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CABINET - 3 JULY 2006 **PORTFOLIO: POLICY & RESOURCES**

FINANCIAL STRATEGY 2006/2010

1. INTRODUCTION

1.1 The purpose of the Financial Strategy is to set out the broad financial framework that the Council will operate over the forthcoming four financial years. It is reviewed on a rolling basis. By adopting a medium term approach the Council will be able to ensure that it does not adopt short term policies without identifying what the medium term implications of those decisions are.

1.2 A four year period has been adopted as the relevant timeframe for the Strategy as this permits reasonably robust financial forecasts to be produced. The longer the timeframe the more speculative the forecasts become.

1.3 Cabinet are asked to consider the Financial Strategy, in the first instance, however formal approval is not an executive function. Therefore the recommendations of the Cabinet will be considered by Council before the Strategy is finalised.

1.4 The Financial Strategy covers the General Fund activities (revenue and capital) but does not cover the Housing Revenue Account as this is covered by a separate Business Plan that will be issued at a later date. .

1.5 As this Strategy will commence shortly before the local elections next year it is important that the document gives some clear intentions of the Administration (in financial terms) for the period of the new Administration.

1.6 The Council will need to continue to identify efficiency gains in order to create capacity to maintain frontline service delivery. This is dealt with in more detail later in this report.

2. USE OF RESOURCES

2.1 The Use of Resources (UOR) is a key element of the Comprehensive Performance Assessment. As Members are aware the Council have received the outcome of their first formal assessment and achieved a score of 3 out of 4 for all five categories of the process. A score only surpassed by 7 district councils nationally, who achieved one score of 4 in the five categories.

2.2 This an excellent indictment of the Council's approach to financial management and officers will be seeking to build on this position. Whilst a number of improvements can be put in place without a significant impact on resources these are unlikely to move the Council's assessment to a level 4. Other initiatives that could change the categorisation will come at a cost. Officers will therefore consult the Cabinet in the near future on whether this is a cost that they wish to incur.

3. EFFICIENCY/PROCUREMENT

3.1 The drive to improve efficiency within the public sector continues unabated. Some of the Governments assumptions and starting positions are challengeable however the issue is, quite rightly, not going away. The Council must use this momentum to maximise the benefit to the District and the community that it serves.

3.2 2007/08 will be the last year of the current three year programme of efficiency targets set by the Government. It is likely that the Council will exceed the £2m target that was set but this is far from the end of the matter, and, in many ways it is only the start.

3.3 Delivering efficient services has always been important to the Council. Efficiency savings have enabled the Council to redirect resources into new initiatives and service enhancements. To a large extent this has been covertly delivered through the budgeting process. The time is now right to take the efficiency agenda to a new level. A draft Efficiency and Improvement Strategy is being produced which should provide a clear framework that will bring synergy to a number of the efficiency drivers.

3.4 If the Council is to adopt a more overt approach to the delivery of efficiencies, and in light of the need to create capacity to fund priorities evolving from the new corporate plan, it would be appropriate to build an efficiency target into the financial forecasts. Creating a target is easy but in order to ensure that those efficiencies are then delivered will require management at both officer and member level. This will be covered in the Strategy.

3.5 The Council should be setting a target that is challenging yet achievable. In some years this may be difficult and in others years the target may be well exceeded. Setting a target of around 2% of the net General Fund Revenue Budget would seem appropriate and would create an efficiency target of £400k.

3.6 In addition to efficiency savings the Council may need to use other mechanisms for creating financial capacity including:-

- Using the performance management framework to identify high-cost services or where performance is not in line with corporate expectations (be that high or low). This information could then be used to inform the fundamental service review programme with a particular focus on achieving financial savings in the cost of service delivery.

- Alternative service delivery options are a method, where appropriate, of deriving efficiency gains.

- Zero based budgeting is an approach which adopts a more critical budgeting assessment rather than the normal incremental approach. Clear expectations of the service need to be compiled from the outset and the level of resources required to achieve these outcomes is then determined from a zero base. This approach does not always lead to savings because the service expectations are often beyond what is currently being delivered.

4. LINKING RESOURCES WITH CORPORATE PRIORITIES

4.1 There will be a number of drivers that will influence the Councils priorities over the duration of this Financial Strategy. The largest of which will be the review of the Corporate Plan which will cover the period of the new Administration following next Mays local election. In addition there will undoubtedly be external influences on the Councils priorities including legislative changes and Local Area Agreements.

4.2 If the Council wishes to develop and invest in certain services it can only do so by;

- Creating capacity through additional efficiencies
- Increasing the Council Tax
- Raising additional revenue through charging
- Or redirecting resources from lower priority services

Or what is more likely is a combination of the above.

4.3 At this moment in time the Council has four key priorities which are:-

- Clean Streets and Public Spaces
- Crime and Disorder and Community Safety
- Housing
- Managing our Finances

4.4 Local Area Agreements (LAA's) are gathering momentum and could have a significant impact on the Council's resources in the coming years. LAA's essentially pool resources on a more area basis (in our case County level) and are held for distribution against agreed area priorities and outcomes. It is possible that the New Forest area could actually see additional resources if it is deemed a priority area for that pooled resource. Most of the existing proposals will have little impact on the Council with the possible exception of Waste Performance and Efficiency Grant. Work continues on the issue of LAA's and Members will be kept up to date as the detailed implications for this Council emerge.

5. 2005/06 REVENUE OUTTURN

5.1 The General Fund Revenue Outturn Statement for the financial year ending 30 March 2006 is elsewhere on this Agenda. Whilst the level of the under spend is significant it must be taken in context of the Council's gross General Fund expenditure of around £80m.

5.2 In addition it does of course provide additional resources for the funding of the capital programme. This will give the Council some flexibility when determining the level of revenue contribution to capital outlay when it considers the detailed budget later this year.

5.3 Many of the items that have contributed towards this under spend were difficult to predict and by nature 'one-off's'. However every effort will be made to build on-going savings from these issues if there is an opportunity to do so.

6. FINANCIAL MONITORING

6.1 It is proposed to change the emphasis of the in-year financial monitoring in order to improve the information that members currently receive and provide more focus. Currently the monitoring report focuses on spending forecasts identified by officers from all services. In addition very high level monitoring against profiled budget is also included but this receives very little attention.

6.2 It is intended to continue with the forecast adjustments to the budget but to add greater focus to the monitoring against profiled budget. Some exceptional reporting will be undertaken that highlight the material variations throughout the year. This should hopefully avoid significant variations between the last monitoring that members receive early in the calendar year and the final outturn statement.

7. GENERAL FUND BALANCE

7.1 The current policy in respect of the level of the General Fund balance is that the Balance should not fall below 10% of net General Fund Expenditure or £2m whichever is the lower

7.2 Last year a risk assessment was undertaken to ascertain whether the current policy provides the necessary safeguard that the Council needs. This
assessment is attached as Appendix B and demonstrated that £2m was adequate level in light of the Council's potential risk exposure. This assessment will be updated as part of the forthcoming budgetary process. As the Council's financial exposure to risks remains largely unaltered it is recommended that the policy remain as a minimum level £2m..

8. RISK MANAGEMENT

8.1 A risk assessment has been undertaken on the level of General Fund Balance (see above) and a Section 25 statement has been completed to assess the potential risks associated with delivering the 2006/07 budgets. This statement is
attached as Appendix C to this report.

8.2 Elsewhere on this agenda is a report on the financial outturn for 2005/06. The level of the under spend provides an opportunity for the Council to reconsider how it finances some of the risks that it currently transfers to a third party. The establishment of an Insurance Reserve will enable the Council to better manage its own risks. A more detailed paper on this subject will be considered by the Cabinet in the near future.

9. ECONOMIC FORECAST

9.1 Although the Councils resources are affected by general inflation there are specific areas of inflation that have particular impact on the input cost of the authority such as:-

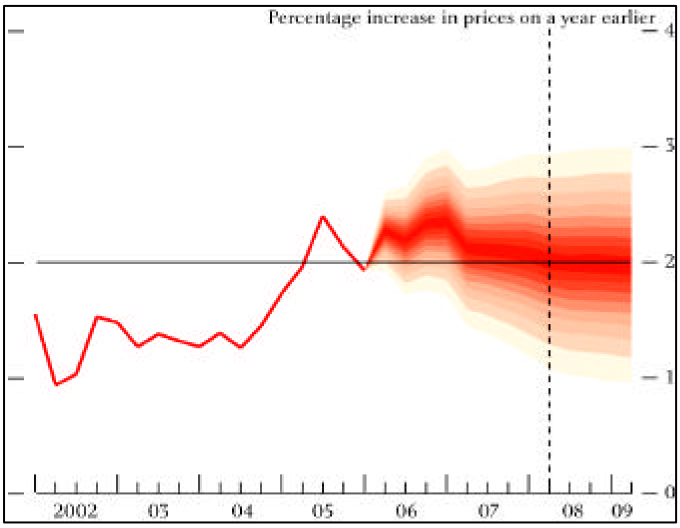
- Employee related costs
- Income generation
- Fuel and energy costs
- Construction costs
- Interest Rates
- General economy (impact on)

Some of the above issues are considered in more detail

9.2 General Inflation

9.2.1 The following graph shows the forecast for CPI inflation to 31 December 2007.Beyond that date it is not forecast presently. In light of the latest inflation data that saw an increase in the general rate of inflation rise to 2.2% the Government is likely to adjust their projections from the current 2% target or take steps to suppress inflationary pressures by increasing borrowing rates or tax changes.

Inflation Projections (based on market rate expectations)



9.3 Employee Related Costs

9.3.1 The current national pay agreement comes to an end in March of next year and therefore negotiations will commence shortly with a hope that these can be settled before the start of the next financial year.

9.3.2 Although the Council has a local agreement on pay there is a default clause that both parties will settle on what is agreed within the national settlement if agreement can not be reached at a local level. This default clause has been used for a number of years.

9.3.3 Meetings with senior officers from Government Departments have indicated that the Government is concerned with the increase in the public sector pay bill, even after having allowed for increase teaching staff and superannuation costs. It is likely therefore that the forthcoming pay negotiations will be difficult and protracted.

9.3.4 Members may be aware that every 1% pay increase in the pay bill has approximately a £200k impact on the General Fund Revenue Budget.

9.4 Income Generation

9.4.1 The Council sets fees and charges against the backcloth of the Charging Strategy. This requires services to maximise the level of income generated unless there are corporate reasons why this is not the case.

9.4.2 The income projections have been based on challenging targets and recently some of those have had to be reviewed following changes to usage patterns. Service areas where achieving the projected target may be difficult are, Health and Leisure Centres, On-street parking, and Land Charges.

9.4.3 In addition it is likely that the Government will create a national charge for the copying of planning application details. At present the Council charges a fee that takes into account the total cost of the production i.e. inclusive of a labour charge. It is likely that this will change to a very notional charge that will only include direct copying costs without a labour element. This will effectively make the service free as collection costs would outweigh the income generated.

9.4.4 Members may be aware that the Customs and Excise are currently locked in a legal case over the VAT treatment of local authority car parking income. An appeal by Customs has been lost and therefore the treatment of that income will change during the life of this Strategy. To date no adjustment has been made to the budget and accounts of the Council but the Council's case has been lodged with the Customs and Excise.

9.5 Fuel and Energy Costs

9.5.1 Additional resources have already been built into the base budget to take account of recent increases to both fuel and energy costs. Spiralling fuel costs are a pressure that has a disproportionate cost on waste collection against other local authority service delivery costs. During the last 3 years the cost of diesel has increased by 35%.

9.5.2 Similarly the energy costs required to run 5 Health and Leisure Centres is significant. The Council has an energy efficiency programme but this has come under pressure in recent years due to wider financial constraints where the pay back period for some initiatives takes it beyond the normal 5 years.

9.6 Interest Rates

9.6.1 The Council is currently debt free and receives investment income on its internally managed cash fund portfolio. The base rate has remained unchanged for some time and therefore the only variation to total investment income derives from changes to the level of cash that it holds. Due to slippages in the capital programme the total amount of investment income exceeded the budget last year. It is hoped that the new project management arrangements that have been put in place will assist the delivery of the capital programme and therefore this will not be an issue in the future.

9.6.2 With recent increases in inflation and property valuations the Governor of the Bank of England has stated that house prices and share prices are over valued. It is therefore highly likely that there will be an increase in the base rate in the very near future. Although this helps the Council's finances in the short term there is a need to borrow in the medium term as the Council continues to use cash reserves. As that borrowing could be on a long term basis (depending on the market position at that time) doing so at the bottom of the interest rate cycle is very important.

Interest Rate Forecasts

	End Period	BASE RATE	LIBOR			GILT YIELDS			
			3 mth	6 mth	12 mth	5-yr	10-yr	20-yr	50-yr
2005	Mar	4.75	4.9	5.0	5.1	4.7	4.7	4.7	n/a
	Jun	4.75	4.8	4.7	4.7	4.1	4.2	4.3	n/a
	Sep	4.50	4.6	4.6	4.4	4.2	4.3	4.3	n/a
	Dec	4.50	4.6	4.6	4.6	4.2	4.1	4.1	3.9
2006	Mar	4.50	4.6	4.6	4.7	4.4	4.3	4.2	3.9
	Jun	4.50	4.6	4.7	4.9	4.7	4.6	4.4	4.1
	Sep	4.50	4.6	4.7	4.8	4.6	4.6	4.5	4.2
	Dec	4.50	4.6	4.7	5.0	4.6	4.6	4.5	4.2
2007	Mar	4.75	4.8	4.9	5.1	4.7	4.6	4.5	4.2
	June	4.75	4.8	4.9	5.1	4.7	4.6	4.5	4.2
	Sep	4.75	4.8	4.9	5.2	4.7	4.6	4.5	4.2
	Dec	4.75	4.8	4.9	5.2	4.7	4.7	4.6	4.2

10. COMPREHENSIVE SPENDING REVIEW

10.1 The Government is moving to a three year Revenue Support Grant settlement process in order to provide local authorities with greater stability to their medium term financial planning. The Government introduced a two year grant settlement for 2005/06 and 2006/07 as a phased approach to this system. Therefore save for any changes to quantum, following potential new responsibilities the Council have already received notification of the 2006/07 Revenue Support Grant
\# Settlement and this is included within the financial projections at Appendix A

10.2 The Government have however introduced a Comprehensive Spending Review (CSR) as a precursor to each three year settlement process. This review will assess each Department's needs against the Government's priorities and likely resources for the period covered by the review.

10.3 In light of the current funding position the CSR07 (to affect the 2008/09 RSG Settlement) is likely to be very difficult for local government. All Government departments have been asked to undertake a zero based budget with some accepting a straight 5% cut in their current budgets. Efficiencies will play a key part of the Governments CSR07 and this is expected to cascade through to local authorities either as targets through the Annual Efficiency Statement (AES) process, or more likely, directly through the RSG Settlement.

10.4 Due to the uncertainties around this process it is difficult to estimate the level of grant the Council will receive for 2008/09 and beyond. As a result no increase has been made to the grant provision for that period.

10.5 Two potential casualties of this Review could be Benefits Administration Grants and Concessionary Travel. The first because the DWP have already accepted a cash reduction in their administration budget of 2.5% (5% in real terms); and the Department of Transport is considering introducing nationalising (or regionalising) the administration of concessionary travel with the introduction of the national bus pass in 2008.

11. LYONS REVIEW

11.1 The CSR07 process will also be influenced by the Lyons Review which is due to be finalised in the autumn and the report available in December. The report will be making recommendations on the future of local government financing and will undoubtedly suggest ways of improving the gearing impact of the current tax system. Whether this will go as far as relocalising NNDR is doubtful but there may be some other opportunities.

11.2 Members will also be aware that the review that Sir Michael Lyons was originally engaged to deliver upon has been extended to include wider local government structure issues. With changes at a ministerial level any proposed changes are likely to be delayed, and possibly not as far reaching.

12. FORECAST

12.1 Attached as Appendix A to this report is the current forecast of General Fund revenue and capital expenditure. This statement takes into account all bids and savings that have been approved by Members and demonstrates what incidence the savings/growth proposed will have in future years.

13. FINANCIAL STRATEGY

13.1 Having taken into account the aforementioned issues it is recommended that the following Financial Strategy be approved:-

13.2 The Council set a balanced revenue budget.

13.3 That expenditure plan proposals only be considered if:

a) The additional cost is unavoidable
b) There is a very good pay back on the level of investment
c) The investment will significantly help the council achieve one of its key priorities

13.4 All expenditure plan proposals be they revenue or capital need to demonstrate their link to both the service planning process and the corporate plan.

13.5 All proposals must fully evaluate both the short and long term costs associated with the proposal in order that the whole life cost of the scheme can be assessed.

13.6 All proposals must include a risk assessment of both progressing with the project and of not doing so.

13.7 The Efficiency Strategy be used to strengthen the existing work programme in order to deliver the minimum targets that have been included within the financial forecast and that the performance management framework be used to inform this process.

13.8 The Council seeks to set a council tax increase in line with the Retail Price Index each year excluding the provision for service development proposals.

13.9 An affordable and deliverable capital programme be developed that delivers corporate priorities or an invest to save scheme that will reduce on-going revenue expenditure and the level of Revenue Contributions to Capital Outlay be reviewed in light of this programme.

13.10 The corporate charging policy to continue to be used as the framework for determining charging levels.

13.11 The General Fund Balance to be a minimum of £2m and be reviewed annually through a formal risk assessment process.

13.12 Any revenue under-spends at the year-end to be allocated to the Capital Reserve other than for specific provisions that assist the Council to achieve corporate objectives which will be approved by Council..

14. EMPLOYEE SIDE COMMENTS

14.1 Employee Side comments to follow:-

15. RECOMMENDATIONS

15.1 It is recommended that the Financial Strategy as set out in paragraph 13 of this report be approved.

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Background information

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APPENDIX A

NEW FOREST DISTRICT COUNCIL
DRAFT GENERAL FUND FORECAST 2007/08 TO 2010/11

	16/06/2006	2006/07 £000	2007/08 £000	2008/09 £000	2009/10 £000	2010/11 £000
Net Portfolio Requirements		21003	21003	21711	22037	22375
Est. Inflation (salary related)		0	620	640	660	680
Other Inflation		0	190	200	200	210
	Sub Total (A)	21003	21813	22551	22897	23265
Capital Financing Provision			0			
	Sub Total (B)	21003	21813	22551	22897	23265
Less Interest on Balances(net)			90	60	50	50
	Sub Total (C)	**21003**	**21903**	**22611**	**22947**	**23315**
Transfer From MRP/Reg157						
Budget Requirements	**Total (D)**	**21003**	**21903**	**22611**	**22947**	**23315**
Add Expenditure Plan Bids						
	Finance & Support	0	249	42	-14	0
	Crime & Disorder	0	25	-2	8	0
	Economy & Planning	0	220	-85	-156	0
	Environment	0	124	-34	0	0
	Health & Social Inclusion	0	0	0	0	0
	Housing	0	51	-49	1	0
	Leisure	0	5	25	0	0
	General Purposes & Licensing Committee	0	0	0	0	0
	Planning Development Control Committee	0	0	0	0	0
	Standards Committee	0	0	0	0	0
	Sub Total Bids	**0**	**674**	**-103**	**-161**	**0**
Deduct Expenditure Plan Savings						
	Finance & Support	0	-338	0	9	0
	Crime & Disorder	0	0	0	0	0
	Economy & Planning	0	-66	-13	-17	0
	Environment	0	-94	154	0	0
	Health & Social Inclusion	0	0	0	0	0
	Housing	0	-5	0	0	0
	Leisure	0	-106	-22	-3	0
	General Purposes & Licensing Committee	0	-7	-10	0	0
	Planning Development Control Committee	0	0	0	0	0
	Standards Committee	0	0	0	0	0
	Sub Total Savings	**0**	**-615**	**109**	**-11**	**0**
Forecast Budget Requirements	**Total (E)**	**21003**	**21961**	**22617**	**22775**	**23315**
	Efficiency Target		-400	-400	-400	-400
	Further Savings/Growth		150	-180	0	-190
	Budget Required after Reserve Transfer	**21003**	**21711**	**22037**	**22375**	**22725**
	FINANCED					
	Collection Fund /RSG/ NDR	**10978**	**11362**	**11362**	**11362**	**11362**
	Council Tax	**10025**	**10349**	**10675**	**11013**	**11363**
		21003	**21711**	**22037**	**22375**	**22725**
	Council Tax	**140.99**	**145.27**	**149.56**	**154.00**	**158.60**
	Council Tax Increase		3.04	2.95	2.97	2.98

APPENDIX B

RISK ASSESSMENT OF GENERAL FUND BALANCE – 2005/06

Area of Risk	**Value of Activity £**	**% Error or Likelihood of Event**	**£000 Reserve**	**Comment**
Inflation				
Salaries and	20,929,700	0.00	0	Due to advance pay award settlement
Wages	5,389,830	5.00	260,491	Maintenance minimised in budget
Premises	3,573,260	3.00	107,198	
Transport	11,567,550	3.00	347,026	Cash limiting in the past – creating
Supplies and	22,000,000	0.50	110,000	pressure
Services				Allow for 10% movement in gross cost
Council Tax and				
housing Benefits				
Income Volatility				
	5,043,240	5.00	252,160	Pressure on Health and Leisure Centres
Fees and				Catering, Land Charges
charges	700,000	5.00	35,000	Sales short on preceding year
Car parking clock				
Interest Rates				
Investment returns	22,000,000	1.00	220,000	20% of £1.1m interest earnings at 5%
Other Budgets				
Vacancy factor	322,036	50.0	161,018	Assumes 1.85% of salary budgets
not achieved			100,000	
General				
Revenue			100,000	
Overspend				
Additional capital				
requirement				
VAT				
Breach of partial exemption limit	208,790	75.00	156,593	Based on 2004/05 activity levels
Emergency Planning				
		10.00	38,910	
Belwin Threshold				

Risk Based Assessment of General Fund Balance for 2005/06 = £1,888,396

Chris Malyon
Director of Resources

8 February 2005

APPENDIX C

STATEMENT ON THE GENERAL FUND BUDGET PROPOSALS BY THE CHIEF FINANCIAL OFFICER

Section 25 of the Local Government Act 2003 imposes a duty on the Chief Financial Officer to report to the budget setting Council on the following matters:-

a. The robustness of the estimates made for the purpose of the calculations (to set the council tax) and;

b. The adequacy of the proposed financial reserves.

Robustness of the estimates

The budget is constructed using numerous estimates that take account of a plethora of different factors and issues some involving quite complex forecasts. By definition the estimates are not facts but are best guesses of expenditure and income some of which will not be expended until 15 months after the budget was first considered by Members.

The key elements of the budget are the provision that is made for inflation on pay and prices, projected levels of income (including investments) achieving the budgeted cost reductions and delivering the service developments within the resources that have been allocated. Particular issues that need to be highlighted are as follows:-

- The Council's budget is constructed in an incremental basis which therefore assumes that the previous year's budget reflected the cost of providing those services. Where this is not the case an expenditure bid/saving is used to adjust the level of resources allocated. This approach is sound especially as the service planning framework requires a more fundamental scrutiny of services on a periodic basis.

- The uncertainty in previous years' over the level of pay award has been removed due to the long term agreement.

- Expenditure plan savings are clearly allocated to individual officers

- The only non service specific saving relates to staffing turnover. Although the level of saving was increased in 2004/05 the target was exceeded for that year and the staffing budget is regularly monitored.

- Although there is no contingency within the budget the level of the General Fund Balance has been subject to a risk assessment and is deemed more than adequate. (Please see comment below).

Adequacy of proposed financial reserves

The Council holds a number of specific reserves for issues such as debt write off.

- The General Fund Balance is used to cover general unforeseen items of expenditure that cannot be funded within the base budget (revenue or capital) in any particular year. If drawn upon the Balance is replenished as part of the following budget process.

- The Council also retains a capital reserve which is used for the funding of the capital programme. It is increased annually by contributions from revenue and by capital receipts. The level of the balance is sufficient to cover the four year capital programme that is included within detailed budget proposals.

- No assumption has been made over future capital receipts that could be generated, save for those generated from sale of council houses. These sales are specifically ear marked for housing purposes and therefore become ring-fenced. The level of the housing capital programme is dependant upon these receipts and therefore could easily be adjusted at any time in the future if these projections do not accurately reflect actual sales.

- There is neither legal definition nor Audit Commission recommendation on the absolute level of reserves that any authority should hold.

- The General Fund Balance has been subject to a risk assessment, which is attached, and Members can clearly see that the current minimum balance approved as part of the Financial Strategy (£2m) could be deemed to be slightly excessive when compared to this risk assessment. However it is not recommended that the Strategy should be amended at this stage.

- Projections of both the General Fund Balance and Capital Reserve are provided for Members and at no time do the above reserves fall into a deficit position.

Chris Malyon
Director of Resources