

TONBRIDGE & MALLING BOROUGH COUNCIL

CABINET

19 November 2008

Report of the Director of Finance and Cabinet Member for Finance

Part 1- Public

Executive Non Key Decisions

1 MEDIUM TERM FINANCIAL STRATEGY

This report provides Members with a further update of the Medium Term Financial Strategy following that reported to the Finance and Property Advisory Board in October.

1.1 Background

- 1.1.1 The Council's Medium Term Financial Strategy covers both capital and revenue budgets over a rolling six-year period, and it is this Strategy that underpins the budget setting process for the forthcoming year and over the six-year period.
- 1.1.2 The Strategy sets out the high level financial objectives the Council wishes to fulfil over the agreed time span. This currently includes achieving a balanced revenue budget by 2012/13 that delivers the Council's corporate aims and priorities and to retain a minimum of £3.0m in the General Revenue Reserve. The Strategy also sets out, based on current financial information, not only the projected budgets for the period, but also the levels of council tax that are projected to be required to meet the Council's spending plans.
- 1.1.3 The aim of the Medium Term Financial Strategy is to give us a realistic and sustainable plan that reflects the Council's priorities and takes us into the future. Underneath the Strategy for the budget setting year sits detailed estimates formulated in conjunction with Services taking into account past outturn, current spending plans and likely future demand levels / pressures.
- 1.1.4 Last year it was largely the very poor local government finance settlement, not only for 2008/09, but for the three-year period 2008/09 to 2010/11 that placed the Council's budget and Medium Term Financial Strategy under severe pressure with at that time a budget funding gap of £500,000.

1.2 Medium Term Financial Strategy

- 1.2.1 As reported to the Finance and Property Advisory Board this year (most latterly on 1 October 2008) the **slow down in the economy, spiralling energy prices** and

inflation running at well above that reflected within the Medium Term Financial Strategy will place the Council's budget and Medium Term Financial Strategy under further severe pressure.

Economic Climate

- 1.2.2 Many of our income streams are suffering due to the "credit crunch" and economic climate with income from fees and charges overall this year expected to be significantly down against budget. What is difficult to assess is when and how quickly will the economy "turn the corner" and what impact this will have on our income streams.
- 1.2.3 To put this into context, 10% of our major income streams including income from fees and charges at our leisure centres equates to about £1,000,000.
- 1.2.4 The Council can, to an extent, minimise the loss of income through economic downturn by reducing costs in related areas. For example, at the present time, due to the downturn in planning income, the Director of Planning, Transport and Leisure is holding vacant two planning posts. That said, Members will appreciate that there are fixed costs that need to be covered and there will, inevitably, be a 'net shortfall' that the Council will need to cover in its financial plans. The impact of this net shortfall will need to be factored into the Medium Term Financial Strategy.
- 1.2.5 As mentioned in paragraph 1.2.2, it is difficult to predict how long the current economic climate will prevail. For the purposes of the Medium Term Financial Strategy, the Director of Finance has assumed that the economic situation will "turn round" part way through 2011/12 and will, therefore, not prevail for the entirety of the medium term. For Members' information, the Director of Finance has assumed a 'net shortfall' (see paragraph 1.2.4 above) of £600,000 in a full financial year, inclusive of the 'lost' income at our leisure centres.

Energy Prices

- 1.2.6 Members will no doubt be aware of recent increases in energy prices well above the prevailing rate of inflation, which is itself well above that currently reflected in the Medium Term Financial Strategy. The significantly above inflation increases in energy prices will increase energy costs by an estimated £320,000 for our leisure premises and £80,000 for Council offices and other premises in a full year.

Inflation

- 1.2.7 The Consumer Prices Index is currently running at 5.2% (September) and the Retail Prices Index at 5.2% (September), both well above the 2.5 % reflected in the current version of the Medium Term Financial Strategy. Most of the Council's major contracts are uplifted annually by the Retail Prices Index. To put this into context, 1% on our major contracts equates to £37,000 in a full year.

Investment Income

- 1.2.8 The Medium Term Financial Strategy approved by Members as part of the 2008/09 budget cycle anticipated an investment return of 5.3% - 5.5% over the period of the medium term. Likely investment returns over the medium term are difficult to predict at any time and has been made no easier by the current economic climate. We have seen a cut in the bank rate of 0.5 % in October, and a 1.5% cut on 6 November. This latest cut is certainly higher than had been predicted by most commentators and brings the bank rate down to 3%.
- 1.2.9 To put this into context 0.5% would currently generate investment income of about £140,000. All other things being equal, the cumulative cut of 2% over the last two months could literally mean a reduction in investment income of some £560,000. As it happens, we do have some deposits that are on fixed rates earning significantly higher interest payments than this so the impact should not be as quite as bad as this. However, once those deposits mature, the prospects for investment income are significantly less.

Capping

- 1.2.10 The Secretary of State still has powers under the Local Government Act 1992, as amended by the Local Government Act 1999, to limit the budgets of billing and precepting authorities and thereby limit the size of council tax increases. These capping powers have been used in recent years after the Government stated its intention to target authorities that bring in council tax increases of 5% or above, and it is assumed that this will continue.
- 1.2.11 Indeed, officers are of the view that the current assumption reflected within the Medium Term Financial Strategy that the increase in council tax will be 4.95% each year over the medium term is **probably unrealistic**. For this reason the latest update of the Medium Term Financial Strategy that the Director of Finance is presently working on assumes that increases in council tax will fall across the medium term to 3.5% by the end of the strategy period. Clearly, the longer we can continue with an increase of 4.95% the smaller the 'funding gap' to be addressed.

Capital Plan

- 1.2.12 The Council has a significant balance in the Revenue Reserve for Capital Schemes and we have been fortunate over the past decade or so to have been in a position to implement a wide range of capital schemes throughout the borough.
- 1.2.13 When the capital reserves run out, the Council will have to borrow to fund any capital expenditure it may have.
- 1.2.14 Members are also aware that as we spend our capital resources there is an immediate impact on our revenue budget because we are unable to earn as much investment income on the remaining balances.

- 1.2.15 As part of the latest working update to the MTFs, and following discussions with the Management Team, the Director of Finance has assumed a different approach to the preparation of the Capital Plan. The purpose of the new approach is to preserve reserves as long as possible, but also to ensure that we are providing an appropriate level of funding for the replacement of our assets which deliver day to day services as well as providing money for statutory services (eg Disabled Facilities Grants).
- 1.2.16 Simplistically, the impact of this approach will be that rather than having detailed capital budget provisions for things like capital grants, there will instead be a maximum annual capital 'allowance'. Any 'bids' for capital schemes or grants would need to be assessed within the context of this annual 'allowance'. If Members are agreeable to this approach, in due course our Capital Strategy will need to be rewritten to reflect the up to date situation.
- 1.2.17 We are still working on the details of this idea and will be reporting to Finance & Property Advisory Board in the New Year with firmer details. However, it is worth saying now that in the current climate, **the amount of 'ad-hoc' capital expenditure will undoubtedly need to reduce significantly.**

1.3 Summary

- 1.3.1 The latest 'working' update to the Medium Term Financial Strategy continues to show that the Council's finances are under severe pressure.
- 1.3.2 Whilst writing this report, the Director of Finance received news of the latest cut in the bank rate (see paragraph 1.2.8) which has more implications for the 'latest' update to the MTFs. The situation seems to be changing almost weekly (sometimes daily!) and therefore Members need to understand that any guidance given in this report may well have to change.
- 1.3.3 Prior to the news of the bank rate cut, the latest projection indicates that we are faced with a savings target (identify options to reduce costs and/or generate additional income) of **£400,000 every other year** over the period of the medium term if the Council is to achieve its financial objectives as set out in the Medium Term Financial Strategy. We need to consider the impact of the bank rate cut and therefore these figures could change again.
- 1.3.4 Management Team will, over the coming weeks, be considering options to address the first £400,000 savings target to be implemented before/by 1 April 2009. It is hoped that the draft Estimates which will be presented to the Finance & Property Advisory Board in January will encompass some of these required savings; but it is likely that some 'harder' decisions may need to be made before the Budget can be set by Council in February 2009.
- 1.3.5 Management Team will also be identifying options to address the next £400,000 'tranche' of savings and at an appropriate time will report to Members.

1.4 Legal Implications

- 1.4.1 There are a number of legislative requirements to consider in setting the Budget which will be addressed as we move through the budget cycle.

1.5 Financial and Value for Money Considerations

- 1.5.1 As set out above.

1.6 Risk Assessment

- 1.6.1 The Local Government Act 2003 requires the Chief Finance Officer, when calculating the Budget Requirement and Council Tax Requirement, to report on the robustness of estimates included in the budget and the adequacy of the reserves for which the budget provides. Consideration will and is given to the risks associated with any budget setting process where various financial and other assumptions have to be made. To mitigate the risks detailed estimates are formulated in conjunction with Services taking into account past outturn, current spending plans and likely future demand levels / pressures and external advice on assumptions obtained where appropriate.
- 1.6.2 The Medium Term Financial Strategy sets out the high level financial objectives the Council wishes to fulfil and underpins the budget setting process for the forthcoming year and over the Strategy period. As the Council's high level financial planning tool the Strategy needs to be reviewed and updated at least annually.

1.7 Recommendations

- 1.7.1 Cabinet is **RECOMMENDED** to:

- Acknowledge the significant financial challenges faced by the Council and the consequent need to address a funding gap of circa £400,000 before/by 1 April 2009 and two further tranches of £400,000 over the period of the medium term.
- Acknowledge the need to re-engineer the Capital Plan as set out in the report.

Background papers:

Nil

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