Appendix 4

Financial Overview – Budget Panel

Introduction

This is a very brief report and is a 'work in progress'.

Proposed changes to the future financing of local government will result in significant uncertainty for medium term financial planning.

If there is one message coming out of this paper it is that there are major uncertainties leading up to the Revenue Support (Formula) Grant Settlement announcement at end of November 2011. The scope for large variations in government support (even for 2012/2013) is just too great for accurate forecasting at this stage.

This paper does however discuss a number of major issues that could impact upon future years budgets.

Business Rates Retention

By far the largest uncertainty revolves around Government proposals to encourage councils to grow their business rates base as reported to Budget Panel on 25th October.

The original concept was that individual local authorities should be able to keep any growth in their business rates income base (after a base position had been set). The detail within the consultation paper seems to suggest that increases in the business rate multiplier (inflation) in 2012/2013 and 2013/2014 will be creamed off by the Treasury. Tuesday's CPI figure for September was an extraordinary 5.2% and, unless this is reduced, will provide an estimated £1.35billion to the Treasury.

The LGA has yet to circulate its official response to the Consultation Paper but early comments from LGA Leaders include:

''overly complex and offer councils little incentive to back changes''
''will undermine local finances''
''will effectively strip local authorities of the benefits from future increases in the income from business rates''
''there will still be too much central government control over the system''
''the spending cuts already imposed on councils raise concerns that changes to the rates system could lead to further loss of income ''

At a local level, Watford may actually be an individual loser out of the system as Watford has had the second lowest growth out of the 51 authorities in the East of England over the five year period 2005/2010. If this relative decline continues then we might feasibly have to be 'safety netted' when the system is fully operational (April 2013, with individual authority details not known until Autumn 2012.

New Homes Bonus

This should be a good news story for Watford.

The original concept was that any net increase in the supply of available housing (including an additional bonus for affordable homes) would result in additional funding from Central Government. This funding to be effectively guaranteed for the first four years before being subsumed within the RSG Formula Grant (and therefore capable of ‘compensatory manipulation’).

In 2011/2012 Watford was notified it would receive £420k from this set aside ‘pot’ (the notification came after our budget for 2011/2012 had been set).

Using the same formula (as applied for 2011/2012) calculations carried out within Housing and the Revenues Shared Services, suggest this New Homes Bonus will increase to £1.5m in 2012/2013 (an increase of £1.1m). Our calculations have been validated by Mike Heiser at the LGA.

The slight ‘niggle’ is that if this were to be repeated nationally does the Government have the money (or will it seek to manipulate the RSG Formula Grant).

Confirmation of Watford’s overall funding package for RSG and the New Homes Bonus is expected at the end of November and indicates (due to the large sums involved) that we need to await that critical announcement before arriving at any firm strategy.

This is however a potentially extremely favourable source of additional funding.

For 2013/2014 onwards however the situation is now far from clear.

The concept of guaranteeing this funding for a four year period could now well change as the Business Rates retention consultation paper suggests it should be ‘rolled up’ within the revised funding arrangements for 2013/2014 onwards. Watford will obviously object to this proposal as additional sources of housing supply are totally different and in potentially direct conflict with making land available for additional business growth. The danger is that if Watford were to be ‘safety netted’ due to low business growth, this financial protection could be totally wiped out by offsetting additional grant (due to be received as a consequence of increasing the housing supply).

Pensions Consultation Paper

On 9th October, a paper was circulated from Central Government in which it provided detail of how the national public service pensions shortfall can be made good.

The Paper needed to distinguish between those schemes which are totally unfunded and are a direct charge on annual revenues (most public sector/ civil servant schemes) and those that are largely funded (local authorities).

The Paper is however rather disturbing in that its main intention is not to seek to ensure schemes are 100% fully funded (Watford's is currently circa 74%, although with stock markets on a knife edge, this has probably deteriorated). Its main intention, for local government, is how Central Government can extract £900m out of the process. The proposal is that there should be an increase in employee contribution rates accompanied by adjusted accrual rates. In effect, the Government is expecting there to be interim actuarial valuations to be in place by 1st April 2012 ! (there is some uncertainty about this date). In a roundabout way, central government could reduce the RSG Settlement for 2012/2013 by £900m because the Pensions change will improve local authorities financial positions.

Again I have written to the finance advisers at the LGA on 10th October. The reply from Mike Heiser is as follows:

''On your question about whether the pensions adjustment would be taken out of Formula Grant, the CLG did not seem to know about it but agreed to check; I have not yet heard anything.''

Again we return to the current uncertainty and the need to await the RSG / New Homes Bonus et al announcement at the end of November.

<u>Council Tax Freeze Grant</u>

The original CT Freeze grant was to apply for four years. It is assumed this will continue although, taken to its logical conclusion, may also be swallowed up in the 'great maw' of business rates funding reform.

The Government announced on 3rd October additional money had been found to enable a further council tax freeze to be encouraged. The same terms are on offer—freeze council tax again in 2012/2013 and authorities will receive the equivalent of 2.5% by way of freeze grant. For Watford that will be another circa £205k. The difference this time is that it will apply for one year only (2012/2013).

The effect is that in 2013/2014 there will be a £205k hole in our budgets which would need to be made good from an additional increase in council tax or greater use of reserves to 'buy time'.

<u>Refuse Collection Additional Support</u>

Clarification from the LGA suggests the additional grant involved is:

£50m available this year !
£100m available in 2012/2013
£100m available in 2013/2014

It is available for existing weekly collection authorities but obviously requiring a four year? Commitment to continue. The detail will need to be studied but this is relatively small beer in the context of other issues.

Welfare Reform

More massive potential change.

The localisation of council tax benefit will set targets upon local authorities to reduce the cost of benefits.

The Universal Credit is another unknown quantity.

Timescales are very tight.

Pay Inflation

The MTFS has currently built in an assumed pay award of 2% for 2012/2013. The majority of Herts authorities are assuming a continued pay freeze (with CPI/ RPI 5.2% and 5.6% respectively how realistic is this?). Nevertheless if there were a continued pay freeze this would reduce forecast budgets by circa £200k per annum (including Shared Services-as the same 2% has been assumed).

Price Inflation

CPI currently 5.2%; RPI 5.6%

Inflation factors particularly affecting Watford/ SLM include:
Gas 22.3%; electricity 12.9%; fuel 17.8%.

Provision has been made within the MTFS for inflation on these items—but will need to be reviewed.

SLM are proposing an increase in charges for core activities of between 3% to 4% which is not unreasonable with utility costs running as they are.

Also (unless the Government changes the CPI formula) pensioners will receive an increase of 5.2% in April.

Service Prioritisation

Devised to meet severe government funding reductions. Sought to avoid salami slicing and to protect services as much as possible. It has been an outstanding success. Gold plated services were identified; services not really valued by the community also highlighted. Main savings have come from reducing bureaucracy. Flexibility existed to vary the plan but at the margins. It is essential this approach continue—benchmarking data has indicated we are a high cost authority.

Council Roadmap

Again evidence of a forward thinking authority. The essence of the roadmap is **primarily** to seek to provide existing services more efficiently. This is the essence of value for money. There are areas where we are high cost and where we should be reducing unit cost through the initiatives proposed, including outsourcing as an option.

Use of Reserves

Is becoming a subjective issue. We do not have £13m to play with.
Some of it is not the general funds to use.
Some of it is making provision to keep our assets in a fit for purpose condition in the future.
The use of reserves is not a one off incident. Their use leaves a budget unbalanced whereby annual income and expenditure are not in tandem.
Ultimately that gap between the two has to be filled from increases in income or reductions in expenditure.
There is clearly room for discussion.
My strongly held observation today, is that the RSG Settlement at the end of November will be key —the central financing situation is remarkably volatile.
It is for that reason there is not a Revised MTFS at this point—it could quite easily be £500k out either way.
The opportune time for a longer term view will be Mid December - January when all the pieces are in place.

Bernard Clarke

Head of Strategic Finance
19th October 2011.