Havering
LONDON BOROUGH

CABINET
14 August 2013

Subject Heading:	The Council's Financial Strategy
Cabinet Member:	Cllr Roger Ramsey
CMT Lead:	Andrew Blake-Herbert Group Director Resources
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Policy context:	The Council is required to approve an annual budget and to establish a financial strategy and this report forms the initial part of that process
Financial summary:	There are no specific financial proposals, this report deals with developments relating to the general financial climate, in particular, the March budget and the outcome of the Comprehensive Spending Review. A further report on the financial prospects will follow
Is this a Key Decision?	No
Is this a Strategic Decision?	No
When should this matter be reviewed?	July 2014
Reviewing OSC:	Value

The subject matter of this report deals with the following Council Objectives

Ensuring a clean, safe and green borough	[X]
Championing education and learning for all	[X]
Providing economic, social and cultural activity in thriving towns and villages	[X]
Valuing and enhancing the lives of our residents	[X]
Delivering high customer satisfaction and a stable council tax	[X]

SUMMARY

Over the course of the period since the 2010 emergency budget, Havering Council has agreed a package of savings to mitigate the impact of very significant cuts in central government funding to local authorities. These measures set the Council on a course to reduce its operating budget by around £40 million over four years.

Alongside this, there have been major changes in the funding arrangements for local authorities, with the localisation of both business rates and Council Tax support payments. Whilst their impact is still being assessed – the changes only became effective on 1 April – the level of financial risk has unquestionably increased.

The global and national economic climate has remained challenging. There are strong indications that the achievement of a balanced national budget will take considerably longer than originally expected. The austerity measures put in place may now continue until 2018, and possibly even beyond it.

With the announcement of the Comprehensive Spending Review (CSR) on 26 June, it is now possible to review the longer term financial prospects set out in the report to Cabinet in February 2013. These need to be set in the context of the current strategy.

RECOMMENDATIONS

Cabinet is asked to note:

1. The analysis of the National Budget and the Comprehensive Spending Review and associated announcements.

2. The Secretary of State's announcement on the timing of the financial settlement, which is now expected to be after Christmas.

3. That a further report will be submitted to the next meeting of Cabinet, setting out the impact of these announcements on the Council's financial planning.

REPORT DETAIL

1. BACKGROUND

1.1 In the light of the global financial climate and the decisions taken by the Coalition Government on public sector spending, the broad financial position and prospects for the future have been set out in previous reports to Cabinet. In very broad terms, the anticipated funding reductions were expected to lead to an overall budget gap of around £40m over a 4 year period. In response to this, Cabinet agreed two tranches of savings, totalling around £36m, and these were subsequently included in the budget formally approved by Council.

1.2 The proposals agreed by Cabinet would largely meet the Authority's savings requirements without excessive Council Tax increases and not raising Council Tax above 2.5% throughout the life of this Administration. It would ensure a stabilised financial position with clear plans in place to meet the overall budget gap and bring as much certainty as possible to residents over both Council Tax levels – given the Administration's commitment to low increases – and the level of service they can expect.

1.3 The system of funding of local authorities has recently undergone substantial change, with the localisation of both business rates and Council Tax support (CTS) payments. The details of these changes have previously been reported to Cabinet at some length, during the last budget cycle. Local authorities in London only retain 30% of the business rates yield, the remaining 70% goes back to Government and the GLA, whilst the localisation of CTS was accompanied by a 10% reduction in funding.

1.4 As part of the annual budget setting process, the report to Cabinet in February 2013 set out the financial prospects for the period from 2015/16 to 2018/19. This period covered the four years immediately after the London local elections in May 2014. Based on the information available at that time, the likely budget gap over that period was reckoned at between £40m and £50m.

1.5 Since then, the general economic prospects, as set out in the Budget announced in March 2013, have worsened, raising the prospect of an extended period of austerity – further affecting local government funding. Following the announcement of the CSR on 26 June, work is now underway to re-assess the budget gap, and to consider how this might impact on the Council's long term financial strategy.

1.6 Once that work has concluded, a further report, setting out both the impact and the strategy to address it, will be brought to the next meeting of Cabinet.

2. NATIONAL BUDGET

2.1 On 20 March 2013, Chancellor George Osborne delivered his annual Budget. It built on his previous announcements made in the Autumn Statement in December 2012 and provided an update on the economy and future government plans for public sector spending and taxation.

2.2 The key elements of the Budget that impact on local authorities were as follows:

- The next Spending Round will be set out on 26th June
- Both next year and the year after, departmental expenditure limits (DELs) will be reduced by a 1% reduction for most departments.

- Local government will be exempt from further 1% budget reduction in 2013/14 but is expected to fall by a further 1% in 2014/15
- Public sector pay will be limited to 1% increase in 2015/16
- Local government DEL will be adjusted in the Spending Round to reflect this pay cap
- Adult Social Care – Dilnot reforms to be implemented a year earlier in 2016; the cap will be set to protect savings above £72k, with a threshold for means tests on residential care to rise from £23k to £118k.

2.3 The immediate impact of this was a further funding reduction for local government. The DEL for Communities & Local Government is now expected to fall from £24bn in 2012/13 to £21.7bn in 2014/15, although largely static in 2013/14. In very broad terms, this reduction of 1% potentially equates to as much as £1m for Havering, ie a further reduction in Government grant, and follows on from an earlier reduction of 2% announced as part of the Autumn Budget Statement.

2.4 Looking at the broader aspects of the Budget, the following key points provided by the Office for Budget Responsibility were included as part of the Chancellor's statement:

- The growth forecast for 2013 has been halved to 0.6% (this was forecast at 1.2% at the Autumn Statement in November 2012)
- The GDP growth forecast for 2013 has halved from 1.2% at the Autumn Statement to 0.6% and is less than one third of the projection made 12 months ago at Budget 2012
- There is an increase in the forecast for inflation measured by both indices (the Consumer Prices Index and the Retail Prices Index in 2013, compared with the forecast at the Autumn Statement 2012
- The forecast receipts from both Council Tax and business rates show an increase in the projected receipts between 2013/14 and 2016/17, but a lower projection than made at Budget 2012
- Borrowing as a percentage of Gross Domestic Product (GDP) is expected to fall from 7.4% in 2013/14 to 5% in 2015/16. However, debt as a percentage of GDP is forecasted to increase from 75.9% in 2012/13 to 85.6% in 2016/17.

2.5 The general message was that financial prospects remained challenging. The Chancellor announced that the UK's debt as a share of GDP is unlikely to start coming down until 2017/18, a year later than previous forecasts. The conclusion drawn from this analysis was that Government spending would need to restrained until then, which would mean a continuation of the existing austerity measures. This in turn has been interpreted as meaning that funding cuts could well be at a similar level over the period to 2017/18, before the economy is sufficiently healthy not to require such measures. This will be taken into account in updating the projection of the future budget gap.

3. COMPREHENSIVE SPENDING REVIEW (CSR)

3.1 The CSR is a long term view of Government spending. It sets out the anticipated Government department spending. The current CSR was announced in October 2010 and details were set out in the report to Cabinet in December 2010.

3.2 Although CSRs have covered a 5 year planning period, in the past, not a single CSR has survived intact without further announcements and changes. It became apparent during the last budget setting cycle that, almost certainly due to the ongoing financial climate, the Government was intending to review its CSR plans, with a further announcement in the “first half” of 2013. It was subsequently stated that details would be released on 26 June. Considerable speculation has followed over potential “ring-fencing” or protection of specific departmental budgets. Should this be the case, then proportionately bigger funding reductions will fall on the remaining departments.

3.3 The details were released as planned on 26 June. To be clear what this entails, the form and nature of the Spending Round 2013 is different from previous processes. Historically, Spending Reviews have tended to cover a multi-year period – usually between three and five years. However, this Round will only focus on 2015/16, reflecting the fact that there will be a General Election in Spring 2015. The current process is called a ‘spending round’ and is not a review. There will therefore be neither a formal stakeholder engagement process nor a wide-ranging review of current Government policies. The Spending Round will have an influence on longer term thinking about changes to public service that will be in the next Spending Review.

3.4 A briefing paper setting out the areas covered as part of the announcement is attached at Appendix A. This goes into some detail, as the scale of the announcement was considerable, but it repeats a consistent message that the economic climate remains difficult, and therefore further measures are needed by the Government to address the continuing imbalance in the overall economy.

3.5 Briefly, the key points impacting on Havering’s long term budget strategy are as follows:

- Further departmental spending reductions of £11.5bn for 2015/16
- NHS and Education remain ring-fenced from any funding reductions
- 10% cut in DCLG departmental spend – DCLG had the second largest “hit” across Government departments
- Creation of £3.8 billion of pooled funding between the NHS and local authorities – this is in addition to the existing £1 billion and it is as yet unclear what new responsibilities will accompany this funding
- Pay rise limited to an average of 1% in 2015/16 and removal of time served pay-progression
- A 1% increase council tax freeze grant for 2 years, 2014/15 and 2015/16.

4. REVIEW OF FINANCIAL PROSPECTS AND PROPOSED APPROACH

4.1 The projected budget gap for the current four year period was assessed as £40m, as Cabinet will be aware. As part of the recent budget setting process, a similar exercise was undertaken to assess the potential gap over the four years from 2015/16; this was forecast as £40m to £50m. In the light of the Budget and CSR announcements, this sum is now being reviewed as part of the analysis and development of a future budget strategy.

4.2 In undertaking this review, there will be a significant number of assumptions to be made, and given that this runs over a period until 2019, these may turn out differently. However, this will provide a reasonable position to start from for planning purposes. The outcome of this review will form the basis for a further report to the next Cabinet meeting, setting out the proposed financial strategy for both the coming year, and the subsequent four year period, based on the information now available.

4.3 There will in any event be some uncertainty until the local government financial settlement for next year is announced. It had been hoped that this would occur earlier in the budget cycle than last year, to enable a full assessment of the position to be made, and for appropriate measures to deliver a balanced budget to be presented to Cabinet in January 2014. However, the Secretary of State is reported to have told the LGA Conference in July that “We will give you the figures as soon as we can but we expect you to hear the sound of Santa’s bells before you get them”.

4.4 This is extremely disappointing and suggests the figures will not be available until early January, certainly too late for inclusion in the January Cabinet report. It will therefore either be necessary to consider issuing a supplementary paper for that meeting, reschedule meetings, or organise special meetings to accommodate the Government announcements. Even then, all the relevant information for setting the 2014/15 budget may not be available until the February Cabinet meeting. The announcement did indicate that the settlement will again cover two financial years, so this will further assist the long term strategy development, but the timing is far from helpful insofar as the next budget setting cycle is concerned.

REASONS AND OPTIONS

Reasons for the decision:
It is essential that the Council’s financial strategy takes due account of Government plans, and any other material factors where these are likely to have an impact on the Council’s financial position. This report provides an update to Cabinet on a range of Government announcements that impact on the Council’s funding for coming years, which are particularly relevant to the budget setting process.

Other options considered:
None. The Constitution requires this as a step towards setting the Council’s budget.

IMPLICATIONS AND RISKS

Financial implications and risks:
The Council's budget process will ensure that financial implications and risks are fully met. There are continuing risks with the full impact of the transition to localised business rates and Council Tax support still to be felt, and the potential impact on funding arising from both the Budget and CSR announcements. The steps already taken by the Council should mitigate this, but it is evident that a longer term approach now needs to be considered, as the potential scale of the future budget gap could prove to be even bigger than the gap the Council is currently addressing.

There are considerable risks in the medium to longer term, with the continuing economic uncertainty as well as the likely impact of further funding changes. The Council therefore needs to maintain a prudent approach over its financial management and the budget setting process.

Legal implications and risks:
The Council is subject to a number of duties in relation to revenue, capital and procurement. For instance, as a Best Value Authority the Council is under a duty to "make arrangements to secure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness." s 3 Local Government Finance act 1999.

Human Resources implications and risks:
The Council continues to work closely with its staff and with Trades Unions to ensure that the effects on staff of the savings required have been managed in an efficient and compassionate manner.

All savings proposals or changes to the funding regime that impact on staff numbers, will be managed in accordance with both statutory requirements and the Council's Managing Organisational Change & Redundancy policy and associated guidance

Equalities implications and risks:
There are no equalities implications or risks at this stage. However any savings that need to be considered following publication of details of the Local Government Financial Settlement may carry equalities implications and risks and accordingly, these will need to be analysed.

Other Risks:
There are no particular other risks arising, other than a very short timescale to properly analyse the LGFS announcements whenever they eventually occur. This is being planned for but much of the detail will have to await the final announcements and publication.

BACKGROUND PAPERS

There are none.

APPENDIX A

2013 Comprehensive Spending Review
Briefing Paper

Headlines

- Further departmental spending reductions of £11.5bn for 2015/16.
- NHS and Education remain ring-fenced from any funding reductions.
- 10% cut in DCLG departmental spend.
- Creation of £3.8 billion of pooled funding between the NHS and local authorities.
- Pay rise limited to an average of 1% in 2015/16 and removal of time served pay-progression.
- A 1% increase council tax freeze grant for 2 years.

Detail

The Chancellor of the Exchequer presented the spending review to the House of Commons on 26th June 2013. This briefing is to highlight the key announcements from the spending review in relation to Local Government. Unlike the 2010 emergency budget and previous spending reviews, this announcement will only affects departmental spending for one year (2015/16).

As a result of the continuing flat lining of the economy, further reductions in the region of £11.5bn have had to be found within this spending round. The table below demonstrates the change in growth forecast since the 2010 emergency budget.

Table 1 – GDP growth forecasts for the UK

Announcement	2011	2012	2013	2014	2015	2016	2017
Budget 2013	0.9%	0.2%	0.6%	1.8%	2.3%	2.7%	2.8%
Budget 2012	0.8%	0.8%	2.0%	2.7%	3.0%	3.0%	-
Emergency Budget 2010	2.3%	2.8%	2.9%	2.7%	2.7%	-	-

With the continuing emphasis on spending reductions and the Chancellor of the Exchequer having to find an additional £11.5bn, table 2 shows the total expenditure forecasted up until 2018 highlighting the areas of spend where the savings are coming from. The Total Managed Expenditure (TME) is increasing considerably despite the austerity measures in place by the coalition. The table below shows the amount allocated to government departments (Departmental Expenditure Limits) against the amount spent on items such as welfare, tax credits and pensions (Annually Managed Expenditure).

Table 2 – Total Managed Expenditure (TME) as per the CSR 2013

Announcement	11/12	12/13	13/14	14/15	15/16	16/17	17/18
	£bn	£bn	£bn	£bn	£bn	£bn	£bn
Annually Managed Expenditure	303.6	317.4	334.0	343.8	359.1	377.8	395.2
Departmental Expenditure Limits	343.7	339.8	338.8	336.1	335.2	325.8	317.8
Capital	49.1	16.1	47.2	50.4	50.4	51.3	52.1
Total	**696.4**	**673.3**	**720.1**	**730.5**	**744.6**	**754.9**	**765.1**

Based on the forecasted TME, by 2018 the total Departmental Expenditure Limits (DEL) which includes local government funding has been reduced by 8% since 2011 compared to the AME which include items of spend such as pensioners and welfare which will have increased by 30% during the same period. The reduction of DEL shows the net reduction in spends a detailed breakdown between can be shown in appendix A. It can be seen over the period Local Government has faced the brunt of the spending reduction however some of which have been masked with the large amount of grants being rolled into the formula grant process. It is important to note that health, schools and international development which make up 54% of the total DEL have been protected since 2010.

As per the Chancellor's announcement, headline figures suggest a 2.3% reduction in local government funding. This includes a £3.8 billion transfer of pooled funding between the NHS and local authorities to support and reward the delivery of integrated services. At this stage it is unclear what new burdens this funding will bring however it has the potential effect of masking the level of reductions affecting local authorities.

Other Announcements

- Public sector pay awards will be limited to an average of up to 1% in 2015-16, saving at least £1.3 billion as well as the end of automatic time-served pay progression in the civil service by 2015-16
- £330 million to support transformation of local services including a £200 million extension of the Troubled Families programme.
- A extra £100bn of infrastructure announced to help boost the economy.

How this affects local government funding

A number of departments will continue to be ring-fenced and those departments that have seen funding reductions since 2010 have being asked to find further cuts for 2015/16. Departments such as the Communities and Local Government and Defence have seen the majority of the funding reductions. Table 3 below shows the impact of the 10% reduction (8.2% in cash terms) against the 14/15 Start-Up Funding Allocations (SUFA). This shows a higher level of reduction in grant than announced in the Chancellor's statement.

Table 3 – Local Government projected RSG totals for 2014/15 and 2015/16

	2014-15 (£m)	2015-16 (£m)	% Reduction (in cash terms)
Control total / Start-up funding (1)	23,623	21,685	(8.2%)
Local Share of NNDR	(11,258)	(11,573)	2.7%
Revenue Support Grant (RSG)	12,365	10,112	(18.2%)

(1) Figures exclude the £3.8bn transfer of NHS money and based 14/15 start-up funding allocation and the 1% reduction announced in the 2013 budget.
(2) Figures exclude any impact of transfers such as the NHB which will reduce the RSG figure further.

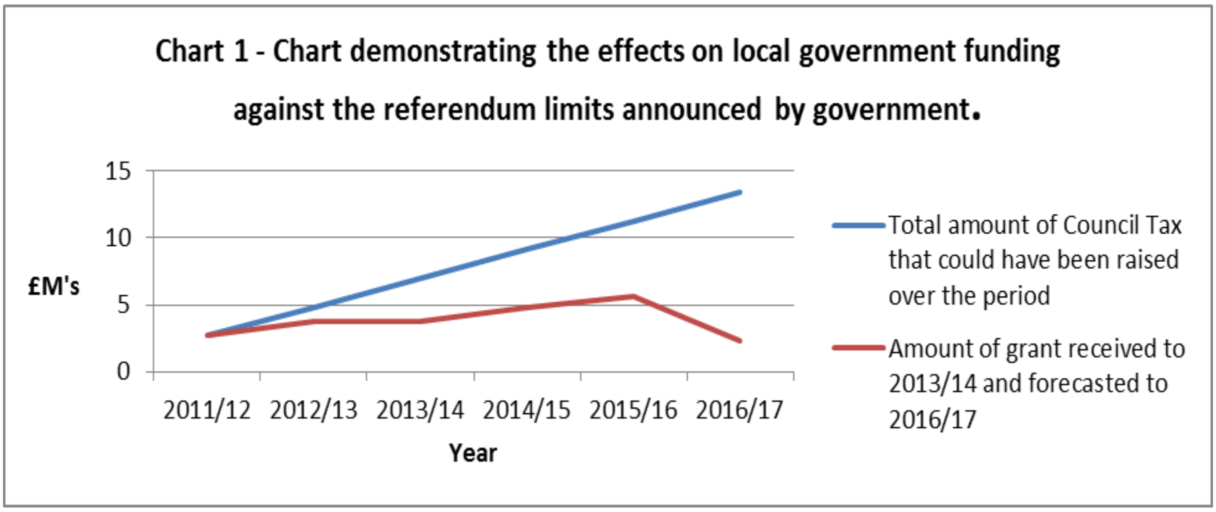
From the reductions identified in the spending review, the 10% reduction results in the removal of £2.1bn from the department expenditure limits however it is currently unclear how this will feed down into local authority budgets.

The funding reductions will affect each local authority differently depending on how these are implemented, for example the impact of any floors or scaling to the formula grant process and the effects on rolled in grants could dramatically affect the level of funding reductions to each authority.

The Chancellor also announced a two year Council tax freeze of 1% a year as well as the extension of the 2013/14 freeze for 2015/16 costing in total £883m for the years 2014/15 and 2015/16. The Chancellor also reiterated the levels at which a council tax increase will trigger a referendum, which will remain at 2%.

This new grant only covers the financial years 2014/15 and 2015/16 which results in a number of risks and uncertainties for the 2016/17 budget. Currently there is no indication that any of the council tax freeze will continue at the same levels or at all. Previous council tax freeze announcements have either fallen into the formula grant process where it has reduced from the on-going austerity measures or have been removed completely.

The chart below shows the effect on the budget if the current council tax freeze grants are removed in 2016/17 compared to the amount that could have been raised locally if council tax was increased locally at the referendum limit.



After the CSR announcement, the Chief Secretary to the Treasury announced how the £100bn of infrastructure was going to be funded. Within his statement £400m is to be top-sliced from Local Authorities New Homes Bonus allocation. It is still unclear how this will be taken.

The funding annoucements set out in the Chancellor's Spending Review creates a number of uncertainities for 2015/16 with the potential treatment of the reduction and the NHS transfer, however this creates even greater unknowns and risks in 2016/17 and beyond the next General Election.