APPENDIX 1

Medium Term Service and Resource Planning 2009/10 – 2011/12

PROCESS & CORPORATE FINANCIAL CONTEXT

A: Background / Process

In February 2008 Council approved a new Corporate Plan, Medium Term Financial Strategy and Capital strategy which taken together set the overall framework for resource allocation.

In setting the Budget for 2008/09 it was recognised that further work was required in relation to future years' budgets to reflect:

- the 3 year grant settlement
- expected spending pressures, and
- new Corporate Plan priorities.

This has been taken forward by the Strategic Directors Group through a suite of 5 Medium Term Service and Resource plans, which form part of this Appendix. The 5 'block' level medium term service and resource plans provide an important link between the Corporate Plan and annual Service Action Plans. They are strategic documents that identify key changes and enable prioritisation. They use an approach previously employed to do this and referred to as 'Squeeze, Hold, Drive'. Priority areas in the Corporate Plan, for example, may need both a drive in performance and budgets, or perhaps just performance. They are crucial in enabling services to anticipate challenges and plan how to deal with these in advance thereby enabling consideration of a wider range of options than would be available at the time.

An initial financial resource envelope for this planning process was set for a 10 year period commencing 2009/10. The objective was to develop proposals that would meet corporate and service objectives budgets being capable of being balanced over each of the next 3 years, but with regard also being given to the following 7 years.

The first draft of these plans was presented to the Overview and Scrutiny Panels in the Autumn, and is now attached for information. These plans form the basis of the Budget proposal for 2009/10 detailed in Appendix 2 but will need to be updated and finalised to take account of the allocation of additional resources from corporate 'headroom', and other adjustments (e.g. in relation to inflation assumptions) in the proposed budget. The plans are further detailed in a series of Service Action Plans, which were presented in draft form to the Overview and Scrutiny Panels in January 2009. Again, these Service Action Plans will need to be updated in line with the final budget agreed. It is proposed that the final documents be updated and published before the end of March 2009.

The process has been linked to and run in parallel with the review and updating of the Corporate Plan which is elsewhere on this agenda.

B: Corporate Funding Assumptions

Government Grant

The February 2008 budget report set out the expected financial context for the 3 years 2008/09 to 2010/11 based on the Government's Comprehensive Spending Review settlement (CRS07).

The level of government grant continues to be low relative to others – the 6th lowest of the 39 unitary authorities when expressed on a per capita basis.

Bath & NE Somerset Council - Revenue Support Grant

<table>
<tr><th></th><th>2008/09
£m</th><th>2009/10
£m</th><th>2010/11
£m</th></tr>
<tr><td>Revenue Support Grant (RSG)</td><td>4.705</td><td rowspan="2">39.993</td><td rowspan="2">41.559</td></tr>
<tr><td>Redistributed NNDR</td><td>33.796</td></tr>
<tr><td>Total Grant</td><td>38.501</td><td>39.993</td><td>41.559</td></tr>
<tr><td>%age change</td><td>4.7%</td><td>3.9%</td><td>3.9%</td></tr>
<tr><td>Grant lost to damping</td><td>2.027</td><td>2.327</td><td>2.494</td></tr>
</table>

It should also be noted that the rate of increase for 2009/10 and 2010/11 is lower than for 2008/09 which in turn was lower than in previous years, in line with the national settlement. The government expects local authorities to achieve 3% cashable efficiency savings each year, and to the extent that this is achievable this releases resources for re-allocation, in addition to the %s set out above. No figures have yet been set for the years from 2011/12, but in light of the deterioration in the national public finances, it must be assumed that the position from 2011/12 onwards will be tighter still, and an assumption of a grant increase of 2.5% underlies the medium term service and resource plans. Early indications in the Pre-Budget Report are that capital rather than revenue will be more adversely impacted in future years and that Schools and Health will continue to be relatively protected. In the short term the government is encouraging and may support advancing some capital expenditure.

This Council continues to not receive its full grant entitlement as a result of damping rules affecting grant increases. The effect of these rules, although once regarded as transitional, is not diminishing. This resulted in £2 million of grant being withheld in 2008/09, increasing to £2.3m in 2009/10 and £2.5m in 2010/11.

One effect of the damping arrangements is that the Council only receives 30% of the additional revenue funding in respect of **supported borrowing** - i.e. grant to cover the costs of repaying debt and interest on capital expenditure. The 2 main elements of the capital programme that are 'funded' from supported borrowing are £3.0m of the LTP (transport) programme and £2.8m of the schools programme. The revenue effect of this is a loss of £255k and £238k per year respectively, which increases cumulatively. As the damping effect is actually increasing rather than decreasing (due to the low % cash increase in overall grant level relative to the floor) this effect cannot be considered to be transitional.

Council Tax

In February 2008 the Council agreed an increase in Council Tax of 3.95% for 2008/09. It was necessary for officers to make assumptions going forward to inform the resource parameters for the medium term planning process, albeit while leaving flexibility for Cabinet to make recommendations to Council in light of the overall position, each year. The assumptions made are as set out below:

Council Tax assumptions underlying medium term service and resource plans

	2009/10	2010/11	2011/12
% Increase in rate	3.95%	3.95%	3.00%
% increase in tax base	0.15%	0.15%	0.10%
% collection rate	97.75%	97.75%	97.75%

The Secretary of State has again written to local authorities as follows:

"The Government continues to expect the average council tax increase in England to be "substantially below 5% in 2009-10 and we will not hesitate to use our capping powers as necessary to protect council taxpayers from excessive increases, including requiring authorities to rebill if that proves necessary".

In 2008/09 the B&NES rate is just below (by £3) the unitary average council tax.

Each 0.5% variation in the council tax rate represents c£360k, and the effect is cumulative.

In addition there is currently a surplus on the Council Tax Collection Fund, of which the Council's share is 85%. The actual surplus in 2007/08 was £1.576m, turning a cumulative deficit into a cumulative surplus at 31 March 2008 of £978k. The 2008/09 budget assumed a £350k use of that surplus (between all the parties) and so the cumulative surplus at 31 March 2009 will be £628k plus any actual surplus in 2008/09. Clearly there is a need to take a cautious view on council tax collection given economic conditions, and so the Council has assumed a surplus of £1.2m at 31 March 2009, of which the Council's share is £1.016m.

The budget proposal allocates this as funding for 'one-off' priorities, rather than built into the base budget, again reflecting a cautious view of economic conditions going forward.

The tax base for 2009/10 was formally agreed by the s151 officer on 30th December 2008. The increase in the tax base was 0.56% of which the council's share is worth £308k more than the 0.15% previously assumed.

The Cabinet's recommended level of Council Tax for 2009/10 is as set out in Appendix 2 Section 4 and the main report resolutions. Figures for future years have been revised to be consistent with that.

C: Corporate Resource Allocation Assumptions

An initial resource allocation was set by the Strategic Directors Group to reflect the likely level of external funding and to give a basis for considering the options for and implications of budgets which will be capable of being balanced over each of the next 3 years. Regard was also been given to the following 7 years.

Initial resource allocation was by reference to the increases in Formula Spending Shares used in central government grant calculation as follows:

FSS Service Block	2009/10	2010/11	2011/12
Adult Social Services	3.9%	3.7%	3.4%
Children's Social Services	3.5%	3.0%	3.0%
Highways	0.0%	0.0%	0.0%
Other Services	2.7%	2.5%	2.4%
Capital Financing	1.9%	1.4%	1.5%
Education	1.7%	2.0%	1.9%

It should be emphasised that these were *initial* resource allocation parameters. It is then an integral part of the process that the final resource allocation will vary from this, by reference to corporate priorities, and in light of the implications of these parameters for services, making use of any available 'headroom' (unallocated resource). The results are contained in the budget proposal, as set out in Appendix 2, and summarised in tables 1, 3 & 4. The full cash limit analysis is as set out in Annex 1 to Appendix 2.

When the Budget is agreed the draft Medium Term Service and Resource plans and the draft Service Action Plans will need to be adjusted in line with the decisions taken, and it is proposed that this is completed by the end of March 2009 and the final documents then be published.

D: Other Corporate Assumptions

Reserves

Section 4 of Appendix 2 sets out the risk assessed Reserves assumptions in light of the out-turn for 2007/08, the expected out-turn for 2008/09 and review of the risks going forward. Appendix 2 Annex 5 sets out the Chief Financial Officer's Opinion on the Adequacy of Balances and the Robustness of the Budget.

The earlier than anticipated improvements in reserves, principally arising from the VAT refund of £4.8m and reported at the end of 2007/08, together with the expected favourable out-turn in 2008/09, means that the Council is able to fully fund the Exceptional Risk Reserve (setting aside a further £4.134m as part of the budget proposal) and to be at the reserves target at the start of 2009/10. This means that the £1.76m revenue contribution to reserves previously thought to be needed in 2009/10 is available for reallocation.

Pensions

The last actuarial review dated 31 March 2007, required an increase in employer's contribution from 16.4% to 17.5% at a cost of £654k, This was implemented from 1 April 2008 in full.

Since the last actuarial review, world market conditions mean that investment performance has been less than expected, and long term inflation expectations have been higher. An interim actuarial review at 31 March 2008 indicated that, at that time, the increase in contribution rate could be as high as 7% when it is applied reflecting an estimated decrease in the overall funding level of the Avon Pension Fund from 83% at 31 March 2007, to 70% at 31 March 2008. Conditions have deteriorated significantly since then, and even at end of August 2008 the funding level was estimated to have fallen to just 63%. A further interim valuation will be carried out at 31 March 2009 and the next comprehensive triennial valuation is due at 31 March 2010.

The required increase is permitted to be phased in over the 3 years 2011/12 – 2013/14 or can be implemented in full in April 2011. An accurate estimate of the impact cannot be made at this stage but it is clear that the Council needs to consider whether to start setting aside funding as part of the 2009/10 budget to mitigate the future impact and ensure it will be manageable. This could mean, for example, that the increase could be stepped over the next 5 years rather than just 3 years starting 2011/12.

Should the required increased be, for example, 12% then this amounts to an estimated additional annual cost of £7.8m, which would be £1.56m in 5 steps. At a national level, consultation is beginning on a scheme to share liabilities with employees so that for future service (not past deficits) employees may pay more or potentially receive less benefits. This is not expected to impact before 2013/14.

The budget proposal in Appendix 2 includes an additional contribution of £1m per annum in each financial year from 2009/10, recognising that it is prudent to begin to recognise the likely liability now, rather than later. Pensions costs are a real cost of staff now and need to be considered in terms of service costs and related prioritisation of Council resources.

Having set aside additional provision in the budget, a separate decision will be required about whether this should be held in an ear-marked reserve or actually passed over to the Avon Pension Fund as additional pension contribution. At this stage it is considered more appropriate to keep as an earmarked reserve but this position will be kept under review.

The cost of these additional contributions has been covered from 'headroom' in 2009/10 but represents an additional pressure which services will need to fund in future years, but which was not taken account of in the first draft of medium term service and resource plans, and hence is the main reason why there are currently 'savings unidentified' in future years, and underlines the need to begin work to address this early on, as detailed Appendix 2, Section 2.

Pay Awards & Employers' NI

The cost of pay awards was assumed to be 2.5% for 2008/09, and while we do not yet have a settlement it is likely to be at or close to this assumption. The position for 2009/10 and future years is less certain, given the now falling inflation outlook and likely significant increases in unemployment.

The first draft medium term service and resource plans generally assumed a continuation of the 2.5% assumption, but the budget proposal is now to assume only 2% for 2009/10 (but still to assume 2.5% in future years) and to allow for cash limits to be adjusted downwards, should the 2009/10 assumption prove too high. The cost of each 0.5% of any pay award is £430k. The £430k released has formed part of the headroom available for re-allocation.

In the November 2008 Pre-Budget Report, the Chancellor announced an increase in Employers' National Insurance Contributions of 0.5% from 2011/12 (together with a 0.5% increase for the employee). The estimated total cost of this is £320k, excluding schools. This is reflected in the medium term figures.

Non-pay inflation

Services have estimated their inflationary pressures as part of their medium term service and resource plans, taking account of known contractual commitments, and the potential to vary them, and other external factors such as RPI, and specific items such as fuel and energy costs.

At an early stage in the process it was recognised that the exceptional upward pressure on fuel and energy costs would be likely to be a 'step change' issue which should be considered for allocation of any headroom available, and that the level of uncertainty going forward meant that corporate provision could be made that would only be released in the event that it proved necessary. This approach still forms part of the budget proposal although these amounts will be ring fenced so that if not required they can be returned to help fund future years' budget pressures.

In addition, and more recently, it became clear that the general rate of inflation and the specific rates associated with fuel and energy costs were actually likely to decline going forward into 2009/10, and that there was even a possibility of 'deflation'.

In light of this changing position reflecting external uncertainty, the principal non-pay inflation assumptions have been reviewed corporately by officers and revised downwards in some cases for 2009/10, but with corporate provision still being retained in respect of gas and electricity costs. The 'saving' of £400k relative to previous assumptions has been re-allocated as funding for potential one-offs.. By removing these sums from the base budget this approach also contributes to closing what would otherwise be even larger budget gaps in future years. The budget proposal allows for cash limits to be revised downwards, should the remaining inflation provisions prove too high, and includes an unallocated corporate inflation provision of £564k in respect of electricity, gas and insurance.

It should be noted that many of the Council's contracts are linked to inflation indices on a retrospective basis, so the financial benefits of falling inflation rates will not fully impact until 2010/11.

Interest rates

The Treasury Management Report elsewhere on this agenda details the Council's approach to Treasury Management. The Budget proposal needs to contain assumptions about interest that will be earned on cash balances, and interest paid on borrowing.

The Bank of England Base Rate was reduced to 1.5% on 8 January 2009, and although this is the lowest rate since the founding of the Bank in 1694, there could be further reductions during 2009/10. While the base rate is likely to rise when the economy comes out of recession it is difficult to be certain when this will be, and it would be imprudent at this stage to assume that the economy will be coming out of recession as early as the 3rd quarter of 2009, as indicated in the Pre-Budget Report.

Interest earned on cash balances can be expected to decline therefore as base rates decline, albeit that this is 'lagged' as the Council decided and was able to 'fix' rates on various deposits of up to one year, as recently as last October, before the large fall in rates. Because of the continued uncertainty in the interbank market the spread between the rates that even the most secure UK banks offer for deposits and base rates is also currently larger than normal.

In this uncertain context, the budget proposal as set out in Appendix 2 assumes that the average interest earned will be at least 1% in 2009/10, 2% in 2010/11, and 3% in 2011/12. An interest rate variation of 0.25% is worth £120k, so a fall in interest rates by 4% results in a loss of interest of £1.9m. The full impact of this will probably not be felt in 2009/10 because of the 'lagging' effect referred to above, and because in the short term the Treasury Management Strategy allows for internal funding of capital expenditure rather than actual external borrowing, as summarised below and detailed in the report elsewhere on this agenda.

As the Treasury Management report makes clear the Council is not expecting to have to increase its long-term borrowing in 2009/10, and it should be noted that the fall in interest rates is a fall in short-term rates. Indeed long-term rates could rise as a result of the government's substantial and growing funding requirements.

The actual level of cash balances is the final element to be considered and this is largely driven by the timing of payments and receipts in the capital programme, as well as the levels of reserves. The Council currently has cash balances invested of between £40-£50m (excluding amounts invested on behalf of third parties and schools). These balances are expected to reduce as the Council is internally funding borrowing for its capital programme in the short term.

The Budget proposal in Appendix 2 includes a proposed Capital Programme, in light of a review of the current Capital Programme, and updated information on Reserves. The final impact on the interest and capital financing line within the budget, also takes account of the likely levels of MRP (minimum revenue provision - the repayment of borrowing) charge, which is detailed in table 1 of Appendix 2, and shows a saving of £878k in 2009/10 compared to previous plan assumptions. This is because the timing of some expenditure has been put back and because of new rules about how to link these charges to the expected life of the relevant capital asset.

APPENDIX 1 Annex a

MEDIUM TERM SERVICE & RESOURCE PLANS

OVERVIEW
2009-10 until 2019-20

Introduction

The medium term service and resource plans are new this year. They fill the gap between the corporate plans (and associated strategies) and annual service action plans (which are a simplified outcome focused version of the old service plans)

Draft medium term plans were developed by Strategic Directors in consultation with the relevant Cabinet member and presented to the Overview & Scrutiny Panels in November. The 5 draft plans covered each of the Strategic Director portfolios as follows:

- Development & Major Projects
- Customer Services
- Resources & Support Services
- Adult Care, Social Care & Housing
- Children's Services

Approach

The new approach is intended to help ensure the links between the various levels of planning and decision making are easier to understand. The approach also encourages a longer term view, and in the case of the medium term plans they look at the next 3 years in some detail, and refer in outline to the following 7 years. The medium term pressures on Council finances and Council services make this approach even more important than was previously the case.

The planning process flows from the Sustainable Community Strategy and Corporate Plan, through the various service related strategies, to medium term plans, then to annual service action plans and ultimately to appraisals for individual members of staff. This is often referred to as a 'golden thread'.

The medium term plans are draft. Any detailed changes, to ensure they reflect late budget adjustments, are delegated to officers. The plans will be republished along with annual service action plans by the end of March.

The annual service action plans have been referred to each of the overview and scrutiny panels and feedback will be considered by Cabinet. The relevant information will be circulated at the meeting on the 4th February.