

THREE YEAR REVENUE AND CAPITAL SETTLEMENTS**1. INTRODUCTION**

- 1.1 The Office of the Deputy Prime Minister recently published a consultation paper as part of their creating sustainable communities' programme that makes a number of proposals around the introduction of longer term revenue and capital funding mechanisms.
- 1.2 As part of this consultation paper the Government poses a number of specific questions upon which they are seeking comments from local authorities. A suggested response is included as an Appendix to this report and the most important issues are dealt with in more depth within the body of the report.
- 1.3 The closing date for making a response is the 11 March.

2. BACKGROUND

- 2.1 The vast majority of the Government's financial support of local government service delivery is allocated on an annual basis. This includes revenue support from both Revenue Support Grant and the contribution from the National Non Domestic Rating Pool, specific revenue grants such as Planning delivery Grant and direct and indirect support for capital expenditure.
- 2.2 Local authorities have long argued that the annualisation and uncertainty of the current grant mechanisms reduce the ability of local authorities to undertake meaningful medium term financial planning. Therefore any process that reduces this uncertainty must be seen as a positive step. There are however a number of issues and concerns on the contents of the consultation paper that are highlighted in this report.
- 2.3 The Government introduced three-year Spending Reviews in 1998 which identified the spending plans of the Government Departments to bring a degree of clarity to the medium term financial planning of those Departments. The Government now wishes to extend the three-year financial process to local government, police authorities and fire authorities with effect from 1 April 2006.
- 2.4 According to the consultation paper (a copy of which is available in the Member's Lounge) this will offer greater certainty and stability in funding, increase the planning horizon, strengthen financial management and support efficient use of resources at the local level. The Government believes that this will enable local authorities to publish indicative budgets and associated tax rates for this period. This is intended to bring increased transparency and accountability at a local level.

3. THE GOVERNMENT'S PROPOSALS

3.1 The Government are proposing to introduce three-year allocations that will be aligned to the Government's biennial Spending Review. This is announced in the July prior to the first year of the three-year period covered by the Review. The Government propose that year 1 will simply reflect the allocations established in the preceding review with the changes coming into effect in year 2 which will then be fixed for the following three years. These allocations will reflect changes to the basis on which the grant was distributed and to take account of the latest base data.

4. FUNCTION CHANGES

4.1 The Government proposals suggest that changes to functions will only occur as part of the Spending Reviews. Should any changes be necessary between reviews these will be matched by additional specific grants. This proposal should bring greater clarity and accountability as function changes are often the most significant impact on year on year resources. At present new responsibilities are in theory funded by an increase in the grant settlement. This is very difficult to prove and rarely reflects the true cost of providing that additional service. If changes to functions were dealt with by way of specific grant it would clearly demonstrate the level of funding that has been provided for that function and the costs associated with it.

5. THREE-YEAR BUDGETS AND REVENUE RESERVES

5.1 The consultation paper includes proposals for local authorities to produce three-year budget and council tax figures that initially would be on a voluntary basis. However it is also suggested that primary legislation could be enacted that would make this a statutory requirement. This requirement could also be required of parish and other levying bodies.

5.2 It is suggested that local authorities would only be able to alter their three-year projections for "unforeseen circumstances".

5.3 Although this Council does produce a medium term financial model that includes the projected level of council tax at that spending level this is purely for illustrative purposes. Should the aforementioned approach be adopted the Council would have to have a significantly more robust approach to longer term adjustments to service levels and their funding.

5.4 Such an approach would restrict the ability of local authorities to deal with new initiatives and evolving priorities. It would also be a significant and unreasonable restriction if there was a change in political control during that three year period.

5.5 If this approach was to be adopted the input costs of the Council would also need to have more stability than they do at present including pay awards, national insurance costs, VAT and NNDR for example.

6. THE GRANT SYSTEM

- 6.1 The Government is considering replacing the existing Formula Spending Share with a more simple system that could include a basic floor increase in grant for all authorities but with a variable top-up to reflect individual local authorities service costs. This latter part of the grant mechanism would still be formula based and would include an element of resource equalisation. Other potential alternatives are suggested including a much simpler formula using just three or four indicators.
- 6.2 A new formula system was introduced in April 2003 following a detailed review resulting in significant gainers and losers as there always will be in any change. This has resulted in this Council being on the 'floor' for the last three settlements. Most council's want more stability and certainty but any formula changes will result in further instability and uncertainty.
- 6.3 The consultation paper gives no indication of what the detailed changes would be or what issue the changes seek to address. There is little time to implement any of the changes which could result in poor decision making and therefore it is recommended that any potential changes to the grant distribution mechanism be deferred until a robust consultation process can be undertaken with all stakeholders.
- 6.4 Any proposal that simplifies the process is to be welcomed but simplicity comes at the expense of making provision for individual factors. It is difficult to perceive that a system could be devised that will be supported by all local authorities.
- 6.5 As a Council that has seen reduced funding since the new grant mechanism was introduced in 2003 a system that allows more resource for the funding of basic services should be supported. By implication this will reduce the amount with the formula that is allocated to take account of factors such as deprivation.

7. CAPITAL ALLOCATIONS

- 7.1 The consultation paper proposes a three-year capital allocation process which will be bid-based. This would produce the allocations that would then feed into the grant settlement. It is further suggested that emergencies would continue to be funded by way of capital grant rather than borrowing approvals.
- 7.2 Introducing three-year allocations will align the revenue and capital processes and create greater certainty and should therefore be welcomed. However as this Council has been on the grant floor any additional borrowing allocations have not resulted in the Government's financial support for these capital projects actually being received in cash. In light of the Council's significant coastal capital programme this is a serious issue. A move to capital grant funding of all schemes would therefore be welcomed.

8. TIMING

- 8.1 The Government is intending to introduce the new regime from the 2006/07 financial year. In light of a number of other changes that will affect the funding of local authorities there is potential for these proposals to make the implementation difficult and to reduce clarity and accountability during this period. It is suggested that the proposed changes should be deferred until after:

- ✓ The council tax revaluation has been implemented
- ✓ The 2006/07 FSS freeze changes have been adjusted
- ✓ The 2006 Spending Review has taken place
- ✓ The results of the Lyons Inquiry have been published

9. CRIME AND DISORDER IMPLICATIONS

9.1 None arising directly from this report.

10. ENVIRONMENTAL IMPLICATIONS

10.1 None arising directly from this report.

11. PORTFOLIO HOLDERS COMMENTS

To follow.

12. RECOMMENDATION

12.1 It is recommended that;

- a. **Members support the principle of three year revenue and capital settlements and;**
- b. **Agree the draft response, as contained within the Appendix to this report as the Council's submission to the Governments consultation paper on 'Three-year Revenue and Capital Settlements'.**

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Background Papers:

Consultation Paper
ODPM
Three-year Revenue and Capital Settlements

APPENDIX

Question	Response
Formula grant settlement	
<p>1. Views are invited on the future shape of the formula grant system for three-year settlements.</p>	<p>This Council supports a simplified distribution formula. This should include a minimum fixed increase for all authorities – an integral part of the Shire Districts argument when redesigning the EPCS was that there should be a fixed element in the grant for the cost of being in business. This argument was accepted and added into the formula calculation. However, this element should be much more than the current £300k and Districts should be treated equivalent to other tiers of Local Government.</p> <p>The problem however will again be how to calculate the proposed two variable amounts. There are inevitably winners and losers in the current and future systems. The current system provides year on year winners and losers with many in the middle with wide fluctuations depending upon the level and funding of the floor. This needs to be changed as it will only get worse when the new revaluation figures start in 2007/08.</p> <p>This Council is concerned over the impact that the proposed timing of the proposals will have on other local government finance issues that are currently being considered – such as council tax revaluation, the unfreezing of the last Spending Review and the latest Review and the outcome of the Lyons Inquiry. It is therefore suggested that the implementation of the proposed changes be deferred until April 2007.</p> <p>This Council believes that the two funding streams of revenue grant support should be amalgamated.</p>
<p>2. Views are invited on when changes in the grant formulae, data and funding totals should be allowed to happen.</p>	<p>The proposals are acceptable.</p>
<p>3. Views are sought on when, how and how far to update the data used in the formulae.</p>	<p>With a three year settlement the only fair way is to use agreed forward looking data which is almost certainly already available. There is however still too many individual items of data used in the EPCS formula that is in effect negated by the floors (and scaling factor). The main problem will be service growth areas, particularly those imposed by Government legislation.</p>

<p>4. Views are invited on the Government's preference for not as a rule making retrospective amendments to the formula grant settlement and on whether floors should be set at higher levels in change years.</p>	<p>A lot of time and effort is spent on re-calculating retrospective amendments which often are negated by the floor. For Districts the amounts are usually so small as to be not worth it. It should be possible to rectify any major discrepancy by adjusting the following years' grant rather than re-opening previous years (see also question 3).</p>
<p>Specific Revenue Grants</p>	
<p>5. Views are invited on:</p> <ul style="list-style-type: none"> • Whether there are ways in which the categories of grants identified for exclusion from three-year settlements could be better incorporated into a three-year framework; and • Whether the types of grants identified are indeed those where allocation on a three-year basis would be most difficult. 	<p>It is agreed that three year settlements should be applied as well to specific grants.</p> <p>For expenditure-based grants it does not really matter as long as the percentage re-imburement is known, as it is easy for Councils to forecast their expenditure in most cases. It would also be beneficial if bid based grants could be agreed for the duration of the project. If criteria are not met there could be a clawback at the end of the project.</p> <p>Performance based grants should certainly have a three year future. A good example is the Planning Delivery Grant where many Districts have struggled to know what to include in budgets from year to year. There have also been a number of smaller grants from other government departments over the past few years egg Waste, Community policies, Drugs, etc. and these all need to be included. It is suggested a review of all these grants, how they are announced and allocated, and how long they will be provided, is carried out by ODPM before it makes a firm decision on how to include them in three year settlements. This in itself would give authorities more certainty when preparing budgets.</p>
<p>6. Views are invited on the Government's proposals for increasing predictability of annual grants.</p>	<p>This is a welcome approach.</p>

Capital Allocations	
7. Views are invited on the Government's proposals for treating bid-based programmes and performance rewards.	<p>The proposal for 3-year bidding rounds would be beneficial from a capital planning, point of view and provide a much firmer timetable for the completion of schemes. Coastal authorities would particularly welcome this approach when planning coast protection works.</p> <p>This Council also believes that the Government should fund all capital schemes by way of capital grants thereby removing it from the revenue grant mechanism.</p>
8. Views are invited on the approved handling of funding for emergencies.	A sensible approach.
9. Views are invited on the options for defining major projects.	Capital programmes vary tremendously depending on amounts of capital receipts, successful bids for grants, etc. A percentage threshold, however, is the preferred choice, but probably linked to the cost per head of population. If the Government moved to capital grant funding for all schemes this issue would become irrelevant.
10. Views are invited on whether the benefits of three-year allocations would outweigh the advantages of the current arrangements for small bid-based programmes.	Similar to question 8 and so the current arrangements seem sensible.
11. Views are invited on whether a move to capital grants for emergencies or large one-off projects would be helpful.	Capital grants are much the preferred alternative method; otherwise there is often an adverse impact on Councils' revenue budgets for those at the floor where Revenue Support Grant is clawed back.
12. Views are invited on what more might be done to provide three-year certainty for the Private Finance Initiative.	There is no comment on PFI.

<p>13. Views are invited on the proposed general approach to providing greater stability and certainty through the publication of forward indications of budget levels and council tax.</p>	<p>This Council already produces three year forecasts of budgets and Council Tax, albeit provisional forecasts. However if there was a change of political control at either a national or local level this should restrict local authorities from changing their priorities and from raising resources commensurate with those priorities. The public in general do not respond to Council Tax consultations but they do make decisions at the ballot box.</p> <p>It is not possible to fix budgets three years ahead unless the cost of increase in the salary bill and other costs such as VAT and business rates are also known. These are a very large part of overall budgets. It would also need a change in the legislation relating to tax bases and collection funds, which can also have an impact on the level of Council Tax.</p>
<p>14. Should there be legislation requiring parish councils and levying bodies to publish forward projections of budgets and in the case of parishes corresponding figures for contributions to council tax and mirror three-year settlements?</p> <p>15. Views are invited on how a legislative basis for requiring forward projections of budgets and corresponding figures for contributions to council tax to mirror three-year settlements might best be achieved.</p>	<p>It would seem sensible to urge Parish Councils and levying bodies to comply – through legislation if necessary.</p> <p>It is a legal requirement really necessary and what would be the penalty if complete changes to the projections had to be made? There are many circumstances that could occur in a three-year period which would result in alterations to the budget/Council Tax, e.g. inflation, interest rate changes, emergencies, changes in politics, changes in services, etc. How will this improve accountability and fit with the Government's Localism agenda.</p>
<p>16. Views are invited on the options for, and practicality of, a voluntary arrangement to the same effect.</p>	<p>A rolling 3-year programme is good practice and so guidance from CIPFA might be appropriate, especially if incorporated in a Code of Practice.</p>
<p>17. Views are sought on:</p> <ul style="list-style-type: none"> • What types of circumstance might merit alteration to three-year budget plans and council tax forecasts, consistent with the aims of transparency and stability underpinning 	<p>See the answer to question 15.</p>

<p>three-year settlements; and</p> <ul style="list-style-type: none"> • What controls could be put in place to ensure that alterations are only made in these circumstances, on either a statutory or a voluntary basis. 	<p>See the answer to question 16.</p>
<p>Context for Implementation</p>	
<p>18. Once initial Local Area Agreements are in place, they could in principle be aligned with the cycle of three-year settlements.</p> <p>Views are invited on the merits of such an approach and its practicability.</p>	<p>At present these do not affect District Councils except if in partnership with County Councils it is therefore difficult to assess the impact on district councils at this stage.</p>
<p>19. Views are invited on how best to move to a three-year settlement for HRA subsidy consistent with the principles in paragraph 1.12</p>	<p>There is concern over moving to a three year settlement for housing subsidy as movements in capital financing costs will as bi-product fall upon the General Fund (either positive or negative).</p>