**Item 3**

| Item No. | Classification: Open | Date: January 31 2006 | Meeting: Executive |
|---|---|---|---|
| **Report title:** | | Policy and Resourcing Strategy - The 2006/07 Revenue Budget (The Budget and Policy Framework) and 2005/09 Capital Programme | |
| **Ward(s) or groups affected:** | | All | |
| **From:** | | Finance Director | |

**RECOMMENDATIONS**

1. That Executive agrees a budget and Council Tax proposal for 2006/07 for recommendation to Council Assembly.

2. That Executive, in line with the two-year local government finance settlement, indicates a provisional increase in Council Tax for 2007/08.

3. That Executive approve in addition to those resources previously approved for the capital programme 2005/2009, new capital bid proposals identified as unavoidable and urgent, totaling £3.25m (paragraph 44).

4. That Executive note that forecast capital resources are not sufficient to meet all of the service departmental investment proposals and therefore instruct the Finance Director to complete further detailed analysis on a number of capital investment options for Executive consideration in the autumn of 2006.

5. That Executive recommend to Council Assembly that the acquisition of the Old Kent Road site in support of the Waste PFI project be funded through prudential borrowing in order to protect the Council investment in view of the Mayor's proposals for a London Single Waste Authority.

**Context**

6. On 13th December the Executive noted the provisional local government grant settlement for 2006/07 with an indicative settlement for 2007/08, as announced on 5th December 2005. It also received an overview of the likely resource availability to support General Fund services arising from this provisional settlement.

7. The position reported to the Executive on 13th December 2005 outlined an increase in general grant of 2.18% for 2006/07. Following the amending reports issued by the Office of the Deputy Prime Minister (ODPM) making adjustments to previous year's grant in respect of issues such as population, the provisional grant settlement increases to a total of 2.5% for 2006/07 only. The difference between the 2.5% and 2.18% equates to an additional £600,000, which is to compensate for previous years. It has been indicated by ODPM that these funds will not be available in future years.

8. The total general grant increase of 2.5% in 2006/07 is below the current rate of inflation being experienced by those services provided by the Council. This is due to a number of issues, but especially the nature of those services (including social care and waste) and London market factors. In addition, the pay award previously agreed between the employers and unions is 2.95% for 2006/07. Like others the Council has also been experiencing fuel price inflation of around 40%. The provisional grant settlement therefore represents a reduction in government funding in real terms.

9. The Council is also experiencing unavoidable service commitments and pressures across all Council departments that are partially offset by cost reductions arising from savings and efficiencies outlined in paragraph 30. Taking all factors into account, a Council Tax increase and / or reduction in levels of service delivery will be necessary to achieve a balanced budget position.

10. The introduction of the new Dedicated Schools Grant (DSG) now formalises the ringfencing of schools funding. This follows on from the passporting arrangements that the Council has adopted over a number of years. Subject to consultation and appropriate agreement with relevant bodies (including the Schools Forum), there may be some opportunity in the future years to use some of the DSG to support the overall children's agenda. However, any such future cross funding arrangement would need to be relevant to the delivery of both schools and children services.

11. Looking beyond 2006/07, for 2007/08 the Council has received an indicative increase in general grant of 2.7%. This excludes the additional resources allocated in 2006/07 as a result of the amending reports. Given the adjustment to the base position made by the ODPM, this represents an overall cash increase of just 2.2% over the settlement for 2006/07. In providing provisional grant levels for 2007/08, the ODPM has explained that it requires Councils to indicate Council Tax proposals for 2007/08. In indicating Council Tax levels for 2007/08, there is a need to consider the degree of uncertainty in estimating future levels of demand on many services and the unavoidable costs that these create.

12. The position for 2008/09 is not yet known, but this will represent the first full year following the outcomes from the Chancellor's next Comprehensive Spending Review. It is expected that the Lyons Review will also have reported by that time. Early indications suggest that the Council is likely to remain close to the minimum or 'floor' increase in general grant for the foreseeable future. This is expected to be at a rate close to the Retail Price Index (RPI) and therefore likely to lead to continued pressure to balance resource needs against expected service levels.

13. The Gershon review has set the public sector a target to achieve annual efficiencies of 2.5% of adjusted net expenditure. At least 50% of these savings must be cashable. There are expectations for achieving these efficiencies in line with the Council's medium term financial strategy in order to deliver a balance budget in the context of grant levels and Council priorities. The Council has a strong history of making efficiency savings and is achieving Gershon targets. The Council remains confident of achieving targets in the future although this will become more difficult over time without additional investment in the Council's infrastructure.

14. The Council remains committed to the delivery of a number of major projects over the medium to longer term. These include regeneration of the Aylesbury Estate and Elephant and Castle. Effective resource management strategies will need to be in place to contain the risks attached to such projects. Resource management of these projects is being considered following on from the recent strategic management review. In preparing the medium term forecast of resource requirements from 2007/08 and beyond, there is a need to highlight the potential investment required in order to ensure the effective delivery of the projects.

**Current Position**

15. On 13th December 2005 the Executive requested that the Finance Director prepare budget proposals based on Council Tax increases for 2006/07 at indicative levels of 0%, 2.5% and at 5%. The Government has indicated a ceiling of 5% as the likely capping level. Each option would need to be considered in as far as it could meet the medium term policy commitments and pressures across the full range of Council services as outlined in the draft Corporate Plan attached elsewhere on this agenda.

16. This report now sets out the extent to which policy commitments and pressures can be met while maintaining working General Fund Balances at current levels as an absolute minimum. Given the limitations of the grant settlement, there are no opportunities for growth over and above the commitments and unavoidable costs detailed in this report without increasing Council Tax significantly above the level of RPI.

## ISSUES FOR CONSIDERATION

### Changes to grant

17. As outlined in the report to Executive on 13th December 2005 the local government finance settlement has been radically altered. Formula Spending Share (FSS) has been replaced by a new 4 block system. In addition and importantly, for the first time schools are now funded through a new Dedicated Schools Grant (DSG). As a result of these changes, straight comparisons with settlements for previous years are problematic.

18. The **new 4-block option** for general grant consists of:

- **Relative Needs Block** – using relative needs formulae (RNFs). This formula is based on five main service areas, which cover Children's Services, Adults, Highways, Environment Protection and Cultural Services (EPCS) and Capital Finance.

- **Relative Resource Amount** – takes account of the fact that areas that can raise more income locally and therefore require less support from Government to provide services.

- **Central Allocation** – cash remaining in the Government 'pot' after the allocation through the above two blocks has been allocated on a population basis.

- **Floor Damping** - this ensures a minimum grant allocation to Authorities (significantly applied across London for 2006/07 to offset adverse variations in formula funding as above).

19. The overall impact of the creation of the 4-block model has been to reallocate resources away from London. For 2006/07 the average increase for London is 2.6%; nationally the average is 3.0%.

20. The introduction of DSG marks one of the most significant shifts in the way the grant is calculated. This now formalises the ringfencing of schools funding and follows on from the passporting arrangements that the Council has adopted over a number of years.

21. For 2006/07 the Council has been awarded an increase in DSG of 7% per pupil in 2006/07 and a further 7% per pupil in 2007/08. This compares favourably to a national increase of 6.8% per pupil increase in 2006/7, and 6.7% in 2007/08. Using the DfES projected pupil numbers, this equates to an estimated total allocation of £172.8m in 2006/07 and £181.5m in 2007/08. This compares with a Schools Budget of £162.0m in 2005/06. The indicative DSG will be amended for the actual pupil count in January 2006 (PLASC returns) and final notification will be received in May/June 2006.

22. The major effects of the change to school funding are as follows:

    - Formula grant nationally has seen a transfer of resources from general grant in order to fund the DSG. This in part reflects the national agenda for Children, but potentially diverts funding from other Council services, some of which support children (nationally, an additional £216 million above the schools FSS was taken out of the grant system to fund DSG).

- The Council has consistently used grant at the maximum level to support schools (previously known as "passporting") throughout a challenging period for the education service. In moving forward and building on this, the Council will need to look at ways of working with schools to supporting the wider *Every Child Matters* agenda.

23. Despite expectations to the contrary, the proportion of specific grants (ring fenced) has substantially changed, in particular arising from the introduction of DSG. For the Council in 2006/07, the proportion of specific grants to total government funding has increased from 9% to 50%. Much of the grant is ring fenced and time limited. This makes planning and prioritisation of options for the Council increasingly complex.

24. Specific grants funding (excluding DSG) in 2006/07 has fallen from £90.1m to £85.3m (-5.3%). This is largely due to the fall out of certain grants, including Safeguarding Children (£1.6m), totalling £3.6m. £1.7m of this has been incorporated back within departmental budgets as unavoidable commitments as they support essential statutory services. The Council has also received notification of new grants to support specific activities to be provided by the Council in line with government policy (approximately £1.1m). For example partnership for older people pilots representing a successful bid for scarce resources where Southwark is one of only 19 authority's to be awarded the grant. The above figures are the best available at this time and could change as grant announcements continue to be made.

25. The uncertainty associated with specific grants further underlines the need for the Council to ensure that it has a sound and stable financial base upon which to fund policy commitments and service pressures as described in the draft Corporate Plan.

**2005/06 Revenue Monitor**

26. The provisional revenue monitor for period 9 (December) is reporting a net underspend of £0.871m on General Fund activities. This is after setting aside funds for the reinstatement of facilities at the Peckham Pulse, which the Executive agreed on 22nd November 2005.

27. This position includes a range of positive and negative variations. They include an ongoing increase in interest earnings arising from higher than expected interest rates and level of balances and one off windfall reductions in net costs for the Revenues and Benefits services. To offset these benefits there are a number of unfavourable variations arising especially from service pressures in adults and children social care and leisure management. Management action is being undertaken in an attempt to reduce the impact of these pressures.

28. In the latest monitoring report, it is proposed that any net surplus on the General Fund arising from the final outturn not otherwise earmarked, be set aside to achieve the Medium Term Financial Strategy objective of increasing the General Fund Balance to £10m (currently £8.9m).

**General Fund Budget Options 2006/07**

29. On 13th December, Executive requested that three options for changes in Council Tax be prepared for their consideration. Chief Officers have completed a review of budget options that reflect emerging price and service pressures resulting in a revised net budget for 2006/07 of £287.3 m (excluding schools). This compares with the 2005/06 budget of £274.0m.

30. In order to help offset the cost pressures that are emerging as a result of unavoidable service demands, total savings, efficiencies and external funding have been identified amounting to £8.6m for 2006/07. This includes general savings and external funding of £4.7m (Appendix B) and Gershon cashable efficiencies of £3.9m (Appendix C). Since early summer 2005 officers have been involved in a rigorous process to identify this level of savings. This process has

been against a backdrop of rising service demands and pressures. Achievement of these savings will be difficult and challenging, requiring skilful management and sensitivity to impact. The Council will also need to adopt further enhanced procurement and structural arrangements across a range of services while improving the way in which such services are delivered.

31. The structure and framework for the Children's Trust is due to be operational by April 2008. This requires growth of approximately £1.1m per annum for at least the next two years with effect from April 2006. These cost pressures will be offset by the LPSA grant funding that is now expected to be received in two parts during the course of that period, amounting to £2.2m. Any release of Local Public Service Agreement (LPSA) monies will require the prior approval of the Finance Director.

32. Subject to the agreement of the Executive and Council Assembly, it is also proposed that the existing revenue provision of £1m in respect of prudential borrowing for invest to save initiatives be earmarked for the acquisition of the Old Kent Road Waste Management site. This is recommended in order to safeguard the Council's investment in the land as part of the package to deliver the Waste Private Finance Initiative (PFI) project (paragraph 51).

33. The following table sets out the revised budget requirement and the net deficit or surplus for 2006/07 based on Council Tax increases of 0%, 2.5% and 5%.

**Table 1**

| **COUNCIL TAX INCREASE** | **At 0%** | **At 2.5%** | **At 5%** |
|---|---|---|---|
| | **£'000** | **£'000** | **£'000** |
| **Revised 2006/07 Base (including inflation and unavoidable commitments excluding savings and efficiencies)** | **295,927** | **295,927** | **295,927** |
| **Funded by:** | | | |
| General Grant | (207,272) | (207,272) | (207,272) |
| Council Tax | (77,314) | (79,247) | (81,180) |
| Efficiency Savings | (3,920) | (3,920) | (3,920) |
| Other Savings / Increased Income (including Youth PSA) | (4,687) | (4,687) | (4,687) |
| **Budget Shortfall / (Surplus)** | **2,734** | **801** | **(1,132)** |
| **Represented by:** | | | |
| **Further Savings & Service Reductions** | **(2,734)** | **(801)** | **0** |
| **Resources Available for Priority Growth** | **0** | **0** | **1,132** |

**Commentary on Council Tax Options**

34. Having taken account of service pressures and savings and efficiencies being offered, the three options as requested create a range scenarios ranging from a budget deficit of £2.7m with no Council Tax increase to a surplus of £1.1m with an increase in council tax at 5%.

35. The main issues arising from the three scenarios are as follows:

**TABLE 2**

| Council Tax Options | Implications |
|---|---|
| No Increase<br><br>Savings and service reductions of £2.7m required. | Further savings and service reductions required up to £2.7m; no priority growth without generating additional service reductions. Options for service reductions are scheduled in Appendix D. In summary, these include the review of early years provision and residential and preventative services for children; tightening of controls of demand pressures across adult services social care; reduction in carers grant to the voluntary sector; review day care provision for adults; reduced level of environmental services such as fewer street leaders, reduced frequency of street cleaning and reduced parks staff; a loss of housing renewal services across the borough. |
| 2.5% Increase<br><br>Savings and service reductions of £0.8m required. | Service reductions required up to £0.8m; no priority growth without generating additional service reductions. Options for further savings and service reductions are outlined in Appendix E. In summary, these include the review of early years provision and residential and preventative services for children; tightening of controls of demand pressures across adult services social care; reduced parks staff. |
| 5% Increase<br><br>No additional savings but savings and growth potential. | Additional funds of approximately £1.1m available to reinvest in priority services. Priority schemes proposed by officers are scheduled in Appendix F. In summary, these include additional investment to tackle violent crime; further investment in Southwark Community Games; investment in leisure services; further regeneration activities; development of apprenticeship and trainee scheme across the Council. Alternatively, the surplus could be used to support a lower level of Council Tax at approximately 3.5%. |

36. The Executive will need to consider these implications in deciding on the level of Council Tax to be recommended to Council Assembly. In view of the base assumptions being made following the budget challenge process, the Finance Director would propose that Executive considerations need to be based on a council tax increase for 2006/07 of around 3.5%. Any lower level of tax recommended would need to consider a reduction in costs that would impact upon the level of services provided.

**GLA PRECEPT**

37. The GLA are to set their budget and precept on 15th February 2006. The draft budget that has indicated an increase in precept of £43 (16.6%) and Band D Council Tax. This includes for the first time the £20 per household increase for the Olympics. Excluding the Olympics element, the increase amounts to approximately 8.7%; the Mayor has indicated that this could fall to 5.5% at the final approval stage, giving a revised total increase of 13.4% including Olympic levy. The revised increase would equate to a 3.1% rise on the Southwark Council Tax bill.

## A STRONG AND STABLE RESOURCE BASE

38. In addition to ensuring that sufficient funds are available to finance the ongoing management of Council services, the Finance Director as the statutory section 151 officer needs to be assured that there is an appropriate level of reserves and balances available. Reserves and balances are needed in any event but especially to protect against risks due to the size, scale and complexity of projects and services.

39. The Council has a good track record in achieving a strong and stable resource base as noted in the Annual Audit Management Letter 2004/05. Maintaining an adequate level of reserves, balances and risk are key factors in the Finance Director's assessment of the robustness of the budget.

40. In agreeing the 2005/06 budget, the Council revised the medium term financial strategy so that a target level of working balances of £10m could be achieved. Principally as a result of windfall benefits in interest earnings in 2004/05, the Council has made progress to achieving this level of balances, currently standing at £8.9m. This amount as included in the audited accounting statement for 2004/05 equates to approximately 1.95% of net general fund expenditure. On average, inner London authorities have average working balances of around 5% of net general fund expenditure. If Southwark were to achieve the average it would require balances of £23m.

41. As part of the assessment of Use of Resources for CPA 2005, it was recommended by the District Auditor that the Council review working balances with a view to increasing current levels. There is some assumption through the CPA that Local Authorities need to consider balances of at least 5% of their net budgets. This would indicate that the accumulation of a higher level of working balance over the medium term may be appropriate. The position will be reviewed further over the coming months and through the accounts closing programme. The Finance Director will submit a report to the Executive in due course.

42. While the future beyond 2006/07 remains uncertain, it is considered fair to assume that inflation impacting on Council services will continue to run at a level above provisional settlement and that unavoidable commitments will not be fully met through general or specific grants. Therefore it is recommended that a council tax increase for 2007/08 will need to be at least in line with inflation.

### Risk Management

43. Risk management is integral to the Council's business processes and as such is being increasingly aligned to business and budget planning. In preparing budget options, officers have assessed associated potential risks and prepared containment actions as appropriate. These will be monitored on an ongoing process as part of the overall arrangements for risk management.

### Capital 2006/9

44. The Council currently has an ambitious programme totalling £0.5bn that has been profiled over 2006/09 period (Appendix G). There is currently £16m of confirmed forecast capital receipts available over the period 2006/09 that is not yet committed and are available for new capital investment. It is recommended that these funds be prioritised to meet unavoidable and urgent works in 2006/7 (as detailed in Appendix H).

45. After taking into account these unavoidable and urgent works, the Executive is advised not to commit the remaining resources at this point in time. Currently there are in excess of £100m investment proposals requiring review and prioritisation. A further report in the autumn of 2006/7 will update the resources position and recommend investment options.

**Old Kent Road Site Acquisition**

46. Council Assembly in February 2005 set aside £21m of capital receipts for the purchase of the Old Kent Road (OKRA) site for the waste PFI project. Since the Mayor announced his proposals for the London Single Waste Authority (LSWA), officers have been involved in discussions with the Mayor's office and Government officials with a view to gaining assurances for the Council's investment proposals – these are considered in a separate report on the agenda for this meeting.

47. Although talks with Government officials and the Mayor's office have been open and positive, officers have not been able to secure the level of assurances, both legal and financial, that would offer certainty of security over the Council's investment proposals. Officers have concluded that it would not be in the interests of the council to proceed with the acquisition of the OKRA site through the use of capital receipts. This because there is no assurance that the council would be reimbursed/compensated for this investment should the Mayor's proposals succeed and the OKRA site transfer to the Mayor. Government officials have indicated that there is no precedent for such compensation.

48. However, officers have further concluded that abandoning the PFI project is not a viable option, as this would expose the council to LATS penalties and failure to achieve recycling targets that could lead to intervention by the Government or the Mayor. Both Government officials and the Mayor's office have made it clear that they want the council to proceed with the PFI project and investment. After consideration of options on the way forward, officers have concluded that the option that minimises the financial risk to the council is to proceed with the acquisition of the OKRA site through prudential borrowing.

49. DEFRA have acknowledged that the council will have increased revenue costs through prudential borrowing and have therefore indicated that they are willing to increase the award of PFI credits from £34.5m to £40m, the maximum they can award without reference back to the government's project review group for PFI schemes. The extra PFI credits equates to approximately £328,000 per annum. over the life of the project. In addition, Government officials have given some assurance that if the OKRA site were to transfer to the Mayor that the government would take into account "issues relating to the management, transfer, support and servicing of debt".

50. Government officials have acknowledged there is precedent for assistance in debt transfer and though they could not commit to the exact measures that might be used, they would look at providing the council with an income stream, possibly through the precept mechanism. However such support would not be available until the LSWA came into being, which is unlikely to be before 2008/9 at the earliest. The council would therefore be exposed to the full revenue costs of prudential borrowing until the LSWA came into being.

51. Subject to the current phasing of the purchase of the OKRA site, indicated through negotiations with the owners, it is expected that the revenue costs of servicing the prudential borrowing in 2006/7 will not exceed £1m. The Executive is reminded that the Council has a base budget provision for prudential borrowing for invest to save initiatives of £1m that is not committed and is therefore available to meet the revenue costs of borrowing in 2006/7. The Executive is therefore now advised to recommend to Council Assembly that the £1m prudential borrowing provision be now earmarked for this acquisition.

52. The full year revenue costs of prudential borrowing are estimated to be £3.2m, some £2.2m over existing budgetary provision. In order to bridge the revenue budget shortfall, it is recommended that the capital receipts earmarked for the purchase of the OKRA site, are set aside so that the interest earned can be used to reduce the revenue costs. Full year interest

earnings on capital receipts at current market rates are estimated at approximately £1m. The Director of Finance will seek to fund the balance of revenue required to support prudential borrowing through the judicious management of the council's cashflow and treasury management strategy. The set aside capital receipt would be available to redeem the debt should the LWSA come into being. The acquisition of the OKRA site will enable the disposal of the Manor Place depot and Mandela Way sites and the inclusion of the capital receipts in the council's capital programme.

**Housing Revenue Account**

53. Early indications suggested a potential loss in subsidy of up to £11m, mainly due to reductions in management and maintenance allowances. Following intense lobbying, the Government has amended its methodology for calculating the allowances, reducing this loss to £5.1m year-on-year. This reduction forms part of an overall £14m budget gap on the HRA in 2006/07, the other main contributory factors are inflation, additional contractual repairs and maintenance costs. This deficit is being met by a combination of increased rents and charges (£9.9m) and savings (£4.1m).

## CONSULTATION

54. The Council will consult with relevant stakeholders. It is suggested at this stage that the Council consults on the basis of what is contained within this report.

## COMMUNITY IMPACT STATEMENT

55. This report outlines budget proposals for Council services following the provisional local government settlement and with Council Tax increases at 0%, 2.5% and 5%. As no decisions have yet been taken as a result of the issues arising from this report, there is no direct community impact at this stage. However, it is recognised that in drawing up proposals that the impact on the community of any potential change in service design, outcomes or access will be need to be addressed in future Executive reports that follow on from the budget decision.

## LEGAL IMPLICATIONS

56. The statutory requirement to calculate and agree the Council's annual budget of the Local Authority is derived from section 32 of the Local Government Finance Act 1992("the 1992 Act"). Section 65 of the 1992 Act imposes a duty on the Council to consult with representatives of the business ratepayers in the Borough before making the calculation required under section32 of the 1992 Act.

57. It is provided under section 67 of the Act that final decisions on the budget and council tax level for 2006/2007 must be made by the Council Assembly and cannot be delegated to the Executive or to a Committee. This provision is reflected in the Council's Constitution Article 4.

58. When Council Assembly makes the final decision on council tax it must have regard to the views expressed during the consultation referred to in paragraph 54 above.

**BACKGROUND DOCUMENTS**

| Background Papers | Held At | Contact |
|---|---|---|
| Policy and Resourcing Strategy and budget working papers | Town Hall | Cathy Doran, extension 54396<br><br>Stephen Gaskell, extension 57293 |

**APPENDIX A**

**Audit Trail**

| | | |
|---|---|---|
| **Lead Officer** | Duncan Whitfield, Finance Director | |
| **Report Author** | Simon Hughes, Assistant Director of Finance<br>Cathy Doran, FMS<br>Stephen Gaskell, Corporate Planning and Performance | |
| **Version** | Final | |
| **Dated** | *23-01-06* | |
| **Key Decision?** | Final agreement of budget and Council Tax is a key decision | |
| **CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / EXECUTIVE MEMBER** | | |
| **Officer Title** | **Comments Sought** | **Comments included** |
| Borough Solicitor & Secretary | Yes | Yes |
| Director of Finance | Yes | Yes |
| **Date final report sent to Constitutional Support Services** | | 23-01-06 |