Cabinet 5 November 2013

Report of the Cabinet Member for Finance, Performance and Customer Services

2014-16 Budget Strategy Update

Purpose of Report

1. This report builds on the July Financial Strategy Refresh and updates Members on the latest Government announcements in relation to grant funding.

Situational Overview

2. Public service spending reductions since 2010 have been a massive challenge for all organisations concerned. The Spending Review announced in June 2013 and political announcements since clearly show that funding reductions will be with us for some time to come as the Government pursues its deficit reduction and welfare reform programmes. More detail on the impact of the spending review will be outlined later in this report alongside an assessment of the implications.

3. Figure 1 below shows that covering the period 2007-08 to 2014-15, the Council will have made approximately £78m in budget reductions, with £52m or two thirds of those coming since 2011-12.

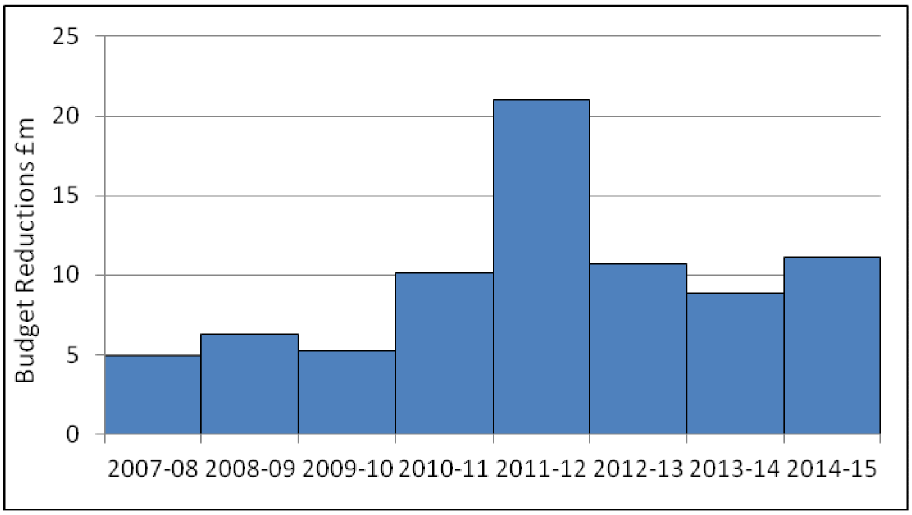

Figure 1: Budget reductions since 2007-08

4. York has responded well to the challenges to date with strong financial management practices, strong financial planning, successful delivery of

efficiencies and a firm economic base when compared with many other local authorities. The most recent annual audit letter from the Council's external auditors confirms this strong financial position. However as each year passes, decision making on service provision will become more difficult, not least against the back drop of further funding reductions and increasing demand for core services.

5. The Barnet 'Graph of Doom' produced by the Local Government Association (LGA) in 2012 has generated much debate in the sector. It showed the reduction in funding up to 2019-20, the projected increase in statutory costs for adult and children's social care and the resulting sharp decrease in money available to fund other services.

6. Figure 2 below shows the York version of the graph and whilst it should be noted that the data is based on projections, there are some broad conclusions that can be drawn. In line with previous growth in the area, the graph shows that adult care costs could increase by 33% by 2019-20 and could account for up to 50% of the Council's net expenditure. At the same time, available income to fund all services could drop by up to 15%. Together with the care pressures, this could mean a 50% reduction in money available to fund all other services.

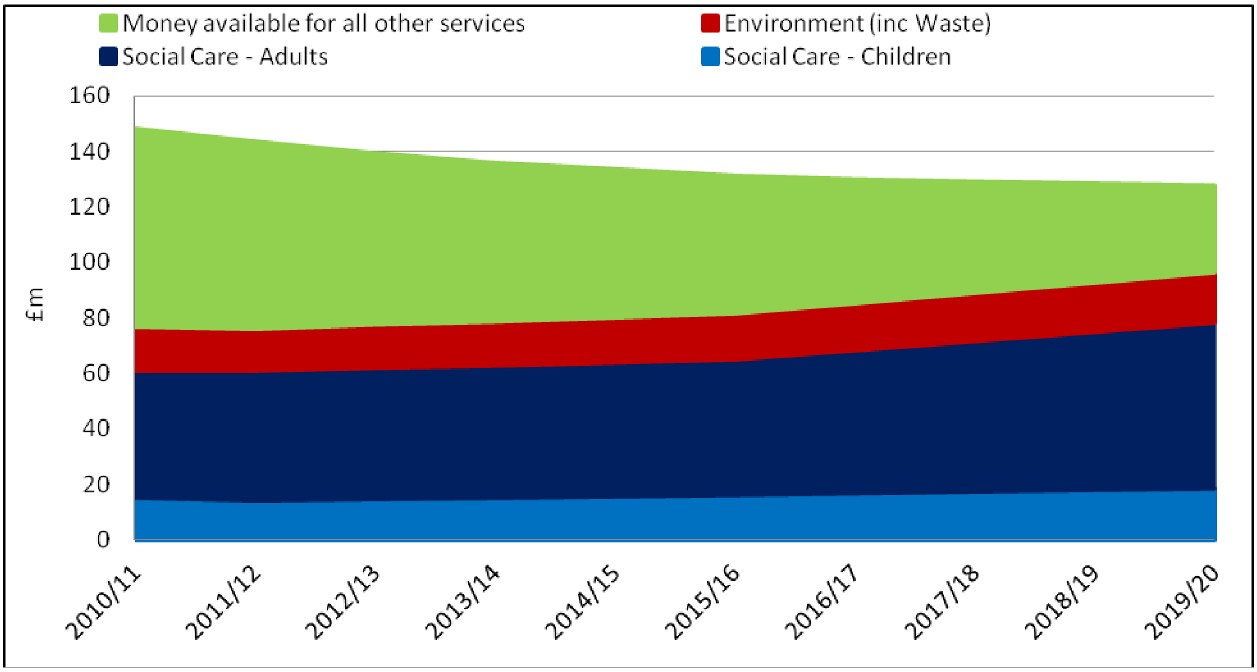

Figure 2: York 'Graph of Doom'

7. A strong financial plan will always ensure capacity is created so that the organisation can fund its priorities. By assuming that funding reductions will remain in the next Parliament regardless of who is in power and that constraints will be placed upon Council Tax increases, linking national studies like the LGA's as well as local intelligence, it is projected that the Council will continue to have to make c. £7-10m of budget reductions year on year until

2019-20. Figure 3 below shows the reduction trajectory from 2007-08 to 2019-20 (a period of three Council terms), totalling around £120m.

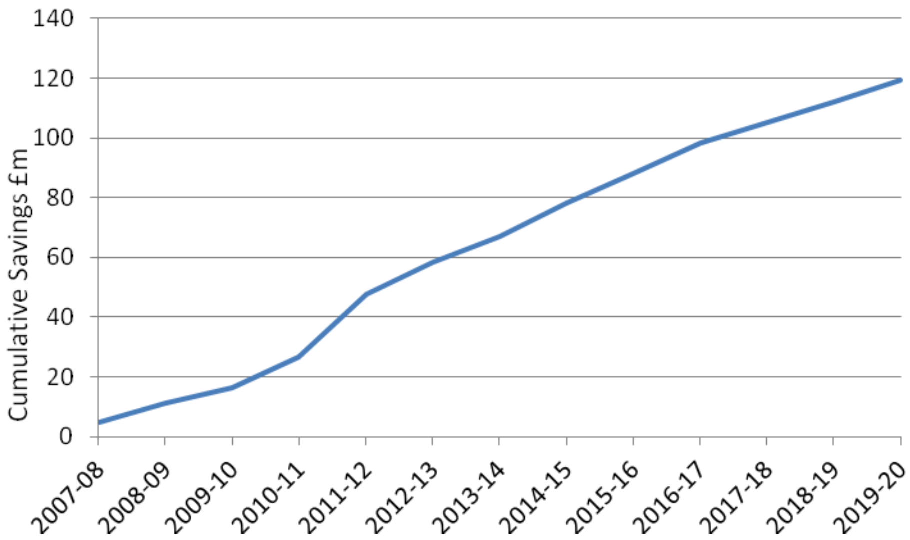

Figure 3: Budget reduction trajectory to 2019-20

8. Previous strategy reports have highlighted that York should strive to be a 'thriving' city, that is one where:

    - there is investment in the economic infrastructure to create sustainable long term economic growth,
    - there is a high degree of self reliance upon its own income sources – ensuring the highest level of local choice and decision making,
    - there is an effective provision of public services ensuring a high quality of life and protecting vulnerable people, creating a city people choose to live and work in, and in turn providing the sources of funds to achieve this.

9. This still remains, however it should not be seen as a panacea for our longer term financial strategy. Taking the themes drawn out in the paragraphs above, figure 4 overleaf compares the yield of a thriving city (broad increases in income from Council Tax (+1%), Business Rates (+1%), income streams (+1%) and reducing welfare costs (-1%)), a declining city (static Council tax, reducing Business Rates (-1%) and income streams (-1%) and increasing welfare costs (+1%)) and the fixed borrowing costs of £20m capital investment against the current level of funding reductions over a ten year period. Whilst it goes without saying that being a thriving city is imperative given the difference in yield over the period compared to a declining one, it is clear that the gulf between that yield and the reductions required is too large for reliance to be placed upon it.

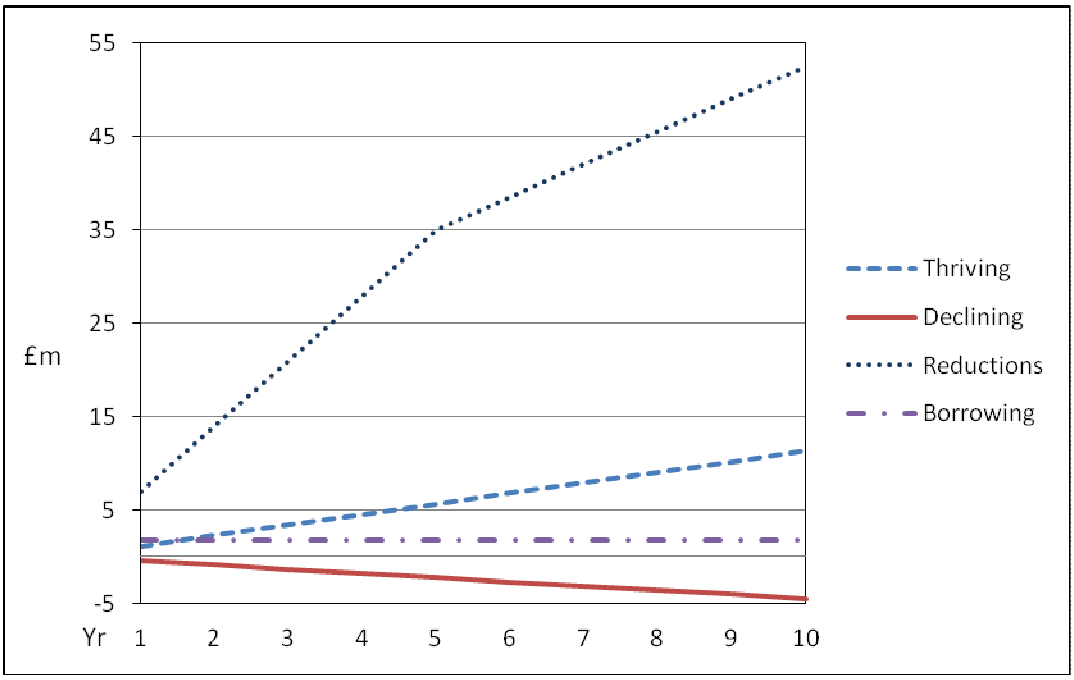

Figure 4: The Thriving/Declining City Quantum

10. The two year budget setting process is seen to be working well and Members have already agreed proposals for 2014-15 in February 2013. These are currently subject to a detailed review to determine whether they can still be achieved. Details on the need for alternative savings will be included within the proposals that will be placed before Members for approval in February 2014.

11. However, the process of equal efficiency reductions to all services isn't a sustainable one in light of future pressures and funding reductions outlined in the preceding paragraphs. Reinforcing the findings of October's Delivering for the People of York report, the only way that the Council can continue to meet the challenges outlined is to target the funding it has available towards its priority service areas. Therefore the budget reduction strategy for 2015-16 and beyond will be achieved by a three strand process comprising:

    i) Council Wide Efficiency: will reflect the work that should be undertaken each year to improve the cost effectiveness of services.
    ii) Priority Based Budgeting: disinvestment in services that are not a Council priority.
    iii) Transformation: to ensure that priority services are fit for the future and meet the current needs of customers.

12. Work is ongoing throughout the autumn to identify proposals for each of these strands so that balanced budget proposals for 2015-16 can be approved by Members in February 2014.

Spending Review and Summer Consultations

13. The July Financial Strategy Refresh outlined a number of key headlines from the June Spending Review with specific Local Government implications, including:

    - a 10% reduction in funding in 2015-16,
    - a 2 year extension to the Council Tax freeze offer covering 2014-15 and 2015-16 with a grant equivalent to a 1% increase,
    - the 2014-15 Council Tax referendum trigger point remaining at 2%,
    - the introduction of a £3.8bn national social care funding pot from 2015-16,
    - adoption of Lord Heseltine's Single Local Growth fund.

14. Since the June announcement, a number of consultation documents have been released by the Department for Communities & Local Government (DCLG) that have attempted to provide more detail, in particular around funding reductions and linkages between the Single Local Growth fund and New Homes Bonus funding.

15. The following sections of this report will provide further detail on the implications to York of these documents.

<u>Funding Reductions</u>

16. Members are reminded that from April 2013, the Formula Grant system was replaced by a new Revenue Support Grant (RSG) and a business rates baseline, which is used in the new rates retention system to compare against retained income after central shares, tariffs and levies have been applied. Together, these are known as a Start Up Funding Assessment (SUFA) and for 2013-14 this totals £58.1m, a loss of £3.9m in funding compared to 2012-13.

17. Draft details of the 2014-15 settlement were released in December 2012 alongside actual proposals for 2013-14 and this showed a net loss in the SUFA of £5.1m (8.8%).

18. In the March 2013 Budget, the Chancellor announced a further 1% total cut to Local Government funding in 2014-15. The funding consultation shows this has been broadly applied to all authorities and accounting for roundings there is a revised provisional reduction in the SUFA for 2014-15 of **£5.6m (9.7%)**.

19. In terms of 2015-16, the consultation provides further detail on the Spending Review's 10% cut and the reality that some of the other measures that were announced will be paid for by a top slice of RSG (detail to follow later in the autumn). As a result, the provisional reduction in the SUFA in 2015-16 equates to **c. £7.0m (13.4%)**.

20. Detail in the consultation also reveals a number of changes to the Government's original policy:

    i) The 2011-12 Council Tax Freeze Grant, a 4 year grant equivalent to a 2.5% increase which was supposed to fall out of the funding system in 2014-15, is retained in the 2015-16 base which in theory benefits higher taxbase authorities like York.
    ii) The 2013-14 Council Tax Freeze Grant, a 2 year grant equivalent to a 1% increase which should have also ceased in 2014-15, is also retained in 2015-16 'rewarding' those councils who accepted it.
    iii) Funding for localised Council Tax Support has been rolled into mainstream funding for 2015-16 and has therefore had the cut outlined above applied to it. This suggests a phased future withdrawal of Government support in this area.

21. It should be noted that all figures outlined above are subject to the outcome of the consultation and the annual settlement announcement in December will provide actual figures.

<u>Single Local Growth Fund and New Homes Bonus</u>

22. The June spending review committed the Government to Michael Heseltine's Single Local Growth fund which will 'empower Local Enterprise Partnerships (LEPs) in driving economic growth'. Funding for the initiative will total £2bn per year from 2015-16 until 2021-22. Following the main announcement, it was revealed that £400m would be funded by top slicing the New Homes Bonus (NHB) pot.

23. The proposed £400m transfer to the Local Growth fund is c. 35% of the projected £1.1bn NHB pot for 2015-16 and following the transfer to LEP's would equal the size of the pot in 2013-14. Therefore all things being equal, we can surmise that York's NHB allocation in 2015/16 would be broadly in line with the £2.4m allocation received in 2013-14 after a LEP pool contribution of c. £1.2m.

<u>Social Care Funding</u>

24. £3.8bn in funding was announced in the spending review for integration of social health care between the health service and local government. There is still great uncertainty around where this money will come from, however there are signs that it will not be new funding. There is also debate as to how the fund will be governed and whether any responsibilities will be transferred between sectors. The key risk to the council, and the local government sector as a whole, is that spend is not correctly aligned to responsibility when any transfer takes place. Future reports will provide further details as and when information is available.

Distribution of Cuts

25. The distribution of funding in the local government finance system has always been a complex process. The key driver has always been perceived need, which can and has had many definitions. The introduction of the new SUFA (see para 16) has added layers of complexity with the maintenance of funding lines in the total funding pot, such as the Council Tax freeze, that deliver the Government's priorities and have their own distribution methodologies.

26. Each Council has its own unique funding ratio between SUFA and Council Tax. Therefore, a thriving authority is most likely to have a high council taxbase and a lower grant, whereas an authority in a less affluent area is likely to see the opposite. York's net budget is 55% Council Tax to 45% SUFA and reliance on Government funding will subside as funding reductions continue.

27. Broadly speaking, every time the Government reduces grant, it has a more significant impact on lower taxbase/higher grant dependency authorities due to that funding ratio. However, having a number of different funding lines making up the total pot, each with their own distribution methodology, can skew the impact even further.

28. Using the data from the latest consultation outlined above, Table 1 below takes a sample of unitary authorities with different economic circumstances to illustrate the impact of the proposed cuts.

Unitary Authority	Net Budget (£m)	Funding Ratio Council Tax	SUFA	2014/15 Cut%	2015/16 Cut%
Wokingham	110.9	70%	30%	-8.5%	-9.9%
Windsor & Maidenhead	86.2	68%	32%	-8.9%	-8.9%
York	127.8	55%	45%	-9.7%	-13.4%
East Riding	248.8	52%	48%	-10.3%	-13.0%
Hull	236.7	25%	75%	-10.3%	-14.6%
Middlesbrough	140.3	29%	71%	-10.5%	-15.0%

Table 1: Funding Ratios and Grant Reductions

29. It is clear from the table that there are three distinct groups and all other unitaries fall somewhere between this scale. At the top of the table, there are affluent southern authorities who have a high reliance on their Council Tax income and a low government grant. These authorities are currently experiencing the lowest relative impact from the cuts. York and East Riding and others like them have a healthy taxbase but still have a relatively even split between Council Tax and grant funding and cuts tend to be around the broad headline figure. At the far end of the scale are northern industrial cities such as Hull and Middlesbrough that have higher levels of poverty which

results in a higher need for Government support and lower Council Tax levels. Due to the current funding set up, the cuts hit them even harder.

30. When the effects of this are added to those of the New Homes Bonus scheme, which favours authorities that have buoyant housing growth, something not associated with areas of poverty, it is clear that there is potential for a significant widening of the gulf between authorities across the country.

Medium Term Forecast

31. The current volatility of local government finance ensures that the Council's medium term forecast, covering the next three years, has to be continually refined. Table 2 below shows current forecast.

	2014-15	2015-16	2016-17
	£m	£m	£m
Pay & Pensions	1.62	0.90	2.50
Supporting Infrastructure	1.30	0.50	0.50
Corporate Priorities	3.85	1.70	2.00
Funding Reductions	6.40	8.30	7.00
Council Tax & Business Rates	-2.08	-1.40	-2.00
Gap	**11.09**	**10.00**	**10.00**

Table 2: Medium Term Forecast

32. 2014-15 is presented in line with the agreed budget from February 2013 on the assumption any undeliverable savings will be mitigated by replacement proposals. Supporting Infrastructure relates to costs arising from borrowing to pay for capital projects. Corporate Priorities includes investment in adult care, waste management and pursuing economic growth.

33. 2015-16 is reflective of the large RSG reduction announced at the spending review as well as a reduction to other grants and a 1% pay award.

34. 2016-17 is still uncertain primarily as spending plans for DCLG do not extend to this point, as this will be the first full year of the next Parliament. The funding reduction shown is a prudent estimate based on the current downward trajectory. The other key issue that is accounted for is potential changes to pension and National Insurance employer contributions, announced by the Chancellor in March. Further work is required to determine the impact on York and future reports will refine the figures presented here.

35. Elsewhere on the agenda for this meeting is the Q2 Finance & Performance Monitor report which is reporting pressures of just under £3.4m at the halfway stage of the financial year. These issues will be considered as part of the medium term planning process.

Conclusions

36. The financial challenges facing Local Government are unprecedented and the Council will have to make many difficult decisions in the coming years. Uncertainty regarding the funding position makes long term planning difficult, and therefore the council will always need to be flexible in its approach to financial planning. Any changes in policy, or indeed Government, over the medium term would likely further increase this level of uncertainty, however the Council remains in a strong position in terms of its financial management as evidenced by the recent annual audit letter.

Analysis

37. The analysis of the financial position of the council is included in the body of the report.

Consultation

38. None specific to this report, however, consultation on the budget will be commencing in November with numerous events including ward meetings and business events.

Council Plan

39. The information and issues included in this report demonstrate progress on achieving the priorities set out in the Council Plan (2011-15).

Implications

40. The implications are:
    - Financial - the financial implications are dealt with in the body of the report.
    - Human Resources - the impact of delivering savings is having considerable implications in terms of managing the HR issues. The Council is seeking to manage the process of reducing staffing number as effectively as possible, through use of Voluntary Redundancy and working with the Trade Unions.
    - Equalities - there are no specific equality implications to this report, however equalities issues are accounted for at all stages of the financial planning and reporting process. Equality Impact Assessments will be completed for individual budget proposals and summary information will be available for the budget review meetings with Cabinet members during the process. The individual EIAs will then be used to complete an overall assessment of the cumulative impact of the budget on all the communities of interest.

Risk Management

41. The risk management processes embedded across the council continue to contribute to managing the risk issues associated with major projects and key areas of service delivery.

Recommendations

42. Members are asked to note the current issues and approach to financial planning;

Reason: To ensure the Council meets future financial challenges and produces a sound, prudent budget for 2014-15 and 2015-16.

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<tr><td>Report Approved</td><td>√</td><td>Date</td><td>24 October 2013</td></tr>
<tr><td colspan="5">Specialist Implications Officer(s) None</td></tr>
<tr><td colspan="4">Wards Affected: All</td><td>√</td></tr>
<tr><td colspan="5">For further information please contact the authors of the report</td></tr>
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Background Papers: None

Annexes: None