

Leicester
City Council

Finance, Resources and Equal Opportunities
Scrutiny Committee
Cabinet

19 September 2002
23 September 2002

BUDGET STRATEGY 2003/04 TO 2005/06

Report of the Chief Finance Officer

1. Introduction

- 1.1 The purpose of this report is to advise members of the current budget outlook, and to make recommendations on the preparation of next year's budget given the current huge uncertainty surrounding government funding levels.

2. Summary

- 2.1 The Council approved a 3 year budget strategy for the period 2002/03 to 2004/05 in March. Normal practice would now be to consult on a further strategy for the period 2003/04 to 2005/06, updating plans as necessary for changing priorities and changing financial estimates.
- 2.2 The budget outlook for 2003/04 to 2005/06 is dominated by uncertainty over the Government's review of local government funding. This review is now at consultation stage, and a number of options have been circulated for comment. At the extremes, these options could result in a £9m loss of, or £20m increase in, resources to the City Council. It is not currently expected that the government will make any firm proposals before November, when we get the draft local government finance settlement.
- 2.3 Since the budget strategy was approved, however, new costs have arisen. These are discussed in this report.
- 2.4 On the assumption that the Council does poorly from the review, and is protected by a guaranteed minimum grant increase, current estimates suggest we will have a £1m shortfall of resources **to meet existing plans** in 2003/04, rising to £2m by 2004/05. These estimates are volatile, and do not make any allowance for additional resources for member priorities.
- 2.5 However, despite this shortfall, I do not think it is sensible to alter current departmental planning targets to reflect different estimates to the ones on which the targets in the current 3 year strategy were based. The fluidity of the situation is such that any new estimates will be no better than the old ones.

- 2.6 Given the uncertainty, the approach recommended to members is:
- (a) to ensure the existing 3 year revenue strategies are delivered;
 - (b) to ask directors to update departmental revenue strategies over the autumn using the existing planning targets (amended only to reflect a changed approach to Best Value and savings from the client/contractor split); reporting to scrutiny committees in December;
 - (c) to update the corporate revenue strategy and (if necessary) revise departmental revenue strategies when we have greater certainty in respect of government funding.

3. Recommendations

3.1 Cabinet is asked to:

- (a) note the considerable uncertainty facing the budget for 2003/04 and subsequent years;
- (b) reaffirm its commitment to 3 year planning, and note that the process recommended this year is an undesirable departure from normal practice;
- (c) endorse the proposed approach to the budget strategy;
- (d) note the potential need to review the budget strategy later in the year, dependent upon the outcome of the government's funding review;

3.2 The Finance, Resource and Equal Opportunities Scrutiny Committee is asked to make any observations it wishes to Cabinet, to assist Cabinet's deliberations.

4. Financial and Legal Implication

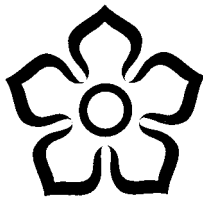
This report is entirely concerned with financial issues.

5. Report Author

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DECISION STATUS

Key Decision	No
Reason	N/A
Appeared in Forward Plan	No
Executive or Council Decision	Executive (Cabinet)



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SUPPORTING INFORMATION

1. Background

- 1.1 On 6 March, the Council approved a budget for 2002/03, and a 3 year budget strategy for the period 2002/03 to 2004/05.
- 1.2 The budget for 2002/03 achieved its goal of redirecting resources to the Council's 4 key priorities of raising educational standards, social care and health, combating crime and disorder, and revitalising neighbourhoods. The budget also honoured the Council's pre-existing commitments regarding council tax (which have now expired).
- 1.3 The budget set in March was recognised as being tight, with pressures in Social Services being particularly noted. As a consequence, new funds were provided for Social Services, although they were one-off only.
- 1.4 The budget strategy recognised that Social Services' position would need to be reconsidered consequent to the government's funding review, although a commitment to increase the budget of that department by £0.5m per annum from 2003/04 was made. Early indications from this year's budget are that Social Services remains under considerable pressure.

2. Spending Issues - Pay

- 2.1 At the time the budget for this year was set, employers and trade unions were at loggerheads over the pay settlement. They now appear to have reached agreement: a 2 year deal has been recommended by both sides. The proposals include:
 - (a) 4.1%, or £5.00 an hour, from April 2002 for the lowest paid workers and 3% for everyone else;
 - (b) a further 2% for the lowest paid workers from October 2002, and a further 1% for everyone else;

- (c) 4.5% for the lowest paid workers from April 2003, and 3.5% for everyone else.

2.2 The table below compares the effects with our budget assumptions:

	Budget Assumption	Actual
2002/03	3.25%	3.63%
2003/04	3.0%	4.17%

2.3 Compared with the budget assumptions, the award will cost: -

- (a) an additional £0.3m in 2002/03. In accordance with normal policies, it is intended to leave departments to find this cost from their current year's budgets (this will be difficult within already tight budgets);
- (b) a further £1.5m in 2003/04 (plus a further £0.4m to be met by the Education Department from within the totality of its resources). This cost will now (in accordance with normal policy) need to be built-in to the departments' spending targets for 2003/04.

2.4 There is no indication that the Government intends to make additional funding available for the pay award.

2.5 Spending projections for the next 2 years have now been revised to include the following pay/price assumptions:

	2003/04	2004/05
Teachers' pay	3.5%	3.5%
Other pay	4.17%	3.25%
Price and Income	2.1%	2.1%

3. Spending Issues - National Insurance

3.1 In his March budget, the Chancellor of the Exchequer increased national insurance contributions paid by employers by 1%. The effect of this on the Council's general fund is £1.2m, of which £0.6m falls (in line with normal policies) to be met by the Education Department from within the totality of its resources. In accordance with normal practices, it is proposed to amend departments' spending targets for the next 2 years to reflect this increased cost.

4. Spending Issues - Pensions

4.1 The approved budget strategy includes provision for pension increases through to 2004/05, reflecting the effect of the pension fund revaluation in 2001/02.

4.2 However, it now seems inevitable (given recent stock market losses) that the next pension fund revaluation will require further significant increases; and there is some possibility of an interim revaluation, the results of which will take effect prior to 2005/06. No assessment has

been made of the effect of such an increase. In accordance with normal policy, the cost of any pension fund increase falls to be borne corporately.

5. Spending Issues - Insurance

- 5.1 The cost of insurance is rising significantly. As part of the budget for 2002/03, departments were advised to assume an overall increase in insurance costs of 40%. In addition to increasing costs of external insurance, the internal fund is under strain due to rising numbers and costs of claims. The current balance stands at around £4.7m, having been reasonably stable for a number of years. A recent actuarial review suggested a worst case scenario would require approximately £8.5m. In my view, the Council should aim to rebuild the fund to a figure of around £6m in the years to 2005/06, which inevitably implies a backdating component of departments' insurance costs from 2003/04.
- 5.2 Departments, through Strategic Resources Group, have accepted the need for this; and have also agreed to pay increased insurance excesses in order to reduce the burden on the insurance fund, and to promote a greater awareness of risk management.
- 5.3 We are currently in the process of tendering our external insurance policies (the insurance year runs from October) which will provide clarity over costs to be met by departments

6. Spending Issues - Savings Outstanding

- 6.1 Following a report on Revitalising Neighbourhoods, which was approved in January, the Council is committed to securing savings of £410,000 from a review of the structural arrangements involving internal clients and contractors. This work is proceeding, and is anticipated to deliver the savings expected (which will fund the appointment of neighbourhood managers).
- 6.2 The current budget strategy requires savings of £1.5m to be achieved by 2003/04 from Best Value reviews in order to fund growth in Education. The final tranche of £0.5m is due to be found in 2003/04. The means of attributing savings to Best Value reviews has not been particularly effective, and a change is recommended to deduct the final tranche of required savings from departmental budgets. This does not mean that we should give up expecting savings from Best Value Reviews - it simply means that savings need not be delivered to achieve a corporate savings target (they can, of course, be used to help achieve departmental savings targets).
- 6.3 Members are reminded that the 3 year strategy approved in March required further savings to be achieved to meet 3 year planning targets (to the extent that savings were not identified in the March report). The outstanding requirement is:

	Cultural and Neighbourhood Renewal	Environment, Regeneration and Development	Other Departments
	£m	£m	£m
2003/04	0.5	0.8	0.2
2004/05 (cumulative)	0.9	1.5	0.3

7. Spending Issues - Summary

7.1 After allowing for pressures which (in accordance with normal policies) are funded corporately, the Council's **current** spending plans would cost the following in the next 2 years:

- (a) 2003/04 £325.5m;
- (b) 2004/05 £340.1m.

7.2 These spending totals assume that all departments can live within their budget planning targets. They do, however, include the cost of the Council's £0.5m commitment to Social Services.

8. Resource Issues - Position in March 2002

8.1 The 2002/03 budget made estimates about the Council's resources for 2003/04 and 2004/05, recognising a significant level of uncertainty because of the government funding review. The forecast increase in the Council's SSA was as follows:

- (a) 2002/03 5.0%;
- (b) 2003/04 5.0%;
- (c) 2004/05 4.5%.

8.2 These figures are below the (then) anticipated national increases in standard spending assessment, reflecting the usual adverse effect of pupil and population movements in the City.

9. Resource Issues - Spending Review 2002

9.1 In July 2002, the Chancellor announced his 3 year spending review outcome, which included national SSA figures through to 2005/06. This, **assuming no change to the SSA formula**, would result in an improvement on the previous position (at the present moment, we do not have sufficient detail of the spending review to prepare a like for like comparison).

9.2 However, the key area of improvement is in respect of Social Services (national SSA provision increasing by 28% over 3 years). However, question marks remain over the extent to which this represents newly available funds:

- (a) some of the increase will inevitably represent transfer of specific grants to mainstream funding;
- (b) the Department of Health has expectations of new standards of service for children and the elderly, which may consume a considerable amount of any increase. Whilst these are unlikely to be ring fenced, they will (in all likelihood) be policed by performance standards.

9.3 Members are also asked to note that there is no explicit link in the Council's budget strategy between Social Services SSA and Social Services budget in the way that there is for Education - pressure to make such a link may increase as a consequence of the Chancellor's spending review.

9.4 A welcome outcome of the spending review is the extension of the Neighbourhood Renewal Fund for a further 2 years through to 2005/06. Initial estimates are that Leicester should receive the following as a consequence (based upon the present method of distributing the grant):

2004/05	£9.5m
2005/06	£11.0m

10. Resource Issues - Formula Review

10.1 This is the single most significant issue affecting the Council's budget planning processes.

10.2 A review of the current SSA system has been underway for some considerable time, and is a commitment in the Local Government White Paper published last year. In July, the Office of the Deputy Prime Minister produced a number of options for consultation, amounting to 49 in total. The consultation period extends until September, and in addition to commenting on the ODPM options, authorities are free to suggest new ones. (The Council's proposed response is the subject of a separate report on your agenda).

10.3 In distributional terms, the extremes of the options presented range from a loss of £9m SSA to a gain of £20m. Within the range, we appear to do well in respect of education options and poorly in respect of Social Services options. Present indications are that we will be no wiser until the end of November, when we receive the draft local government finance settlement. Whilst the range of options suggests that the outcome of the review may be better than previously feared, there can be no certainty, and there will doubtless be intensive lobbying over the next few months by various interest groups (we will, of course, continue to make our own representations).

10.4 We have so far been planning on the basis of distributional losses arising from the review, subject to protection by a floor mechanism. This would result in total estimated resources to the Council of:

2003/04	£324.6m
2004/05	£338.5m

- 10.5 Assuming services can be delivered in line with the spending projection given above, this would result in a funding gap of:

2003/04	£0.9m
2004/05	£1.6m

- 10.6 These estimates assume that the Council continues its present policy of “passporting” increases in Education SSA directly to the Education service, and assumes a small distributional loss in Education resources.
- 10.7 These figures are very volatile and likely to prove to underestimates.
- 10.8 The gap identified above does not allow for any increased funding to Social Services over and above the £0.5m already planned.

11. Reserves

- 11.1 Uncommitted corporate reserves currently stand at £5m, which is the Council’s agreed minimum working balance.

12. Way Forward

- 12.1 The outlook for the Council’s resources from 2003/04 onwards is shrouded with extreme uncertainty, and we do not expect to have any more certainty until November. This is clearly less than satisfactory, but outside our control.
- 12.2 The following approach is recommended:
- (a) to update the departmental revenue strategies through to 2004/05 to reflect any new spending pressures or savings opportunities, based on the **existing** planning targets (adjusted only for savings required from the client/consultant/contractor split and the residual Best Value savings target);
 - (b) to plan for 2005/06 only on a very provisional basis, and ask departments to assume a zero overall position for that year (ie any extra cost pressures to be balanced by extra savings).
- 12.3 This may require plans to be changed once we have certainty about the funding review, but I do not think this can be helped.

13. Corporate Budget Strategy

- 13.1 At this time of year, we would normally start redrafting the corporate budget strategy. Given the absence of good financial estimates, it is recommended that we delay this task until later in the autumn.

14. Consultation

- 14.1 All departments, through Directors’ Board, have been consulted in the preparation of this report.

15. Other Implications

OTHER IMPLICATIONS	YES/NO	Paragraph Within Supporting information	References
Equal Opportunities	No		
Policy	Yes	The report discusses financial policy	
Sustainable and Environmental	No		
Crime and Disorder	No		
Human Rights Act	No		
Elderly/People on Low Income	No		

16. Report Author

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