

HAMPSHIRE COUNTY COUNCIL

Decision Report

Decision Maker:	Cabinet
Date of Decision:	24 October 2011
Decision Title:	Medium Term Financial Strategy – Update
Decision Reference:	3338
Report From:	County Treasurer

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1. Executive Summary

- 1.1. the Medium Term Financial Strategy (MTFS) was approved by Cabinet in July 2011. Since that time there have been significant changes in the economic outlook within Europe and the rest of the world and it was therefore felt timely to update some of the assumptions with the medium term financial strategy in advance of the work being undertaken for budget setting in 2012/13.
- 1.2. The key underlying assumptions that were approved as part of the MTFS were:
 - Assumptions about changes to Council Tax levels will be zero or low
 - Reductions in formula grant of 9% in 2013/14 and 8% in 2014/15
 - A pay freeze in 2012/13 followed by increases of 1% and 1.5% in 2013/14 and 2014/15 respectively
 - General inflationary increases of 2.5% per annum
 - Savings of 8% in 2012/13 and a 2% Annual Efficiency Target from 2013/14 onwards.
 - ‘Passporting’ of any further losses of specific grant to the relevant services
- 1.3. The MTFS assumes that taking these factors into account and the estimated savings achieved from the Corporate Efficiency Savings and the 8% per annum reduction in service budgets, the Council will have achieved it’s ambition to broadly meet the four year grant reductions over two years. From 2013/14 onwards it was also agreed that the County Council returned to an Annual Efficiency Target (AET) approach. An AET was therefore set at 2% per annum for each Department from 2013/14 onwards.

- 1.4. The MTFS outlined the significant risks attaching to the assumptions within the strategy and the need to keep these under review. The recent changes in the world economy have increased the risks within the strategy and pushed many of the factors to the upper limits of the parameters within which we are working.
- 1.5. The purpose of this report therefore is to review the assumptions in the MTFS, to look at the impact on the forecast budget gaps and savings required in 2011/12 and 2012/13 and consider whether any changes to the strategy are required as a consequence.

2. Contextual information

- 2.1. Although by their nature, financial strategies deal in high level assumptions and forecasts, it has long been a strength of the County Council to prepare well in advance for the impact of financial challenges both globally and internally.
- 2.2. This is even more important following the announcement of unprecedented reductions in public expenditure as part of the current 4 year Comprehensive Spending Review.
- 2.3. The MTFS approved in July made various assumptions around, inflation, interest rates, pay and grant reductions and after allowing for those, it was assumed that reductions in Departmental spending of 8% per annum for 2011/12 and 2012/13 followed by an Annual Efficiency Target of 2% per annum would see the County Council reach a position of 'dry land' far quicker than the majority of other local authorities.
- 2.4. Current changes in the world economy that are only just short of the scale witnessed in 2008 mean that it is timely to review the assumptions in the MTFS ahead of the formal development of the detailed budget for 2012/13.

3. Review of Assumptions

- 3.1. The following paragraphs outline the key assumptions within the MTFS and consider whether these need reviewing in light of recent economic events and the medium term impact of these.
- 3.2. **Inflation** – Current inflation remains well outside of the Governments target level for CPI, coming in at 4.5% in August. Whilst much of this relates to the spike created by the increase in VAT in January, which will drop out after a year, predictions for next year are still at the high end of the Government's target of between 1% and 3%. Whilst CPI does not necessarily impact on County Council costs directly, it will have an influence on contract payments and pay inflation pressures.
- 3.3. **Pay Inflation** – The current MTFS assumes a zero increase for 2012/13 and increases of 1% and 1.5% in 2013/14 and 2014/15 respectively. Continued high inflation and the current debate around pension contributions may bring significantly more pressure to bear on employers to agree greater pay awards in the later years of the CSR particularly as there has in effect been a pay freeze in place for the last 3 years.

- 3.4. **Fuel and Energy Inflation** – Fuel costs remain at an all time high level and high end increases in energy costs have either already been announced or are predicted in the near future. Both of these items have a significant impact on the Council's bottom line spending and whilst most of this was already accounted for in the 2012/13 forecast it is more difficult to predict the longer term impact this may have.
- 3.5. **Interest Rates** – Pressure on interest rates has now all but disappeared with some experts predicting that it could be as late as 2015 before any increase in the base rate is seen. In general terms the base rate only impacts on the short term borrowing and lending position for the authority, but the current turmoil in the world markets could push up longer term money which the Council utilises to fund its capital expenditure.
- 3.6. **Council Tax** – The MTFS assumed that council tax increases over the next three years would be zero or low and this remains an integral part of the strategy going forward.
- 3.7. The above paragraphs show that there are a number of risks associated with the assumptions built in to the MTFS and small changes in those assumptions (particularly around pay) will impact on the bottom line position for the County Council and may require changes to be made to the savings assumptions for future years.
- 3.8. The recent announcement from the Chancellor that further grant will be made available in 2012/13 to freeze council tax for a second year is very welcome news and gives specific financial support to the strategy of keeping council tax increases at zero or low.
- 3.9. It should be pointed out however that the funding identified for the council tax freeze in 2012/13 is one off and therefore this could create an upward pressure for a greater increase in 2013/14 if this funding were to drop out. There is also still uncertainty around the funding given for 2011/12 which was only guaranteed up until the end of the current CSR period, which again could create an upward pressure on council tax if this funding is withdrawn on an ongoing basis from 2015/16 onwards.
- 3.10. At this point, whilst there continues to be upward pressure against the risks contained within the MTFS, it is not recommended that we significantly change the broad assumptions in the strategy, we must simply recognise that we are at the 'upper limit' of those assumptions and consider measures to help mitigate the pressure under a worse case scenario.

4. Budget 2011/12

- 4.1. Whilst some of these items will impact on spending in the current year, the key issues are that no pay award has been granted for staff in 2011/12 and current forecasts of adult social care pressures are within the allowances made within the overall budget.
- 4.2. The budget gap reported for 2011/12 was £55m. Full Council in February 2011 agreed proposals for closing this gap comprising the 8% departmental and corporate efficiency workstream savings which totalled £52.3m, net of planned cost of change, together with a further £1.3m in respect of the

waste management contract savings held centrally in contingencies. The remainder of the budget gap was primarily made up by grant received for freezing the council tax which was in excess of the assumed council tax income anticipated for the year.

- 4.3. Given the scale of the savings, the timescales for delivery and the need for Departments to cover the costs of change, a contingency provision of £20m was set aside in the budget.
- 4.4. Although performance against savings is strong in 2011/12, there are still some areas where implementation is ongoing and there are still risks that the net planned savings may not be delivered in full by the end of the year, other factors such as the cost of change also need to be taken into account and it is therefore prudent to retain this contingency at this juncture.

5. Forward Forecast 2012/13 – 2014/15

- 5.1. Section 3 outlines some of the upward pressures on the assumptions contained within the MTFs. For the 2012/13 budget the County Council must continue to deliver on the savings agreed for 2011/12 and implement new savings proposals to reach the target of a second 8% savings.
- 5.2. In addition, there is still uncertainty beyond 2012/13 over the additional funding given to Adult Services through the NHS and the extent to which this will continue to be passported through to the County Council to meet pressures in this area.
- 5.3. There are also several confidential reports on the Cabinet agenda today which will have a significant impact on the County Council's financial position going forward and these will need to be fed into the medium term forecasts and budget development process for 2012/13 as the financial impact of these becomes clear. Approval is requested in this report to give delegated authority to the County Treasurer in consultation with the Leader to make changes to budgets and forecasts consistent with the proposals in the exempt reports on the agenda.
- 5.4. Despite all of these issues, the actions that the County Council has taken to address the large scale reductions in Government grant means that it can cover these risks through appropriate contingency provision during 2012/13 in a similar way to 2011/12. This will provide sufficient flexibility within the budget to allow for slippage or non-delivery of savings within the year, in the knowledge that as long as the required recurring savings are delivered within the MTFs period, the Council will be on a sound financial footing by 2014/15.
- 5.5. It is important however that the County Council remains aware of the potential impact of some of these risks particularly in the last two years of the current MTFs period and that it has contingency plans in place to deal with any large scale issues that arise.
- 5.6. The extent to which any action is required will clearly be dependant on the actual level of pay and price increases, grant reductions and other changes in national funding experienced during the next three years. Potential

contingency measures that could be considered are as follows, although it is too early to require any specific consideration at this juncture :

- Making a stronger link between anticipated pay and price inflation and council tax increases for the year from 2013/14 onwards. Using council tax as a means of tracking and offsetting higher than expected increases in pay and prices
- Increasing the Annual Efficiency Target for Departments from 2%.
- A combination of the above.

6. Conclusions

- 6.1. Medium Term Financial Strategies are by their very nature based on a large number of broad assumptions that are refined as budget setting takes place for each financial year.
- 6.2. This report outlines some of the pressures and issues surrounding the key assumptions within the MTFS and recognises that, on balance, the current economic climate has pushed some of these assumptions to the upper limits of our existing parameters.
- 6.3. However, the majority of these risks had already been outlined in the MTFS approved in July this year and the actions the County Council had already put in place has helped to mitigate many of these financial risks, particularly in the earlier years of the strategy.
- 6.4. It is therefore not considered necessary at this stage to fundamentally change the assumptions or direction outlined in the MTFS, but to ensure that the position is kept under review as we move into the more detailed budget setting process for 2012/13.

7. Recommendations

Cabinet is recommended to :-

- 7.1. Note the pressure on key risk assumptions that underpin the financial forecasts for the next three years and the need to keep the position under review.
- 7.2. Delegate authority to the County Treasurer in consultation with the Leader to make any necessary changes to forecasts or budgets consistent with the proposals contained in the exempt reports presented elsewhere on the agenda.

CORPORATE OR LEGAL INFORMATION:

Links to the Corporate Strategy

Hampshire safer and more secure for all:	Yes
Corporate Business plan link number (if appropriate):	
Maximising well-being:	Yes
Corporate Business plan link number (if appropriate):	
Enhancing our quality of place:	Yes
Corporate Business plan link number (if appropriate):	

Section 100 D - Local Government Act 1972 - background documents	
<p>The following documents discuss facts or matters on which this report, or an important part of it, is based and have been relied upon to a material extent in the preparation of this report. (NB: the list excludes published works and any documents which disclose exempt or confidential information as defined in the Act.)</p>	
<u>Document</u>	<u>Location</u>
None	

IMPACT ASSESSMENTS:

1. Equalities Impact Assessment:

- 1.1. Equality objectives are not considered to be adversely affected by the proposals in this report but specific issues arising from any detailed budget proposals will have full EIA's carried out where appropriate.

2. Impact on Crime and Disorder:

- 2.1. The proposals in this report are not considered to have any direct impact on the prevention of crime but will be taken into account when the detailed budget proposals are developed for 2012/13 and beyond.

3. Climate Change:

- a) How does what is being proposed impact on our carbon footprint / energy consumption?
No direct impact.
- b) How does what is being proposed consider the need to adapt to climate change, and be resilient to its longer term impacts?
No direct impact.

