SHEFFIELD CITY COUNCIL

Cabinet Report

Report of:	**Eugene Walker, Director of Finance**
Date:	**17th October 2012**
Subject:	**Medium Term Financial Strategy 2013/14 to 2017/18**
Author of Report:	**Allan Rainford, 52596**

Summary:

This report sets out the updated Medium Term Financial Strategy (MTFS) for the period 2013/14 to 2017/18. The Council's financial position continues to be significantly affected by the Government's plans for deficit reduction. The 2010 Spending Review (SR10) included a reduction in local government funding of 28% over the 4 years to 2014/15. The 2011 Autumn Statement extended the period of austerity by a further two years.

Although the Council will not have certainty about the level of funding until the local government finance settlement in December 2012, the latest indications are that the 2013/14 financial year will be as difficult as that experienced in the first year of the SR10 period, with potential funding reductions of up to 13%.

The introduction of the business rates retention scheme from April 2013 is also adding considerable complexity and uncertainty. The updated assumptions underpinning the MTFS reflect the potential impact of funding settlements and the necessary budget provisions for unavoidable costs. On this basis the forecast financial position of the Council is for a potential revenue shortfall of approximately £50m in 2013/14 rising to a cumulative resource shortfall of approximately £116m by 2017/18. These figures do not include Portfolio cost/demand pressures that could potentially add £20m per annum.

The report proposes an approach to financial and business planning that involves:

- For planning purposes, the development of forecast budget totals that fit within the level of the available resources over the next 5 years
- The allocation of resources to Services/Portfolios and also to strategic outcome areas in a way that reflects priorities

- Executive Directors taking the lead in the development of realistic, affordable 2 year delivery plans within a 5 year context for each outcome area and which will fit within the available level of resources

- Delivery plans that consider all income and spending, cost and demand pressures, as well as setting out clearly any major changes required in service delivery

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Reasons for Recommendations:

To provide a strategic framework for the development of budget proposals and the business planning process for 2013/14 and beyond.

Recommendations:

That Members:

- note the medium term financial forecast

- approve the approach to balancing the budget and to business planning in 2013/14 and beyond as set out in this report

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Background Papers:

Category of Report: OPEN

If Closed add – 'Not for publication because it contains exempt information under Paragraph… of Schedule 12A of the Local Government Act 1972 (as amended).'

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* Delete as appropriate

Statutory and Council Policy Checklist

1 FINANCIAL IMPLICATIONS
No. There are no direct financial implications as a result of this report.
2 LEGAL IMPLICATIONS
NO
Equality of Opportunity Implications
NO
Tackling Health Inequalities Implications
NO
Human rights Implications
NO:
Environmental and Sustainability implications
NO
Economic impact
NO
Community safety implications
NO
Human resources implications
NO
Property implications
NO
Area(s) affected
Relevant Cabinet Portfolio Leader
Cllr Lodge
Relevant Scrutiny Committee if decision called in
Is the item a matter which is reserved for approval by the City Council?
NO
Press release
NO

MEDIUM TERM FINANCIAL STRATEGY – 2013/14 TO 2017/18

Purpose of the Report

1. The purpose of the Report is to:

- provide Members with details of the forecast financial position of the Council for the next 5 years; and
- to recommend the approach to budgeting and business planning that will be necessary to achieve a balanced budget position in the medium term.

Background

2. The 2010 Spending Review (SR10) set out the coalition Government's plans for deficit reduction with an emphasis on reducing public expenditure as a percentage of Gross Domestic Product (GDP). SR10 covered 4 years from 2011/12 to 2014/15 and set out plans to reduce local government funding by 28% over this period. The November 2011 Autumn Statement extended the period of austerity for two further years: 2015/16 and 2016/17. The key message for local government was that spending reductions would continue at the same rate as SR10.

3. Since then, economic growth has been lower than anticipated. The 2011 Autumn Statement referred to the forecast of the Office of Budget Responsibility that economic growth would be revised down to 0.9% for 2011 and 0.7% in 2012 with a slower recover thereafter. The actual position for 2011 is that GDP decreased by 0.5% and has fallen by 0.4% between the first and second quarter of 2012. In view of this decline in economic growth there exists the potential for even larger reductions in public expenditure in years 2015/16 and 2016/17.

4. The first two years of the SR10 period introduced many changes including the abolition of Area Based Grant and the reduction in the number of specific grants with many being "rolled up" into Revenue Support Grant (RSG). This resulted in the loss of a significant amount of core funding in 2011/12. Planning for 2012/13 was relatively stable as the Government announced a 2 year Local Government Finance Settlement in December 2011 covering the 2011/12 and 2012/13 financial years.

5. The Government have been reviewing the way in which resources are allocated to Councils as part of the Local Government Resource Review. Proposals relating to the retention of business rates and the localisation of Council Tax support are two of the main elements of the Local Government Finance Bill. These will represent the most significant changes in local government finance for decades. The complexity and lack of clarity relating to these arrangements, aspects of which are still open to consultation, has introduced a high level of uncertainty that will not be resolved until early December 2012 when the Local Government Finance Settlement will be announced.

6. Although there is considerable uncertainty, the Council needs to prepare plans for the medium term based on the most likely position. This report contains

forecasts of the potential position facing the Council and sets out the issues that are likely to impact on the revenue resources and revenue expenditure position of the Council over the five years to March 2018.

Local Government Finance Bill

Retention of Business Rates

7. Since 1990 business rates have been collected by local authorities and paid over to Government. Local authorities would then receive a share of the re-distributed business rates through a needs driven formula grant mechanism to provide revenue support. The Local Government Finance Bill proposes to abolish the current system and instead allow councils to retain an agreed percentage of locally collected business rates. The new local retention of business rates model assesses the difference between each council's individual business rate baseline and their calculated baseline funding level and either a top up or a tariff will be paid.

8. The Governments key principles in formulating the system are:

- to build into the local government finance system an incentive for local authorities to provide economic growth over the long term

- to reduce local authorities dependency on central government and to create a high degree of self sufficiency

- to achieve a degree of redistribution of resources to ensure that authorities with high need and low taxbases are still able to meet the needs of their areas, and

- protection for businesses and no increases in locally imposed taxation without the agreement of local businesses

9. The principles on which the scheme will operate will mean that Sheffield City Council will receive a funding top up as the business rate baseline will be less than its calculated baseline funding level. A safety net will be established to protect councils where there are substantial downward movements in the business rate base due to changes in the local economy, funded by levies imposed on councils that are assessed to have "disproportionate" gains. These changes will potentially introduce a range of volatility in funding that has not been experienced previously.

10. The Government issued proposals for business rates retention in a number of consultation documents in August 2011 and published the Governments response to the consultation in December 2011. The proposals included the retention of 100% of business rates by local authorities which created the prospects of a high degree of autonomy from Government and the potential for local authorities to retain the benefits arising from economic growth.

11. However a further announcement by Government in May 2012 included a revised proposal that local authorities would retain only 50% of business rates with the other 50% being returned to Government in order to fund RSG allocations. This provides the Government with the ability to make the SR10 reductions in the amount of funding for local government. This represented a watering down of proposals that had promised to provide a strong incentive for local authorities to grow the local economy and reduced the benefit from increased autonomy from Government decisions about funding

12. One of the proposals in the May 2012 announcement is that funding presently provided through a number of specific grants will be rolled up into RSG from April 2013. The specific grants to be included in RSG include Learning Disability Grant, Homelessness Prevention Grant, Council Tax Freeze Grant and the majority of Early Intervention Grant which in total currently amount to approximately £39m to the City Council. This suggests that the SR10 reduction will be applied to a level of RSG that has swelled by the rolling up of specific grants and therefore that the actual monetary value of the reduction will be much larger.

13. The Government issued a detailed Technical Consultation paper on Business Rates retention in July 2012. This focused on how the Government proposes to calculate local authority baseline funding levels including the locally retained level of business rates and the amount received through the RSG process. One aspect of these arrangements is that in order to keep within the overall control total for local government spending, the Government intends to make reductions to provide sufficient funding for the following:

- New Development Deals: the Government have announced that Sheffield, Newcastle and Nottingham are to be awarded funding for projects in which business rates uplift will be exempt from the levy and which will finance additional infrastructure that will unlock business rates growth to repay the initial borrowing. £120m over 6 years will come from the local government control total to finance these projects.

- New Homes Bonus: in order to ensure that there is sufficient funding for the New Homes Bonus the Government will remove £2 billion from the local government control total for each of the next 7 years.

- Capitalisation: the Government on an exceptional basis allows local authorities to treat revenue expenditure as capital. The cost of such “directions” count as revenue expenditure in the national accounts and therefore the total amount of capitalisation in 2013/14 and 2014/15 will be funded from the local government finance settlement. The Government intends to hold back £100m for this purpose.

- Safety Net: the business rates retention scheme will include a safety net to protect local authorities from adverse movements in business rate income. The arrangements for providing this will be met from levies on the disproportionate benefits that are likely to be generated by some local authorities. However given the uncertainties in the first few years of the

14. The purpose of the July 2012 consultation document is to provide details of the issues that impact on funding for the start up of the business rates retention scheme. A further issue relates to the proposal to transfer funding from RSG to schools that have converted to academy status. Local authorities deliver a range of central education support services on behalf of schools which, when schools become academies, they have to secure for themselves. Currently academies receive money for these responsibilities through the Local Authority Central Spend Equivalent Grant (LACSEG). From April 2013 LACSEG will be replaced with a new grant which is distributed by the Department for Education as a separate un-ringfenced specific grant to local authorities and to academies proportionate to the number of pupils for which they are responsible.

15. The message from these documents is that once the various top slicing adjustments have been made, the overall level of local government funding will reduce by up to 13% in 2013/14 and up to 9% in 2014/15. There are no details of spending control totals for 2015/16 and subsequent years as these will be considered as part of the next Spending Review. Some further analysis of the position for each local authority has been provided by the Department for Communities and Local Government (DCLG) which provides confirmation that grant funding to individual local authorities will be reduced by up to 14% for 2013/14.

16. The operation of the revised financing system will be particularly complex as the Government is also reviewing the factors that make up the calculation of the Formula Grant. For planning purposes, the task involves producing projections relating to business rate collection and factoring in forecasts of RSG reductions. In reality at individual local authority level the RSG calculations will vary as the Government changes the factors feeding into the calculation and applies them retrospectively to produce a notional revised calculation for 2012/13.

Localisation of Council Tax Support

17. The current Council Tax Benefit system is to be abolished and replaced with a Council Tax Discount Scheme from April 2013. Under this scheme each council will receive a grant paid into the General Fund to compensate for the reduction in council tax income resulting from the application of the new discount. However, the major change for councils is that the grant will cover only 90% of the current level of benefits awarded. Councils are expected to introduce revised local benefit schemes that, in total, reduce benefits by 10% overall (total approximately £4.6m for the City Council) or make up the shortfall from their own resources. The City Council is required to have an agreed Council Tax Discounts Scheme by 31 January 2013.

18. Consultation papers issued by the Government in May 2012 set out the proposed arrangements for distributing funding to support local schemes and give an indication of the level of funding for the new scheme. The introduction of the new discounts will have an impact on the Council Tax base and therefore on

the Band D equivalent Council Tax. In order to offset the potential rise in Council Tax, the funding for the Council Tax Support scheme will be allocated to all authorities that set a Council Tax: i.e. billing authorities and precepting authorities. On the basis of the levels of Council Tax set for 2012/13, this results in a potential allocation of circa £35m for the City Council and circa £90k for the Police and Fire authorities.

19. The funding for the localisation of Council Tax support will be incorporated within the RSG allocation. This means the risks associated with the new scheme will fall on the City Council and there will not be a variation in funding, for example for changes in caseload, as existed previously. The potential risks and associated greater costs with this include:

- Increases in the number of claimants, for example should a major employer cease trading in the area

- Changes in claimant behaviour, for example as individuals decide to change use of a property in order to qualify for a different discount

- Losses on collection are likely to increase as individuals who previously qualified for benefit are now required to make contributions towards the Council Tax bill.

20. These potential risks will need to be quantified and factored into the estimate of the losses on collection and the level of the Council Tax base. The latter will need to be adjusted downwards to reflect that proportion of the taxbase who will be in receipt of Council Tax support. There is the potential to increase the amounts generated from empty properties and second homes. However the overall challenge will be to ensure that the overall additional costs/income and adjustments to the tax base are equalised by the amount of Council Tax support funding so as to not have an impact on the overall level of Council Tax and not require reductions in funding for core Council services.

Other developments impacting on funding

School Funding Reform.

21. In April 2011 the Government embarked upon a consultation process on the reform of school funding. The aim is to simplify the process, make it more transparent and improve consistency of funding for schools (including academies) in different local authority areas. Whilst there are no firm proposals as yet, major changes to school funding are anticipated A major concern with any future national funding formula is that it will be based on a simple “per pupil” amount with uplifts for deprivation factors based upon a simplistic measure such as the number of pupils qualifying for free school meals. There is therefore some uncertainty as to the level of grant support the City Council will receive in future years to support both school expenditure.

Forecast Revenue Resources

22. In previous years the net level of Council expenditure has been funded from the total of Formula Grant and Council Tax income. From April 2013 the position

relating to business rate income will become a feature of the Council's financial position, with a reduced proportion of business rate income being channelled through the Formula Grant process.

Formula Grant

23. The actual level of Government grant will not be known until the Local Government Finance Settlement in early December. The level of Formula Grant for 2012/13 amounted to £265.7m and represented an 8% reduction compared to the previous year. It is particularly difficult to accurately forecast the level of formula grant for 2013/14 due to the range of uncertainties and the potential impact of:

- The changes in the grant distribution formula for 2013/14

- The business rates retention scheme including the establishment of the baseline level for 2013/14, the application of the safety net/levy arrangements and the uncertainty surrounding the level of top for 2013/14.

- The inclusion of significant amounts of specific grant into RSG for 2013/14 and the application of SR10 reductions to this figure.

24. Population is one of the most significant elements of the RSG complex formula. The 2011 census revealed that by comparison with the population data in the 2011/12 formula Sheffield's population has reduced by about 2%. This would be expected – all other things being equal – to lead to a reduction in Sheffield's Formula Grant for 2013/14. However the position relative to that of other local authorities, some of whom may have experienced a much larger reduction in population, would need to be known to accurately determine the impact.

25. The Department for Communities and Local Government (DCLG) have recently issued illustrative figures to aid local authorities in understanding the funding position for 2013/14. This provides confirmation that the funding reduction will be in the region of 13% for 2013/14. Applying the 2013/14 methodology and control totals, provides a formula allocation for 2013/14 of £224m: a reduction of £41m compared to the Formula Grant for 2012/13. The most significant aspect of the reduction relates to the funding for education support services to schools and academies: this has resulted in a reduction of nearly £12m to provide the funding for the Department for Education to provide support to schools and academies on a pupil number basis. It is estimated that the new specific grant for education support services will be approximately £8m.

	2012/13 £000	2013/14 £000	Difference £000
Formula Distribution methodology			
Grants rolled in	27,594	27,536	
Relative Needs Amount	186,295	164,055	
Relative Resource Amount	-17,080	-19,836	
Central Allocation	69,214	73,920	
Floor Damping	-5,210	-9,066	
Council Tax Freeze Grant	4,919		
Education support within LACSEG		-11,854	
Formula Funding allocation	265,732	224,755	40,977

26. The illustrative figures also provide an indication of the impact of the “rolling up” of specific grants into RSG. The level of Early Intervention Grant is expected to fall by approximately £7m (or 27%). However a proportion of this is to be channelled through the Dedicated Schools Grant (DSG) route and ring fenced for use in supporting services for 2 year olds. The amount to be distributed through DSG is estimated at £3.8m in 2013/14 rising to £8.8m in 2014/15. Whilst the overall total level of funding may not change as a result of the redirection via DSG, it may have implications for the amount the Councils spends on services for 2 year olds. For the purposes of this forecast it has been assumed that this issue will have a neutral effect.

27. Bringing together the position on formula funding and specific grant allocations results in an overall level of grant funding that is £40m (or 13%) below the level for 2012/13, in terms of the reduction facing general fund services. This reduction does not include the expected level of funding for the Council Tax support scheme – of circa £35m – which although included in the formula allocation will be managed through changes in the council tax support scheme rather than reductions in spending on council services.

	2012/13	2013/14	Impact on General Fund
	£000	£000	£000
Formula Funding	265,732	224,755	40,977
Council Tax Freeze Grant 2011/12	0	4,919	-4,919
EIG	25,191	18,403	6,788
Homelessness	680	517	163
Lead Authority Flood	221	135	86
LD & Public Health	14,126	14,515	-389
Formula Grant funding before CT support	305,950	263,244	42,706
Council Tax Support Funding		35,459	
Formula Grant funding including CT support	305,950	298,703	
Movements on Specific Grant			
Council Tax Freeze Grant 2012/13	4,931	0	4,931
Grant for Education support services	0	7,500	-7,500
Specific Grant variations	4,931	7,500	-2,569
TOTAL GRANT FUNDING	310,881	306,203	40,137

28. The funding figures shown above provide an indication of the start up funding allocation for the business rates retention scheme from April 2013. When details of the settlement are announced, the total funding figure will be a combination of

- The governments estimate of the 50% local share of business rates; plus
- Revenue Support Grant (from the centrally retained 50% share); plus
- A top up grant to ensure the overall baseline position matches the allocations shown above.

29. The DCLG have not provided any illustrative figures for 2014/15. For the purposes of the forecast it is assumed that the level of funding for 2014/15 will fall by a further 9%, as set out in DCLG consultation documents. On this basis the Council faces a further reduction in grant of up to £24m in 2014/15.

Council Tax Freeze Grant

30. The Council qualified for Freeze Grant in 2011/12 and 2012/13 as a result of maintaining the Council Tax at the level for 2010/11. This provided the Council with a level of income that was equivalent to a Council Tax increase of 2.5% and amounted to £4.9m each year. However the 2012/13 allocation was announced as a one off allocation whereas the grant for 2011/12 will fall out in 2015/16.

The Council will therefore need to provide for the loss of the £4.9m in 2013/14 and this is included in the forecast reductions in funding shown above. It has been assumed that there will not be another Council Tax Freeze Grant in future years.

Business Rate Income

31. The process of determining allocations of business rates to local authorities for 2013/14 and beyond is complex. Whilst the general principles relating to the operation of the scheme have been set out in consultation documents there is a lack of clarity as to how that will be translated into individual authority allocations. The process has several stages outlined below:

- DCLG will first calculate the total business rates that will be collected by English billing authorities in 2013-14 (estimated business rates aggregate). This will be based on rateable values from the VOA with 50% being retained as the central share.

- A proportionate share for each authority will be calculated based on a 5 year average (2007/08 to 2011/12) of business rates collected locally. This will form the business rates baseline of each authority.

- The business rates baseline will then be split between billing and major precepting authorities.

- The baseline funding level for each authority will be calculated by applying the 2012/13 formula grant process to the 50% local share of the national aggregate.

- If an authority's baseline funding level is assessed as higher than their business rates baseline, they will receive a top up grant. If the converse is true, then a tariff will be charged by government. Sheffield will receive a top up grant.

32. The City Council currently pays approximately £190m in business rates to the national pool. There has been an increase in the overall amount paid across in 2011/12 compared to 2010/11 of £12m. Further analysis needs to be made of the specific reason for this increase. The 2012/13 budget includes NNDR pool income from formula grant of £261m.

33. At the present time, for planning purposes it has been assumed that there will not be any additional income generated by business rate growth. With 50% of business rate income being returned to Government a 1% increase in the remaining "local share" would amount to approximately £1m. As the City Council has been awarded a New Development Deal, it is not known to what extent the business rate base outside of the parameters of this scheme will grow in future years.

Council Tax

34. The Council Tax for 2011/12 set by the Council in March 2011 was £1,282.75 for a Band D equivalent property. This has been unchanged for the last 2 years and has involved the acceptance of the Council Tax Freeze Grant over this period.

35. The analysis of SR10 suggested that the Government expected Council Tax increases to make up some of the shortfall in local government funding and implied that annual increases of up to 4% were assumed. However the Localism Act has introduced the requirement for local authorities to conduct a local referendum if the increase in Council Tax exceeds a level set by the Secretary of State. Last year the Secretary of State would regard an increase as excessive if it were more than 3.5% for local authorities and more than 4% for Police and Fire Authorities. The levels to be prescribed by the Secretary of State for 2013/14 will not be known until the announcement of the Local Government Finance Settlement in December

36. The actual Council Tax increase for Sheffield is a matter for the City Council to decide. Each 1% increase in Council Tax generates approximately £1.6m in Council Tax income: this is less than had been the case in previous years due to the reduced tax base following the introduction of the localised support scheme in April 2013. For the purposes of the forecast it is assumed that the increase in Council Tax will be 1.5% per annum, with the Council Tax base increasing each year and generating an additional 1% income: i.e. a total increase in overall Council Tax income of 2.5% per annum.

Forecast Revenue Expenditure

37. The Council set a net revenue budget for 2012/13 of £463.5m. This represented a net reduction of £16.76m compared to the previous year when the net budget stood at £480.28m. Included within the budget were resources to meet the cost of corporate items and initiatives. A key issue for the Medium Term Forecast is the impact of additional expenditure during a period in which resources are constrained. There will be a number of corporate issues that will impact on the financial position of the Council that Members will want to ensure are properly included in future revenue budgets. Some of the corporate issues impacting on the corporate budget include:

- **Pension deficit** – Sheffield City Council's pension scheme is carrying a deficit. To repay this deficit, annual contributions of £17.6 million are made to the scheme, additional to the current service contributions. This amount was made up in 2011/12 by adding a charge to the employer's contribution of 6.4%. With a reducing workforce, this percentage will no longer be sufficient to cover the £17.6 million payment. We have increased this to 6.9% in 2012/13 but further increases may be necessary in future. A triennial review of the pension scheme is due in 2013/14 and is likely to increase the £17.6 million payment. However national changes to the pension scheme may compensate to some extent, as yet unknown. This will come into affect in April 2014. This payment was frozen for three years at the last review and could be inflated by the equivalent of 3 years CPI (or around 10%).

- **ITA Levy** – The Integrated Transport Authority (ITA) Levy currently amounts to approximately £37m for Sheffield. The ITA medium term financial plan provided for a reduction of 10% in 2012/13 and 2% in 2013/14. This reduction has been built into the forecast but is subject to change through a revised ITA forecast. Discussions are taking place on possible efficiencies in the ITA but also on possible levy increases to fund a strategic transport investment fund to contribute to economic development across the City Region. The final ITA levy is also dependent on Sheffield's share of the South Yorkshire population which may change as a result of the 2011 census. The levy for 2013/14 and beyond is therefore uncertain.

- **Capital financing costs** – Future years revenue budgets will need to include sufficient provisions to meet the debt charges on borrowing to finance capital expenditure. The revenue budget will also need to include the full year costs of borrowing undertaken in the current financial year. An initial assessment suggests that an additional £2m in 2012/13 rising to £7.3m in 2017/18 will be required due to the need to externalise funding currently covered by internal balances as our reserves reduce.

- **Funding for redundancy/severance costs –** the budget for 2012/13 included a total of £13m for funding redundancy/severance costs of which £8m was financed from reserves. It is likely that the Council will have an ongoing requirement for a redundancy/severance costs budget given that the period of austerity will continue for the foreseeable future. It is proposed that the Council set aside at least a further £4m in 2013/14 with additions also in subsequent years to replace the current one off funding from reserves.

- **Salary increments** – the current contractual arrangements regarding the freeze on salary increments are due to expire in April 2013. Reinstating increments is likely to add £5m per annum to Council expenditure. The Council is currently consulting with trade unions on a proposal to extend the increment freeze to April 2014.

- **Debt Collection benefits** – the budget for 2011/12 included a saving of £1m from improved debt collection procedures and the associated impact on cash flow. This has involved a procedure whereby payments to the Council that are received more than 60 days of being due are used to benefit the corporate financial position. This has successfully increased debt collection within 60 days and the practice of taking such income to a corporate budget is less sustainable: the benefits are back in service budgets. The £1m saving built into the 2011/12 budget is planned to be phased out over the medium term.

- **Invest to Save Investment fund** – the Council has in previous years used funding from reserves to support investment in infrastructure and efficiency programmes. This amount of funding however does not exist indefinitely and it is proposed that a reserve be established to support new transformation initiatives by making a contribution of £1.5m per annum.

- **Digital Region costs** – The current year budget includes £3.8m in respect of the potential write off of the loan to the company, pending the outcome of a request for approval to capitalise this expenditure. The approval by

- **PFI costs** – the revenue budget in future year's will need to include the full year costs relating to current PFI schemes. It is estimated that the costs of Highways PFI and Howden House PFI will add £1.9m in 2013/14 rising to £10m in 2017/18.

38. If the above items were to be included in future years budgets they would add a total of £10m in 2013/14 rising to £36m by 2017/18.

Service Cost and Demand Pressures

39. By the nature of the austerity budget financial settlements for local government, there will be insufficient resources to meet inflationary pressures and to offset the rising cost of increased demand. In previous years whilst additional resources have been built into the budget, it has required Services/Portfolios to identify offsetting compensating savings of equal value.

40. It is proposed that for the medium term, an approach is adopted which encourages Services/Portfolios to adopt the reality of the current position and to minimise the scale of cost/demand pressures. Services will be required to manage pressures from within existing resources. The impact of these pressures will be recognised and identified through the business planning process. At this time therefore no specific forecast of cost/demand pressures has been included.

41. It is likely that the Services that have experienced increased levels of demand, such as adult social care, will again face additional pressures. Services have been provided with broad guidelines as to the current level of price inflation and can use these to evaluate their relevance or impact for individual services. There is the possibility of a pay award in 2013/14 and beyond, following the announcement by the Chancellor of a two year public sector pay freeze in the June 2010 budget. This was in respect of employees earning over £21,000 per annum and will apply to 2011/12 and 2012/13. The Chancellor's Autumn Statement included an instruction that pay awards in the public sector would be limited to 1% for a further two years. Services have been advised of the potential impact of such pay awards.

42. The level of Portfolio cost/demand pressures over the medium term is unknown. The budget for 2012/13 includes a total of £29m for pressures, of which, reductions in funding accounted to £11m. There is the potential for pressures to amount to circa £20m per annum.

Other Issues

43. There are a number of other national and local issues that could impact on the budget some of which are uncertain at the present time. They include the items set out below.

Public Health

44. The Health and Social Care Bill changes the way the NHS and Public Health Services are organised in England. From April 2013 the leadership and the bulk of the public health responsibilities will transfer from Primary Care Trusts (PCT) to Local Authorities. Specialist elements of Public Health such as children services 0-5, cancer screening will transfer to the NHS commissioning board - Clinical Commissioning Group (CCG).

45. The indicative allocation of funding transferring to Sheffield City Council (SCC) from the PCT is approximately £26m, this is subject to review and will be finalised in the Autumn. The funding will be ringfenced to Public Health services initially and will cover the costs of the contracts transferring to SCC and the associated staff.

Sheffield Homes

46. Following the tenant ballot with regard to the future of the Councils Arms Length Management Organisation (ALMO), Sheffield Homes, the decision was taken to bring the management of the council's housing stock back into SCC with effect from 1st April 2013. It anticipated that by bringing the management back in-house it will deliver savings for the Housing Revenue Account (HRA) and facilitate better co-ordination with general fund services and the strategic outcomes.

Pensions auto-enrolment

47. The Government has introduced pensions reform which will require employers to automatically enrol employees into a workplace pension scheme, including those employees who had previously decided to “opt out”. There are eligibility criteria relating to the auto-enrolment and employers may use existing pension schemes or set up a new one. Employees who have been automatically enrolled will have the option to subsequently opt out, although this will involve individuals obtaining the relevant documentation and may involve the employer processing refunds of deductions. Each employer will be allocated a date from which the duties will first apply to them, known as their “staging date”, which for Sheffield City Council is March 2013.

48. The implementation costs will include collecting data relating to employees who are currently not in pension scheme membership, preparation of communications, creating the appropriate processes, adjusting systems and potential amendments to payroll arrangements. However the most significant cost may be in respect of employer’s pension contributions for employees not currently in the local government pension scheme. The details need to be worked through thoroughly before a precise figure can be put on the potential costs but the overall cost could be significant for the Council. However, proposals are being formulated that will help to defer the majority of costs to a later financial year.

Overall Financial Projections

49. Bringing the forecast level of resources and expenditure together suggests that the Council continues to face a challenging medium term financial scenario. The Local Government Finance Settlements are likely to be increasingly complex given the number of intended changes and that the actual levels of grant funding are expected to be significantly reduced.

50. It is forecast that the potential revenue gap for 2013/14 will be in the region of £50m and the cumulative gap by 2017/18 will be about £116m. It assumes that the funding settlements for local government will be stable by 2017/18 but much depends on the economic situation. The figures do not include cost/demand pressures which Services/Portfolios are expected to manage from within existing resources and which will require sufficient offsetting savings: this could potentially add a figure of £20m to the annual gap. The following table summarises the forecast budget gap for the next 5 years:

	2013/14 £m	2014/15 £m	2015/16 £m	2016/17 £m	2017/18 £m
Annual reduction in resources	40	20	15	9	-4
Annual increase in Expenditure	10	15	5	3	3
Annual Gap	50	35	20	12	-1
Cumulative Gap		85	105	117	116

Approach to balancing the budget

51. The Council requires sufficient savings proposals to meet a potential forecast shortfall of £50m in 2013/14 plus sufficient savings to meet the value of Portfolio cost/demand pressures. The Council needs to adopt a long term approach to the identification of proposals as it is unlikely that short term solutions will be sufficient and the decisions required are likely to involve fundamental issues about the long term future and delivery of some Council services.

52. In terms of planning spending reductions, there are some elements of the Council budget where it is particularly difficult to make reductions and where the expenditure is largely fixed in nature. These will include:

- Benefit payments
- Integrated Transport Authority Levy
- Pension costs of former employees
- Howden House PFI costs
- Capital financing costs
- Housing legacy payments

53. If the required savings were to be achieved by making reductions across all Services it would require a reduction in all services of up to 15% in 2013/14, after adjusting for expenditure on major contracts and the fixed costs referred to above. There will however be number of priority services that the Council would want to offer a degree of relative protection to. Depending on the number of “protected” services and the value of their budgets, it is likely to result in much larger reductions in remaining services. For example, initial protections suggest that, based on a set of assumptions about the protected services, other services would be required to make savings of up to 25% per annum. Eventually this would result in the complete removal of some services.

54. The approach to balancing the budget over the medium term and the application of a more strategic approach to the identification of savings proposals has involved adoption of the following principles:

- For planning purposes, the development of forecast budget totals that fit within the level of the available resources over the next 5 years

- Resources have been allocated to Services/Portfolios and also to strategic outcome areas in way that reflects priorities

- Executive Directors have been given responsibility for developing realistic, affordable 2 year delivery plans within a 5 year context for each outcome area and which will fit within the available level of resources

- The plans are to consider all income and spending, cost and demand pressures, as well as setting out clearly any major changes required in service delivery

55. To assist in the development of these outcome driven plans, the current year Service/Portfolio budgets have been aligned to strategic outcomes. In order to provide broad budget limits for planning purposes, services have been given a ranking according to order to priority: this reflects the realistic position that there are some services that the Council will want to give a relative degree of protection to and would not expect to find savings on the level of some other services. It is likely that services such as Children’s and Adult Social Care would fall into the category of relative protection. It is important to note, however that the purpose of this approach has been to assist in the formation of broad planning totals rather than making decisions now about the precise allocation of budgets for future years.

Housing Revenue Account

56. Cabinet on 25th January 2012, considered the Housing Revenue Account (HRA) 30 year business plan and approved the recommendations. 2012/13 was the first year of self-financing and was based on the Government paying off £515 million of Sheffield City Council’s housing debt in exchange for the City Council having the freedom to manage and fund council housing locally from rents and other charges.

57. From April 2012 the City Council had £349 million housing debt and a borrowing limit set by Government of £391 million. Self-financing means more money for council housing over the long term although the cost of tackling Sheffield's maintenance backlog (£257 million) was not addressed by the Government's self-financing determination and this creates a significant funding pressure which is most acute in the early years.

58. The move to self-financing involves a significant transfer of risk from the Government to the local authority, which will require the Council to consider how governance arrangements (involving tenants, elected members and officers) could be strengthened. The two key risks to the business plan in the coming years will be the Government's welfare reform proposals and the financial risks associated with carrying forward a maintenance backlog.

59. The objectives of the business plan is to create balanced budgets for the next five years and to prioritise investment that will reduce costs over the long term and allow funding of activities that are currently unaffordable.

60. The main areas of investment in the early years, aimed at reducing costs overall will be:

- Activity to mitigate the impact of welfare reform

- Making the best use of the homes we have by improving the re-housing process and supporting tenants to sustain their tenancy

- Invest to save projects on estate services

- Reducing the maintenance backlog early with top priorities being completion of the Decent Homes forward programme and investment in heating systems to tackle fuel poverty.

61. Under self-financing the main source of funding for the business plan will be from tenant rents which will continue to be set in line with the Government's national social rent policy, with convergence of rents for the majority of homes to be in 2015/16.

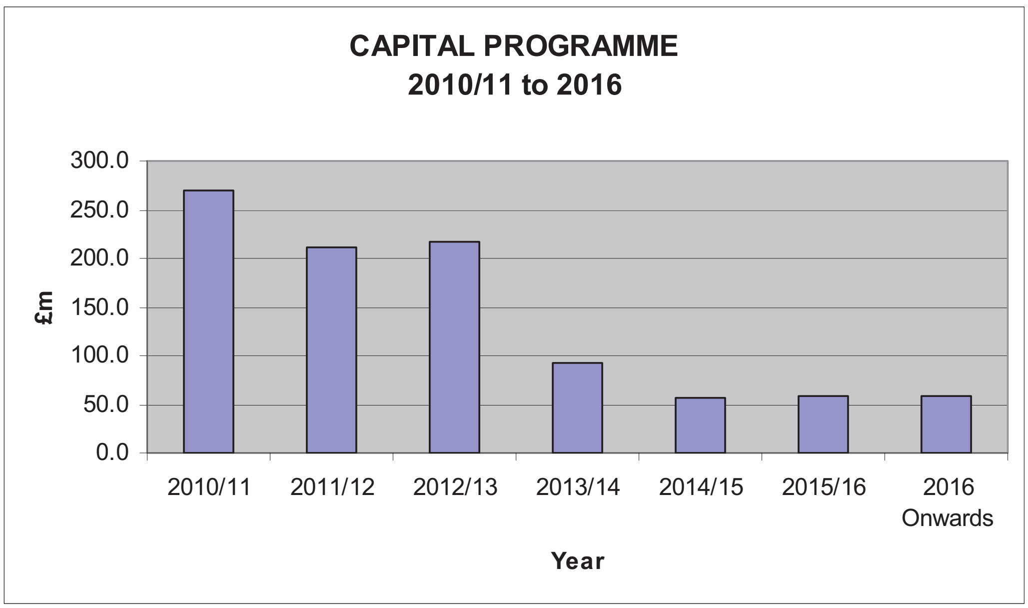
62. Another remaining challenge for the business plan in the coming years will be the repayment of debt. In choosing to prioritise the funding of the maintenance backlog, the business plan cannot afford to pay off the debt in full over 30 years. This results in continuing interest payments and less resource to fund other activities. At present there are a number of activities (e.g. refurbishment of communal areas) which are still unaffordable to the business plan. Further efficiencies will be required in the coming years in order that these could be funded in future.

63. The HRA reserves strategy will be reviewed during 2013 it proposed that reserves are maintained at the appropriate level to fund potential future financial pressures from risks such as welfare benefit reform, interest rate increases and backlog maintenance. The forecast position for reserves at the 31st Match 2013 is £15m.

2013/14 CAPITAL PROGRAMME

64. Capital spending pays for buildings, roads and council housing and for major repairs to them. It does not pay for the day-to-day running costs of council services. 2011/12 saw great changes in the funding of the Capital Programme. The national spending reductions forced the Council to utilise more of its internally generated resources from asset sales or revenue budget savings as funding from central government reduced. This trend has continued throughout 2012/13.

65. The impact of the changes coincided with the Building Schools for the Future and the Decent Homes programmes approaching physical completion. Typically these accounted for 90% of the programme. The graph below illustrates the change in activity from 2010/11 to 2016.



66. This will have a major impact on the next five year capital programme period. However many new schemes are still to be prepared and input to the programme leading to a much steeper fall from 2013/14 onwards.

Capital Investment Plans

67. So, looking forward, the current Approved Capital Programme is projected at £481.7m. 2012/13 will see the introduction of a Highways Private Finance Initiative (PFI). The PFI will result in less spend in the capital programme as the authority will lose the LTP Maintenance Grant of approximately £6m per year, but the PFI funding of £1.2bn should deliver substantial improvements to the Highways network over a 30 year period.

68. The HRA Self Financing project delivers to local authorities greater autonomy in the management of their housing stock and writes off substantial amounts of accumulated debt. This will allow the authority to plan contributions to the capital programme from the Housing Revenue Account with greater certainty over a

longer term period, and the Authority has developed a 30 year business plan which will inject on average £40m per year to the Housing Programme.

69. School building works will be financed mainly by Department for Education, formula calculated central grants supplemented by occasional specific grants to deal with building condition or population growth.

70. The graph above does not include a number of major projects worth £80m which are currently the subject of funding bids or approvals as detailed below.

City Centre development (£40m): funded by a TIF scheme (Tax Incremental Financing), this project is intended to address infrastructure works [specify] to prime the private sector led development of the city centre.

Bus Rapid Transit Scheme North (£32m+): funded by a combination of Department for Transport and European Regional Development Fund (ERDF) this scheme will build a priority traffic scheme for buses between Sheffield and Rotherham which will increase job opportunities for people in the Don Valley and support the regeneration of the Lower Don Valley in Sheffield

Asset Rationalisation project; a detailed strategic and operational review of Council buildings which will reduce duplication, co-locate services to benefit users and generate capital receipts from the release of surplus buildings. The business case may require some investment, funded from prudential Borrowing, to reconfigure properties to their new role or make more attractive for sale.

Asset Enhancement Project: a project to enhance the attractiveness or existing surplus land for development by undertaking site surveys, obtaining planning permissions. Cash flowed by Prudential Borrowing but ultimately repaid by the capital receipts from sales.

Don Valley Flood Defence Scheme (£7m): the objective is to provide enhanced flood defences between the city centre and Meadowhall which would protect homes and businesses against a 100 year flood event. To be financed by a combination of Environment Agency and ERDF grants.

Pressures on the Capital Programme

71. This summary details the pressures on the Capital Programme and the consequences for its funding.

Building Schools for the Future Affordability Gap

72. There is an affordability gap of around £9.6m over the life of the Building Schools for the Future programme (BSF). The gap has decreased by £8.8m from £18.4m reported last year following the realisation of some of the planned costs reductions identified as part of the strategy to close the gap.

73. The remaining shortfall will be funded through the use of Prudential Borrowing and prioritisation of capital receipts. The crystallisation of the shortfall is not expected until September 2015.

Homes

74. The Housing Programme has suffered twin pressures caused by reductions in nationally funded programmes and reducing capital receipts. There are however pre-existing commitments to complete the Decent Homes programme which include the redevelopment of some estates. The Scowerdon, Weaklands and Newstead (SWAN) project is one such example. Failure to complete these projects could trigger clauses which would expose the Council to payments which would create a revenue budget risk.

Roads

75. The forecast position on the Inner Relief Road scheme has deteriorated by £0.2m due to the crystallisation of risks associated with the finalisation of the outstanding land settlements. There is currently a £0.6m difference between funding and costs for completed works but almost £2m cash flow support to the scheme has been provided.

Maintaining the Existing Fabric of the Property Estate

76. The Council has traditionally allocated several million pounds each year to fund building renovations and machinery replacement. The Council has provided for a £4.4m programme which is currently the subject of a capital investment submission to Cabinet.

77. In order to mitigate this pressure, the Property and Facilities Management (P&FM) service is currently reviewing the estate to identify under utilised or high cost buildings where the facility can be provided from existing or new premises. This project, the Asset Rationalisation Project, will run in conjunction with the Wider Accommodation Strategy which will reduce the Council's office space needs.

78. The Asset Rationalisation and Asset Enhancement projects business case is being developed but the preliminary indications are that this will require funding in the early years to assess, develop and market sites before the enhanced value in the sites can be realised. This process could take up to three or four years.

79. There is also a substantial programme of remedial works in schools. A small proportion of this can be met by specific grants from the Department for Education but the majority of works will require alternative financing.

Developing the Local Economy and Infrastructure

80. Despite the downturn in the property market, the Council will be presented with opportunities to acquire strategic land sites which will help the city recover once the economic upturn gathers pace or provide sites for housing development. Investing in the city's people is also a key priority and the Council has done so by acquiring land to build a University Technology College.

81. The Capital programme funding strategy needs to be flexible enough to respond to such opportunities.

Funding the Capital Programme

82. The impact of the national expenditure reductions, the uncertainties of the weakened property market and the need to manage the risks and contain the pressures within the programme combine such that the authority becomes increasingly reliant on capital receipts. Looking beyond this source, there are opportunities within the capital programme and new funding streams which have been combined to create funding pools such as the Local Growth Fund. Other initiatives such as the Tax Increment Financing Scheme (TIF) are now in operation and the Community Infrastructure Levy (CIL) should come into force in 2014.

The Capital Resource Pool (CRP)

83. Historically the Capital Resource Pool (CRP) has been used to improve the authority's building estate and deal with backlog maintenance demands and deal with unplanned failures of structures or other property losses caused by natural disasters such as the floods in 2007. The authority needs to retain a prudent level of reserve to cover such risks.

84. CRP is also a key resource for funding those projects which are not supported by specific central government grants for homes, schools or roads. It can also be used to demolish empty properties to redevelop land for sale. This can bring benefits to the revenue budget as well as replenishing the CRP.

85. The success of the Asset Enhancement programme is key to replenishing this reservoir of funding.

Slippage within the Capital programme

86. For the last five years there has been always been an underspend against the approved capital programme. Subject to Cabinet approval, funds are rolled forward into the next year in order to complete projects. Slippage reflects delays in physical progress of a project and in most cases the work is delivered in the next financial year. However, the new reporting system has provided greater transparency and identified instances where money appears to be repeatedly carried forward from earlier years. This allows members to question if the funding is really needed and could be reallocated to other priorities.

Local Growth Fund

87. This fund which has been created out of two government incentive payments for building new homes and reducing the number of long term empty properties. It is available for projects which improve the local housing or neighbourhood environment. Approval of such projects is given by local elected members following recommendations from Council officers.

88. The value of the fund to the Council is estimated at £30m over five years. To date £10m has been committed. The fund is being used to provide infrastructure or clear derelict buildings to kick start developments at sites which have been unattractive to developers. Often this improves the neighbourhood as well providing new homes.

Tax Increment Financing (TIF)

89. This initiative was announced in September 2010. The principle is to allow the authority to borrow funds to undertake capital improvements in an area. The money would be repaid from increased tax revenues (i.e. business rates) in the area as land values rise as a consequence from the capital investment. This scheme has been used successfully in the United States over the last fifty years, often for major transport, infrastructure or regeneration projects.

90. The Council has applied for a £40m of funding to develop infrastructure required for the New Retail Quarter development.

Community Infrastructure Levy

91. This will replace the current Section106 (Town & Country Planning Act 1990) arrangements which fund many of the local neighbourhood facility improvements especially in Parks & Countryside as well as City Development Division.

Equality Impact Assessments

92. The report indicates that reductions in Council spending will be required in the medium term. When details of the proposed reductions are available the Council will need to carry out an equalities impact assessment to ensure that Members are fully aware of the specific impact of any decisions on certain groups in the City.

Recommendations

93. It is recommended that Members:

- note the medium term financial forecast
- approve the approach to balancing the budget and business planning in 2013/14 and beyond as set out in this report