APPENDIX 1 TO AGENDA ITEM

EXECUTIVE

DATE:	**29 AUGUST 2006**
SUBJECT:	**2007/8 BUDGET PREPARATION AND STRATEGY UPDATE**
REPORT BY:	**HEAD OF CORPORATE FINANCE AND HEAD OF CAPITAL AND ASSET MANAGEMENT**
CONTACT OFFICERS:	**DAVE KEMPSON 01582 546087/NEIL SIMON 01582 547074**

IMPLICATIONS:

LEGAL		**STAFFING**	
EQUALITIES		**COMMUNITY SAFETY**	
FINANCIAL	✓	**RISKS**	✓
OTHER			

CONSULTATIONS:

COUNCILLORS CONSULTED	✓	**SCRUTINY COMMITTEE CONSULTED**
STAKEHOLDERS CONSULTED		**OTHER**

WARDS AFFECTED: All

LEAD EXECUTIVE MEMBER(S): Cllrs Yasin, Franks, and Howes

RECOMMENDATION(S)

1. **Executive is recommended to:**

(i) **Approve the 2007-08 estimate guidelines set out in Appendix A, as the basis for the preparation of a budget for 2007-08, and a medium term plan by the Executive for submission to Budget Council in February 2007.**

(ii) **Endorse the approach to the Capital Programme and capital resources set out in paragraphs 43 to 52 of this report.**

(iii) **Approve the approach to Budget Consultation set out in paragraph 33.**

(iv) **Consider the use of a Budget Protocol for the 2007-08 budget, as set out in Appendix C.**

(v) **Approve the Value for Money Strategy set out as Appendix B**

(vi) **Require each Head of Service to complete the Value for Money self-assessment checklist included in the Value for Money Strategy, by 13 October.**

<u>REPORT – REVENUE BUDGET</u>

Background

2. Financial Regulations state that 'Guidelines on budget preparation are issued to Members, Corporate Directors and Heads of Service by the Executive following agreement with the Head of Corporate Finance.' Appendix A sets out proposed guidelines. On a much more detailed level, budget preparation guidelines for cost centre managers and accountants are produced directly by the Head of Corporate Finance.

3. The Council's current Medium Term Financial Plan is shown in the 2006-07 estimates book. It is based on the assumption of a 4.9% increase in Council Tax yield (for 2007-08 estimated to equate to a tax increase of 4.6%).

The National Perspective

4. The 2006-07 Local Government financial settlement was for 2 years, and the initial intention was that the 2007-08 settlement would be for 3 years. However, a meaningful 3 year settlement requires definitive allocations of funding for local government functions over that time. The delay of the comprehensive spending assessment to June 2007 (this is being abbreviated to CSR07) means that there can be no definite funding allocations for 2008-09 and 2009-10 provided as part of the 2007-08 settlement.

5. Local Government Association officers have confirmed that in their view the provisional figures for 2007-08 should not be subject to more than minor change at final settlement time. The 2007-08 figure can therefore be regarded as reliable for planning purposes. No reliance can be placed on any figures for future years produced prior to the CSR07.

6. Work is currently taking place in preparation for the CSR07. There are many concerning signs. Civil servants have indicated that the Government is seeking 'much greater' cashable efficiency savings than the current 1.25% per annum, in order to fund new commitments. The total funding available to the Chancellor is likely to be limited, and when the commitments to the National Health Service and Schools are taken into account, it is difficult at present to see local government receiving any increase beyond 2%. This is particularly concerning since medium term pressures are likely to be huge on the Council.

7. The major pressures resulting from national initiatives are the annual running costs of schools improved or rebuilt under the Building Schools for the Future Initiative, and the costs of waste disposal arising from the EU decision to limit the amount of waste sent to landfill, and to fine countries exceeding those limits. The DfES have made clear that they regard the residual costs of building schools for the future as an 'affordability gap' that is down to local authorities, as their contribution towards the initiative. DEFRA have made clear that they will pass EU fines on to local authorities. There is a joint review of waste management being undertaken by DEFRA, the Treasury, and DCLG as part of the preparatory work for CSR07. DEFRA has traditionally been the weakest department in arguing its case for cash in spend reviews, and there is as yet no indication that the costs of reducing waste sent to landfill have been recognised in Government resource plans.

8. The Chancellor has stated that the concessionary fares scheme will be developed from April 2008 to allow national travel. It should be noted that the announcement implied that the funding would remain part of the local government settlement.

9. The Government has delayed the council tax revaluation, so there will be no significant change to the council's tax base in the medium term. A Local Government white paper, and the Lyons Report, are expected before the end of the calendar year. At this stage it seems unlikely that there will be major change in local government finance as a result, even though the Government set up the initial balance of funding review because of fears that the current balance of funding between national and local taxpayers is not sustainable in the long term.

Implications for Luton

10. The Council must plan to produce a balanced budget for 2007-08, and also needs to produce a medium term plan. However, there will not be any reliable grant figures for 2008-09 and future years so the medium-term plan will of necessity be highly speculative.

11. In 2008-09, when the settlement will be produced in the light of CSR07, a detailed 3 year plan of council tax levels and provisional budgets will be required.

12. Based on current information, it is likely that in future years very large reductions in all services will be required to fund the maintenance of improved schools and the costs of waste disposal, as will be seen in the section on Medium Term Planning, below.

Medium Term Planning

13. The first aim of the Council's Medium Term Financial Strategy is to maintain a balanced budget position, and to set a medium term financial plan demonstrating how that position will be maintained. The 2007-08 indicative budget, based on a 2% pay increase (which is in line with the Chancellor's planning assumptions) requires a further £280k of efficiency savings to be balanced. However, it should be noted that there are likely to be further growth pressures, which mean that significantly more may be required in savings. Planning for future years is particularly difficult at present given the issues set out in paragraphs 4 to 12 above.

14. It is assumed that the allocation of airport income remains as for 2006-07 – split between the revenue account, the revenue allocation for resourcing transformation, and that any additional airport funding is allocated to the capital programme. Pay inflation is set at 2% for 2007-08, and 2.5% for future years, plus an allowance for increments; price inflation is set at similar levels to that included in the 2006-07 budget (generally around 2.3% with a greater allowance for energy inflation etc)

15. Nothing is included for the performance reward grant from the second Public Service Agreement, on the basis that departments are expected to fund the work required to achieve an increase in performance. Performance Reward Grant for the first public service agreement, receivable in 2006-07 and 2007-08, is used for revenue spend. I have noted in previous budget reports that this is given as 50% revenue grant, 50% capital grant, and that to all use this money for revenue purposes will require a resource switch with airport funding. This is made more complex by the Government announcing that the pump-priming for the second public service agreement will also be a mix of revenue and capital.

16. Pension costs for future years are assumed to increase from 2008-09 in line with a recent very rough estimate made by the actuary. However, the Government is currently conducting a major review of the local government pension scheme and there could be fundamental changes. Overall costs will not reduce as a result. It is a question of whether, and by how much, they may increase further. Fundamentally, the major reason for the increase in the estimated cost is the actuaries' increased

assumptions for life expectancy of pensioners. It is likely however that work will proceed at a national level on methods of valuation and actuarial assumptions used in order to try to minimise the impact on the Council Tax. Members may have seen that the Chief Executive of the Audit Commission was recently quoted in the press saying that Council Tax may have to increase to pay for the cost of local government pensions. Pension costs remain a major risk area.

Table 1 – Grant and Net Spend Excluding Schools	2007-8 £m	2008-9 £m	2009-10 £m	2010-11 £m	2011-12 £m
Formula Grant at 2% increase	-75.4	-76.9	-78.4	-80.0	-81.6
Council Tax with 5% increase in yield from 2008-9	-56.2	-59.0	-61.9	-65.0	-68.3
Net income	-131.6	-135.9	-140.3	-145.0	-149.9
Net Spend based on 2006-07 budget approvals	131.9	139.5	146.2	154.4	160.7
Building Schools for the Future		1.8	2.0	2.2	3.2
Waste Disposal technology to meet LATS targets			8.6	8.8	9.0
Pension revaluation		1.6	1.7	1.7	1.8
Net deficit before new savings & growth	**0.3**	**7.0**	**18.2**	**22.1**	**24.8**
Potential for further growth pressures	*???*	*???*	*???*	*???*	*???*

17. It can be seen that this is not sustainable.

18. It can also be seen that, apart from Building Schools for the Future, and the estimated costs of new waste technology to meet landfill targets, no new growth/demographic pressures are included in the table over and above those identified in the 2006-07 budget process. Those pressures are currently being reviewed, and are likely to worsen the situation. In 2006-07, £8m of growth was approved. Only £1.6m of that was identified in the previous year’s medium term planning figures. Even if the new pressures turn out to be only half of last year’s, that would still give us a net deficit for 2006-07 of £3.5million before any further savings are found.

19. From this it is clear that a further savings programme will be required for 2007-08, as well as in future years.

20. The amount included for Building Schools for the Future are the maximum currently estimated for each year. Efforts need to be made to minimise the costs to the taxpayer, and this will include ensuring an appropriate amount of the cost is met from schools budgets.

21. It should also be noted that expenditure figures do not make any specific allowance for revenue costs of the Translink project. It is assumed that the capital costs are fully met from grant and external income, and that the operator covers all revenue costs. These are very optimistic assumptions. The externally commissioned financial appraisal of the Translink scheme has yet to be completed. It is critical that the financial appraisal and the potential risks are carefully considered before any final commitment is made on this project, as the potential for cost overrun, increases in costs of land required for the scheme, or for the Council to fund revenue shortfalls, could have a further major negative effect on the Council’s financial position. The risk

of undertaking 2 major capital schemes, Translink and Building Schools for the Future at the same time must also be seriously considered.

22. If the estimate for Government grant increased from 2% to 3% per annum, the deficits shown in Table 1 would be as follows:

Net deficit before new savings & growth	**0.3**	**6.2**	**16.5**	**19.7**	**21.6**

23. If the estimates for Council Tax were reduced to 4% from 2008-09, and the Government Grant increase remains at 2%, the deficits would increase as follows:

Net deficit before new savings & growth	**0.3**	**7.6**	**19.3**	**23.9**	**27.4**

24. No modelling is shown of an increase in Council Tax since the current government has made quite clear that it aims to cap unitary authorities with tax increases of more than 5%.

25. The Medium Term Financial Plan shown in the Council's budget book is based on the assumption of a 5% increase in formula grant. In light of the current work taking place between the LGA, DCLG, and the Treasury, this is overoptimistic. Colleague unitary treasurers I have discussed this with are using 2% estimates at this stage.

26. The combination of the anticipated outcomes of CSR07, that is very limited resources available for local government, plus
    - the potential costs to the Council of Building Schools for the Future;
    - the estimated costs of developing waste disposal solutions to meet Government Targets;
    - increased demand for services;
    - increased expectation for improved standards of services from inspectorates (and, in social care cases) from courts;
    - increased costs of local government pensions; and
    - council tax increases of no more than 5%;

    simply do not add up. It is evident that the search for cashable efficiencies and value for money will have to be far more rigorous than ever before. However, this will not be enough.

Efficiency Savings

27. Members will recall that authorities have been asked to find at least 2.5% efficiency savings (as defined by Government) each year, and that half must be cashable. The new Use of Resources CPA places an increasing emphasis on efficiency and value for money. In future years, if the Council is to aspire to a mark of 3 or 4 for the Use of Resources, it must, amongst many other things, exceed the 2.5% target.

28. Far more fundamentally, however, the above analysis demonstrates that the crucial importance of the search for efficiency savings throughout the Council, in order to minimise the impact of budget reductions on the public.

29. The Gershon Report (that began the Government's current efficiency drive) expects substantial savings across the public sector through, among other things, major economies of scale obtained by carrying out transactional services at a few regional centres rather than in every organisation, the development of e-procurement, the removal of duplication, the development of on-line forms that can reduce processing, and the transformation of key business processes.

30. Efficiency savings need to be developed in the context of the Council's value for money strategy (see below).

Value for Money

31. Another key requirement of the Use of Resources CPA is that one of the Council's main aims is to achieve value for money for local taxpayers. Appendix B sets out a recommended value for money strategy and policy, intended to ensure that efficiency and value for money issues are at the forefront of the mind of all staff.

32. In order to apply the strategy in 2006-07, it is recommended that each Head of Service is required to complete the Value for Money Self-Assessment check-list, including the production of ideas for efficiency savings, by 13 October.

Budget Consultation

33. The Executive and Council, when considering the budget, will also need to ensure they take into account the views of both the taxpayers of Luton, and the Government. In 2006-07, both of the unitary councils who tried to set budgets above the 5% level, York and Medway, were nominated for capping. This approach is likely to continue.

34. Members will need to determine how to obtain the views of taxpayers. Last year we used Lutonline, and the internet to obtain views of people's priorities, prior to the detailed budget setting process. It is recommended that this approach is continued, as it has the advantage of being low cost. Should specific proposals be developed that would affect particular public groups, members may wish to consult on those particular issues in addition.

Local Authority Business Growth Incentive

35. There is nothing included in these estimates for income from the Local Authority Business Growth Incentive Scheme (LABGI). This scheme is intended to encourage Local Authorities to promote economic growth in their areas, by allowing them to retain a proportion of the resulting increases in business rates. However, the scheme is very complex. Amounts due are calculated by the Inland Revenue's Valuation Agency (VA) and intended to be paid in the February of the financial year concerned, just after budgets have been set. The complexity is illustrated by the fact that the VA got the 2005-06 amounts wrong, and extensive corrections were issued in July 2006. This did not alter Luton's allocation, which was still nothing.

36. Should Luton receive anything in 2006-07, it is important to recognise that this is one-off funding, that should not be used for ongoing spend. Such funds could be used for invest to save purposes, if there are budget difficulties at the time of the payment, to help sort out those difficulties. The Executive will take a view at the time.

Scale of Charges

37. The approval of scales of charges is another key part of the budget process and it is intended to report on these to Executive and appropriate committees in November. It is important to note that the estimates of net costs are based on the assumption that the yield from those charges will increase by at least the rate of inflation.

Council Tax

38. The planning figures shown above are based on a 5% increase in Council Tax yield each year from 2008-9. Members need to keep under review the maximum level of Council Tax acceptable to public and Government. Each 1% increase in Council Tax yield now gives around over £535,000 of additional revenue. The council tax base is set in December. The yield is increased both by a higher tax rate, and by an increase in the number of dwellings.

Business Partnership

39. At this stage some of the partnership's work is included in the estimates shown above, and some is not. To clarify, savings and costs that may arise from the following business cases are excluded from these figures:
    - Property Maintenance
    - Printing and Multi-functional devices
    - Supported Living
    - Day Care
    - Fostering and Adoption
    - Occupational Therapy
    - Transport.

40. Members will need to take a view as to the amounts of net savings that are safe to include for planning purposes, and whether those savings are used to commission further partnership work, to replenish the Invest to Save Reserve, or to contribute towards meeting the future years budget deficit.

Budget Protocol

41. For the 2005-06 and 2006-07 budget processes, members will recall a budget protocol was developed between the Executive and Scrutiny. Members will also recall concerns from Scrutiny as to the amount of time available for budget considerations, arising from the Government's late announcement of the final formula grant figures. The protocol has been updated to try to enable greater scrutiny at the end of the process, and is attached as Appendix C. Members need to decide whether they wish to continue operating this protocol.

CAPITAL
CAPITAL PROGRAMME 2007 – 2012

INTRODUCTION

42. The capital Programme 2006 – 2011 has had a major impact on assets due to the decision to cut a number of core capital budgets. This was partly a result of retaining the housing stock and the reprioritisation of resources required as part of this decision.

43. The effect on the programme has included:-

- Current buildings are deteriorating at an accelerated rate.
- Risk of closing buildings has increased markedly.
- Should this continue statutory functions will be affected.
- Reducing capital expenditure has increased pressure on revenue budgets.
- Increased risk of failure to comply with legislative requirements

CURRENT PROGRAMME

44. The current programme includes projects that are fully funded by grants, third party contributions, supported borrowing, and those partly funded by a mix of those resources. The remaining projects that do not attract specific capital resources are funded by sales of council dwellings and other assets, part of the London Luton Airport dividend, and other revenue resources. Prudential borrowing is mainly utilised for funding acquisition of vehicles and equipment that have been previously leased.

45. The programme is subject to a detailed bidding process using strict criteria and discussed and agreed with the Executive. The overall process is being reviewed and

it is proposed that the officer capital and asset forum takes on the role, on a six monthly basis, or reviewing the outcomes of capital investment, in order to learn lessons to ensure the effectiveness of future investment, with key issues being reported through to Corporate Directors and the Executive.

46. The initial stages of the process will be to challenge existing projects in order to then compare with any new project that might get through the first round. The first round will involve inviting new bids (with description and budget figures only) in order that those fulfilling the criteria (to be set by the Capital and Assets Forum) are invited to put forward a full bid. These will then be compared with existing bids and the Executive will make decisions on what is included in the draft capital programme 2007 – 2012 to be reviewed by Scrutiny and proposed to Council.

47. Existing projects will be challenged on cost and timescales. Themes will include considering more planned maintenance in order to alleviate the problems caused currently by an increase in the call on revenue resources for reactive maintenance. A backlog maintenance plan will be reported to the Executive.

CAPITAL RESOURCES

48. Additional capital resources were forecast from sales of assets of £15.18m and these were used as additional resources to fund the capital programme. Just under £1m was raised in 2005/06 with £850,000 raised in previous years. This year it is estimated that £1.4m will be raised with £740,000 achieved so far.

49. Major receipts are forecast in the next three financial years although some require considerable development work and there is no specific revenue budget to achieve this.

50. The reshaping the estate initiative together with building schools for the future is designed to reduce the number of Council buildings. Any capital receipts created should be reinvested into the capital programme and it is suggested that the majority should be utilised to bring the remaining buildings into good condition.

51. Other resources such as Section 106 agreements should also be considered as a resource towards achieving the aims of the capital programme.

52. Sales of Council dwellings dipped last year although these have increased again in recent months. Any decrease in the future will have an impact on the amount of resources available to fund the capital programme.

53. The capital programme slippage increased last year, partly due to the moratorium imposed. It is intended to keep members advised by way of quarterly monitoring to the Executive with detailed information on the projects that are not going to plan.

FINANCIAL IMPLICATIONS

54. Financial implications are shown throughout the report. In particular, Members need to consider the uncertain and extremely difficult medium term revenue position when planning both the revenue and capital budgets for 2008-09 onwards, and considering service priorities and plans. It should be noted that the projections show major deficits in future and that the level of savings likely to be required is far greater than shown previously. A thorough review of the position will be required as part of the 2007-08 budget process. The figures shown in the tables above demonstrate that unless far more funding is found for local government than is currently anticipated in CSR07, the future is very bleak indeed.

RISK IMPLICATIONS

55. The budget is one of the major risk areas faced by the Council, hence the development of the Budget Risk Management Strategy approved by Council in February 2006. Key risks in terms of budget development include
- the risk of capping if any planned level of Council Tax is deemed too high,
- the risk of service reductions if, as predicted in this report the level of resources available is insufficient
- the risk of setting a budget at a level that is not sustainable.

56. These risks need to be managed by a careful assessment of relative priorities through budget setting, a rigorous appraisal of budget requirements, and a continuous search for efficiencies and options to optimise the use of resources.

LEGAL IMPLICATIONS

57. There are no specific legal implications to this report as agreed with the relevant solicitor in legal services

OPTIONS

58. The Executive could approve the Budget Guidelines as proposed, or determine alternative guidelines.
59. The Executive could determine an alternative approach to budget consultation.
60. The Executive could determine whether or not to agree the budget protocol.
61. The Executive could endorse the approach to capital shown in this report, request further information, or propose an alternative approach.

APPENDICES

A. Budget Guidelines 2007-08 for Members, Chief Officers, and Heads of Service
B. Value for Money Strategy
C. Budget Protocol

BACKGROUND PAPERS

Estimates of Grant income and Medium Term Expenditure – Tim Lee, 01582 546087