure of the Icelandic banks has had a direct impact on the council, by putting at risk the £15m the council had invested in them and an indirect impact by forcing the council to significantly reduce the list of institutions the council is willing to invest in (further details on this will be provided at the Scrutiny Panel meeting). If the council recovers its £15m invested in Icelandic banks, overall capital financing costs should be below budget in 2008/09 but lower interest on investments in 2009/10 and future years means that the council will have to review assumptions on this in the medium term financial strategy.
- d. *Impact on the Pension fund of collapse in the value of shares.* This poses a significant threat to the council’s Pension Fund which is due to be valued in 2010. Whilst valuation of the Pension Fund involves assessment of long term trends, losses due to reductions in value of shares mean that it is almost certain that the employer’s contribution to the Pension Fund will have to be increased following the valuation, affecting budget projections from 2011/12 onwards.

This will need to be factored in to the medium term financial strategy from 2011/12.

- e. *Deterioration in public finances.* Formula Grant, Area Based Grant and most specific grants are fixed for three years until 2010/11. Despite the worsening of the government funding position, it is unlikely that these fixed allocations will change although there is likely to be an impact when the new Spending Review has an effect from 2011/12. It also appears unlikely that the government will make further reductions in the ceiling for housing benefit subsidy on private sector properties leased directly by the council. There will remain pressures from known government funding changes including reduction in the level of subsidy for housing benefit administration and the increase in land-fill tax. There are also unlikely to be additional government resources should new pressures arise. Whilst allowances have been made in the medium term financial strategy for increases of just 1% in grant from 2011/12 even this may prove to be too generous an assumption.

Internal pressures

- a. *Current year monitoring.* The latest position on the 2008/09 budget was reported as part of the quarter 1 Performance and Finance Review report to the Executive on 9th September. Balances are currently forecast at £2.065m below the target level of £7.5m. Measures are being taken to address this shortfall but this remains a major risk area. If balances are not at their target level at 31st March 2009, the budget gap for 2009/10 would increase.
- b. *'Inescapable growth'.* The £2m allowed in the budget is significantly less than 'inescapable growth' funded in previous years. The adequacy of it depends in particular on the successful continuing delivery of the 'invest to save' programme in children's social care, the delivery of transformation savings in adult social care to offset growth, and the other factors listed above under 'external pressures'.
- c. *Budget savings.* First stage savings of £2.8m were agreed at the Executive on 6th October but this is still £1.9m short of the 3% target. Whilst each of the service areas has a strategy for delivering the balance of 3% savings required for 2009/10 and further 3% savings required in 2010/11, achievement of this higher level of savings is challenging particularly since it follows a number of years in which savings targets have had to be achieved. The development of the council's new improvement and efficiency strategy is aimed at helping this process.

- 3.9 As noted in the report to the Executive on 6th October, there is insufficient information to change any of the underlying budget assumptions for 2009/10 and 2010/11 at this stage. However the changed economic environment will mean that there will have to be a rigorous review of the medium term financial strategy. Proposed changes to the medium term financial strategy will be reported to the Budget Panel before they are included in the 2009/10 Budget Report to Full Council on 2nd March 2009.

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**'INESCAPABLE GROWTH' FROM 2009/10 ONWARDS IDENTIFIED IN
THE 2008/09 BUDGET REPORT**

Items which were identified as 'inescapable' growth in the 2008/09 Budget Report and will require growth funding in future years are as follows:

- a. £15k in 2009/10 to 2011/12 for Town Centre CCTV;
- b. £320k in 2009/10 for additional Police Community Support Officers following the ending of the subsidy arrangement with the Metropolitan Police;
- c. £309k in 2009/10, a further £248k in 2010/11, and a further £25k in 2011/12 for properties at Middlesex House/Lancelot Rd which fall out of the HRA ; and
- d. £395k in 2010/11 and a further £20k in 2011/12 to re-align HRA/General Fund recharges following transfer of South Kilburn properties.

APPENDIX B

ANALYSIS OF CENTRAL ITEMS 2008/09 - 2011/12

	2008/09	2009/10	2010/11	2011/12
	£'000	£'000	£'000	£'000
Coroners Courts	198	203	208	213
LGA	69	71	72	74
London Councils	198	203	208	213
LGIU Subscription	19	19	19	19
West London Alliance	20	20	20	20
Park Royal Partnership	25	25	25	25
Copyright Licensing	13	13	13	13
External Audit	425	433	442	450
Corporate Insurance	280	300	320	340
Capital Financing Charges	23,374	24,394	25,584	25,810
Net Interest Receipts	(3,549)	(3,656)	(3,734)	(3,960)
Levies	8,373	10,430	12,574	15,091
Premature Retirement Compensation	4,200	4,280	4,370	4,460
Middlesex House/Lancelot Road	454	489	526	565
Remuneration Strategy	2,500	2,500	2,500	2,500
South Kilburn Development	570	570	1,500	1,500
Investment in IT	820	820	820	820
Insurance Fund	1,800	1,800	1,800	1,800
Property Repairs and Maintenance/Civic Facility	1,200	2,200	2,400	2,600
Neighbourhood Working	850	850	850	850
Local Authority Business Growth Incentives	(1,500)	0	0	0
Freedom Pass Scheme Growth	0	900	1,300	1,700
Affordable Housing PFI	514	764	1,003	1,159
Council Elections	0	0	350	0
Corporate Efficiency Savings	(1,150)	(1,150)	(1,150)	(1,150)
Income Generation Initiatives	(587)	(587)	(587)	(587)
Future of Wembley	350	350	350	350
Leasing Costs (Internal Scheme)	(120)	(117)	(100)	(100)
Invest to save	(156)	0	0	0
Capitalisation adjustment	(600)	(600)	(600)	(600)
Building Schools for the Future	0	500	500	500
Other Items	68	108	150	150
TOTAL	38,658	46,132	51,733	54,825