



Financial Strategy (2007 onwards)

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1. Executive Summary.

The overall objective of the Financial Strategy is to work out how the Council wants to structure and manage its finances over the next 5 years to ensure this fits with and supports the direction of the Council's objectives, particularly the Council's Corporate Strategy.

Prior to setting the 2005/06 budget a fundamental review of service priorities expenditure was carried out through the Leader's Service Prioritisation Group against the background of a predicted funding gap of £2 million. This difficult exercise was successfully completed with the Council setting, and spending within, a balanced budget for 2005/06.

This work has put the Council on a good footing for producing future year balanced budgets and, along with improved budget monitoring and reporting to the Executive Board, has raised the profile of financial management.

However, along with the majority of other local authorities, East Devon will continue to struggle to afford its spending plans with expenditure forecast to increase at a faster rate than income. The need for increased spending arises from inflation, pay awards and higher pension costs, and specific areas such as the introduction of job evaluation. Further the requirement for services to the residents of the new community, at Cranbrook, will be increasingly felt during the period of the financial plan, and the Council can continue to anticipate changes in legislation and pressure on service cost through increased user demand. Against this it is assumed annual increases in central government funding and the council tax will be in low single figures.

The Medium Term Financial Model which forms part of this Strategy shows the financial difficulties faced by the Council with a predicted gap between expenditure compared with the resources available. In 2007/08 there is an estimated shortfall on the General Fund of £459,000 with this gap increasing annually, for the life of the Plan, to 2011/12.

This Financial Strategy sets out in detail the assumptions and estimates involved in producing the Medium Term Financial Plan (5 Year Plan) and sets out clearly the actions the Council needs to take to manage its finances in order to produce balanced budgets whilst delivering its objectives. It needs to be emphasised that most Councils will be in a similar position, but the work already undertaken by this Council does make this work more manageable.

2. Purpose and background of the Financial Strategy.

- 2.1 The overall objective of the Financial Strategy is to work out how the Council wants to structure and manage its finances over the next five years to ensure this fits with and supports the direction of the Council's objectives, particularly the priorities and measures identified in the Council's Corporate Business Plan.
- 2.2 In addition to the Corporate Business Plan, which incorporates the Council's Strategy the Financial Strategy links with other key strategies of the Council including its Service Plans (2006/07 to 2008/09), the Asset Management Plan, Treasury Management and the Capital Strategy.
- 2.3 The medium term financial planning process, which forms part of the Financial Strategy, has been in place for a number of years and is now an essential part of the budget setting process. This provides a financial forecast of the cost of providing the Council's General Fund services over a number of years, and the resources that are likely to be available over the same time period. The process provides an early warning of any estimated budget gaps between the two. The Plan now looks forward 5 years, as opposed to earlier plans which forecast the position for only 3 years.

As well as considering General Fund revenue services the Plan considers the Council's Capital Programme over the next five years and again looks at any shortfall in funding. This Strategy does not look at the Housing Revenue Account for which a separate business plan has been prepared (available on the Council's website).

- 2.4 There are of course uncertainties involved in any budget planning process, even when only looking ahead for a single year. These uncertainties become more difficult to predict as the period covered lengthens. These assumptions and risks, identified within the Strategy, which will be periodically reviewed as the Plan is updated, are Risk assessed in Appendix A
- 2.5 In setting the Council's 2005/06 budget a fundamental review of services and expenditure prioritisation was carried out through the Leader's Service Prioritisation Group (LSPG) against the background of a predicated funding gap of £2 million. This worked successfully with the Council setting and keeping within a balanced budget for 2005/06. This work put the Council on a good footing for producing future year balanced budgets and along with improved budget monitoring and reporting to the Executive Board this has improved and raised the profile of financial management in the Council.
- 2.6 The Medium Term Financial Plan (MTFP) contained within this Strategy, covering the period 2007/08 to 20011/12, identifies an annual problem

with a predicted gap between the cost of providing services compared with the resources available to it. This Financial Strategy sets out in detail the assumptions and estimates involved in producing the MTFP and outlines the actions the Council needs to take in order to meet its twin objectives of setting a balanced budget whilst delivering its objectives.

3. The Medium Term Financial Plan – Framework.

3.1 In order to produce a detailed MTFP the following steps are required:

STEP 1 - Forecasting the Baseline

The 2006/07 budget, reflecting the current cost of services, is taken as the base. Additions or reductions are made to this to reflect any one off items included in 2006/07 budget, any supplementary estimates agreed by Council since the original budget was approved and in respect of any forecast variances identified through budget monitoring.

STEP 2 - Future Year Projections – inescapables

To the baseline there are a host of costs that the Council can not escape when it looks at projecting its budgets forward. These have been termed inescapables within the Plan. They cover such items as pay increases, inflation, job evaluation, the new community and any cost of new legislation that the Council has to comply with.

STEP 3 - Future Year Projections – Corporate Strategy & Service Plans

The Plan then needs to reflect costs associated with delivering the objectives as set out in the Council's Corporate Strategy. These sums are to be distinguished from the more inspirational service enhancements contained within Service Plans (see 3.2).

STEP 4 - Future Year Projections – Other Implications to Budget

In addition to the above account has to be taken of the revenue implications of the Capital Programme and the return to be anticipated from Council investments.

STEP 5 - Future Year Projections - Resources/Funds Available

This considers and makes assumptions about the level of council tax for future years and the level of central government funding through the Formula Grant.

- 3.2 The aggregate of the above steps indicates whether the Council will have sufficient resources to achieve its objectives or whether steps are required bridge a funding gap

As well as considering this position, the MTFP highlights possible future costs which, depending on decisions taken by the Council, could have an impact on finances. These early warning costs have been categorised under two headings:

- Early Warning Pressures - Service Plans

This highlights cost pressures identified by Heads of Service in delivering the current service in line with the Service Plans. In the main this relates to either a growing demand for a service or the costs involved increasing above normal inflation.

- Early Warning Bids - New areas

These are areas were Heads of Service have identified were a budget provision currently does not exist but they would like consideration to be given in the future for there inclusion.

The ability to fund the projects identified here will be dependent upon the Authority finding scope within its overall resources.

- 3.3 In formulating the calculations above a number of assumptions have been made and a number of external influences considered. Appendix A identifies the risks associated with these matters and comments on there influence within the Model

- 3.4 A similar exercise is undertaken in respect of future capital expenditure and the anticipated resources that will be available to the Council to fund the programme of works

4. Summary of the MTFP Model.

4.1 The full MTFP Model is attached in Appendix B and comprises of:

- Summary Sheet of the General Fund position
- Early Warning summary for Cost pressures on Service Plans and Early Warning summary for New Bids Areas.
- The remaining pages of Appendix B are supporting calculations to these summary sheets with the exception of the final sheet which outlines the capital position.

4.2 The Summary position on General Fund services shows the latest prediction for the current year, 2006/07, of a surplus of £25,000. This then turns to a projected deficit for 2007/08 of £459,000. This deficit then grows each year in the MTFP under the assumption that the deficit in 2007/08 is not addressed and the position then gets worse each year. Clearly this is not a position the Council will allow and the Strategy addresses this point in Section 5.

Table 1: MTFP Model – Summary of General Fund Position

	2006/07 £'000	2007/08 £'000	2008/09 £'000	2009/10 £'000	2010/11 £'000	2011/12 £'000
Budget Requirement	13,721	14,599	15,085	15,679	16,435	17,339
Resources Available	13,746	14,140	14,506	14,881	15,266	15,661
(Surplus) / Deficit	(25)	459	579	798	1,169	1,678

Note: In 2007/08 there are one off costs included of £76,175 for the District Council Election and implication of Electoral Administration Bill.

4.3 Looking more closely at the first year of the MTFP model there are a number of one off items, totalling £252,000, contained within the 2006/07 base budget which will not be required in future years. These can be deducted from 2007/08. However there are a number of additions to make in terms of “inescapable” costs for pay increases, inflation, job evaluation, costs associated with Cranbrook, District Council election etc. These inescapable costs amount to an addition of £1,145,000.

No additional costs have been identified as being required to deliver the priorities and measures linked to the Corporate Strategy. Here it is assumed that current budget provides sufficient capacity.

By going through the steps identified in 3.1 above this gives a budget requirement in 2007/08 of £14,599,000 with resources/funds calculated as being available to the Council of £14,140,000. This results in a projected deficit of £459,000.

- 4.4 The funding gap widens in 2008/09 to £579,000. However, as it is to be anticipated that the 2007/08 position will have been resolved the sum, then required to be found in order to set a balanced budget, would stand at £120,000 i.e. £579,000 less the £459,000. .
- 4.5 In addition to this deficit position other costs have been identified as early warnings which have not been included in the above total, these are summarised below and consideration needs to be given on how these are to be addressed. The early warning costs are summarised as follows, and fully listed in Appendix B:

Table 2: MTFP Model – Early Warning Costs (General Fund)

	2006/07 £'000	2007/08 £'000	2008/09 £'000	2009/10 £'000	2010/11 £'000	2011/12 £'000
Cost Pressures on Service Plan	0	334	16	125	0	0
Bids for new areas	0	317	(18)	1,000	0	0

- 4.6 The final page of Appendix B considers capital expenditure and funding projections over the same five year period. The current position of the programme is shown in table 3 below and shows a deficit of £1,425,000 in 2007/08 which then decreases towards the end of Plan, the reason being is the Programme in latter years, only includes recurring items such as Disabled Facility Grants with no new major projects/schemes included.

Table 3: MTFP Model – Capital Expenditure and Funding Position

	2006/07 £'000	2007/08 £'000	2008/09 £'000	2009/10 £'000	2010/11 £'000	2011/12 £'000
Net Expenditure (agreed programme)	5,935	2,675	977	977	977	977
Resources Available	5,162	1,230	1,256	1,262	1,269	1,275
(Surplus) / Deficit	773	1,425	-279	-285	-292	-298

Note – 2009/10 to 2011/12 the rolling programme items have been carried forward.

4.7 In addition to the funding of approved schemes consideration must also be given to a list of early warning capital bids that have been identified (Appendix B) but not included in the projections shown in table 3. These early warning bids are summarised in Table 4 below:

Table 4: MTFP Model – Capital Expenditure New Bids (Early Warning)

	2006/07 £'000	2007/08 £'000	2008/09 £'000	2009/10 £'000	2010/11 £'000	2011/12 £'000
Net Expenditure	0	1,871	898	903	856	500

4.8 The new bid items mainly come from the Street Scene service; the significant bids being £798,000 in 2007/08 for additional costs to those already included in the capital programme for the Imperial Field, Pollution Prevention scheme, with £320,000 in 2008/09, £340,000 in 2009/10 and £370,000 in 2010/11 for the purchase of containers for kitchen waste in accordance with step changes anticipated in the refuse and recycling contract. The only additions to those from the Street Scene bids are from Housing and Social Inclusion with a request for £500,000 a year as a pot for affordable housing and a £23,000 bid in 2007/08 from Planning & Building Control for computer software.

As with revenue expenditure the capital deficit position requires further consideration on how to deal with the problem and this is discussed later in the Strategy

5. The Way Forward

5.1 Underpinning the Strategy the following principles are adopted:

- The Council will annually set a balanced budget where expenditure is met from available resources year on year.
- That the General Fund balance will be maintained at or above the previously adopted advisory level of 7.5% of net budget with an annual decision taken on the use of any sums available above this target.
- In determining the annual budget, and focusing on the longer term, the Council will prioritise the funding of essential areas and in the high priority services in accordance with the priorities and specific measures laid out in the Corporate Strategy.
- Council tax increases will be kept within annually announced Government guidelines

- In considering the capital budget the Council will continue to follow the methodology agreed within the Capital Strategy of scheme scoring and prioritisation in terms of which projects shall be funded. The Council will also seek to maximise the use of its assets, and consider the appropriateness of holding them with the intention where appropriate to obtain a capital receipt which can then be reinvested in areas of high priority.

5.2 To address the gaps in funding identified for both the General Fund and Capital Programme particular consideration needs to given to:

- Each year the Council will strive to achieve Gershon efficiency savings to provide the current level of service at less cost, or an improved level of service at current cost. This will include better use of Information Technology, improvement in absence management, process mapping, continuing to invest in staff training, improved procurement etc.
- In budget setting the base budget will always be questioned for relevance, appropriateness and Value for Money and savings will always be sought to reinvest in key areas.
- Continue to challenge alternative service delivery, such as the recent example of creating a Leisure Trust.
- Ensuring that finances are used in the most appropriate way in terms of funding activities; i.e. Investment Strategy is still appropriate: consider options for leasing or buying equipment; use of the Prudential Code to borrow for capital purposes, etc.
- To maximise income from fees and charges where appropriate including the measure within the Corporate Strategy to operate certain services on a business like model and to follow up the recommendations of the Fees and Charges Task and Finish Forum.
- Consider the early warnings on cost pressures and new bids and consider there priority in terms of inclusion within the future budget and to also determine there appropriateness and seek alternative solutions.
- Continue to scrutinise budget spending during the year including the necessity of replacing vacant posts. It is anticipated that savings will accrue during 2006/07, such items as a full year budget was allowed on refuse and recycling for the enhanced scheme which is unlikely to be in place in the first half of the year, two economic development posts remain unfilled and the Local Authority Business Growth Incentive Scheme has not been budgeted in 2006/07; these savings could be used to offset one

off costs in future budgets. These have not been included in the Model at this early stage but as budget monitoring reports identify areas these can be included with more certainty.

The gap in funding identified is now unfortunately a common theme in terms of setting the Council's budgets. This Strategy does not suggest a fundamental review is required in order to produce future balanced budgets, however, should the Council wish to significantly invest in key or high priority areas then there is little scope currently to do so.

6. Process for Delivering the Financial Strategy

- 6.1 This Strategy will need to be considered and debated by the Executive Board at its meeting on 19 July 2006 and then further by the Overview Committee on the 3 August 2006. A timetable is given in Appendix C of the integrated service planning and budget setting process for which this Strategy will provide the overarching remit in terms of the Councils finances if agreed.

7. Measuring Delivery

- 7.1 Effective delivery of the financial strategy depends on the success in achieving both financial and non-financial targets. This will link to the Council Performance Management Framework with the monthly budget and performance monitoring.
- 7.2 The Strategy and the MTFP model will be updated annually for presentation to Executive Board, but in addition the MTFP model will be constantly reviewed and updated for consideration by the Strategic Management Team and can, with the lead from Members, steer the Councils detailed budget preparation for future years.

APPENDIX A

EXTERNAL INFLUENCES AND KEY ASSUMPTIONS WITHIN THE MTFP MODEL.

- **Comprehensive Spending Review**

The Governments Spending Review sets out the framework for Government grant support to local government. The last Spending Review was in 2004 and covered the period 2005/06 to 2007/08. This review determines the total grant to local authorities for the following three years. In 2006/07 for the first time the Government also produced forward allocations and EDDC were informed of the allocation of formula grant for 2007/08. This being a 2.7% increase, again as in previous years calculated at the floor (minimum) level. The next spending review, to take place in 2007/08 will cover the subsequent three years and future grant allocations for all three years are expected to be announced in the first year, 2008/09. In terms of the MTFP Model a 2.7% increase has been used for 2007/08, as notified, and for the remaining years of the Plan. Here it has been assumed the Council will continue to be protected by the use of a 'floor' mechanism in the grant allocation formula.

Risk assessment

The Government have previously provided all authorities with a real term increase in formula grant. Whilst it is anticipated this provision will be retained in future years, there is a risk that this might not be the case. The impact for example of a nil increase would have significant effect on the funding gap by increasing it by £207,832 for 2008/09. However based on previous experience the likelihood of funding not being increased in "cash terms" is seen as low.

What ifs

Below is the effect of a different outcome to that used in the Plan.

Effect of changes in Formula Grant- comparison made in 2008/09, as certainty over 2007/08.

Worse	Model	Better
1.7%	2.7%	3.7%
£7,828,356	£7,905,331	£7,982,306
-£76,975	-	+£76,975

- **Inflation**

These calculations can be seen from the supporting sheets to the MTFP Model summary, attached in Appendix B. Varying increases have been applied depending on the classification of expenditure. In the main pay has been increased at 2.9% for 2007/08 and then 3% onwards. Main inflation as been taken at 2.5% with the exception of electricity, gas, water, and fuel which have been taken at significantly higher increases, mainly 8%, based on recent experience. Fees and charges have been increased at 3%. Each of these can be separately looked at to see “what if”, but below the effect of increasing each factor by 1% is shown and the effect of decreasing each factor by 1% is shown. A set amount was included for the increase in the refuse and recycling contract of £187,000 annually up to 2009/10 and then an annual increase of £274,078, this follows the report to the Executive Board 14 December 2005. No increase has been assumed on the Leisure Trust Contract.

Risk assessment

The most significant budget provision, in cash terms, is employees pay. Here the assumption is made for pay awards in line with inflation, as in prior years. With regard to other budgets the rise in energy prices are more difficult to predict, however as the overall spend in this area is only £292,000 the impact of prices higher than that allowed are not considered significant when viewed against a net budget of £14/£15m.

What if

Below is the effect of a different outcome to that used in the Plan.

Effect of changes in inflation sums allowed for 2007/08.

Better	Model	Worse
-1.0%	Various %	+1.0%
£365,963	£476,879	£587,795
-£110,916	-	+£110,916

- **Investment Returns**

Current interest return assumes 4.6%, forecasts suggest that rates may fall, but a prudent budget has been set in 2006/07. The Model assumes a 0.1% fall to 4.5% in 2007/08, the same rate is then assumed for the remainder of the Plan. It is assumed that there will be no growth in the investment fund as annually the interest is taken from the fund and used to support revenue funding, it is also assumed that the Council will maintain the level of funding and not use its current reserve levels.

Risk assessment

A number of factors determine the level of interest the council will receive and incur in a year, including:

- Sum invested
- Interest rates
- Speed and level of revenue collection
- Expenditure patterns

The assumption is made that the Council will set a balanced revenue budget and set a capital programme in line with the resources available to it without recourse to the use of balances.

If that position is achieved and the council maintains revenue collection rates the one area of most concern is future interest rates. Here commentators are divided over whether the next move in the market will be upwards or downwards and when. Whilst there are uncertainties in these areas there does not appear to be a commonly held view that rates will move significantly from their current position. The approach adopted, of budgeting for investment income at the bottom end of the portfolio manager's prediction, remains prudent.

What if

Below is the effect of a different outcome to that used in the Plan.

Effect of a change in investment return for 2007/08.

Worse	Model	Better
-0.2%	4.5%	+0.2%
£990,911	£1,037,000	£1,083,089
-£46,089	-	+£46,089

- **Job Evaluation**

A sum has been included in 2007/08 of £351,309 relating to the introduction of job evaluation and costs associated with those individuals who will be protected from immediate salary reductions (currently assumed for 4 years) due to job evaluation, whereas those who are to receive a pay increase will do so immediately. The figure of £351,309 has been calculated based on 3% of pay which is based on advice received from the experience of other authorities introducing job evaluation.

This cost of protecting salaries is recovered over an estimated 3 years as it is assumed that those who receive a reduction in salary under job evaluation will not receive the annual pay award.

Risk assessment

The calculation of this as been taken on advise from other authorities experience, if the costs are greater than predicated than this would not significantly effect the overall conclusions of the calculation within the Plan as it is assumed costs will be recovered fairly quickly by the non increase in pay awards for those effected.

- **New Community – Cranbrook**

Costs have been predicted for the provision of servicing to the new community at Cranbrook. The phasing of development and likely amenities to be required have been considered, although this is an area where future updated MTFP models will require further analysis. The significant costs are currently expected to fall outside the life of the current Model. Predicted costs are shown in the Plan offset against the likely level of additional council tax income which will be received from the new community. This is difficult to estimate as additional properties will affect the Council's Tax Base which in turn will affect the Council's formula grant, again this will need to be revisited when further details our known, but the effect on the Plan projections are considered not material at this stage.

Risk assessment

Timing on speed of delivery will be dependant on the granting of planning permission, the capacity of builders and the general housing market. The impact on the plan of delays will be the effect of deferring expenditure, therefore not seen to be significant in financial terms.

- **Local Authority Business Incentive Scheme (LABGI)**

The Council received a grant under the LABGI scheme in 2005/06 of £130,000. The exact calculation for future years is currently under review by Government, however the Council's base of business rate valuations has continued to grow steadily and it is extremely likely that the Council will receive at least this figure in the future. An income sum of £130,000 has been included in the model for future years from 2007/08, but this is considered a prudent amount. If the Government continues to support this scheme in a similar fashion then the Council could benefit substantially in future years with the introduction of Skypark etc.

Risk assessment

There is no reason to believe businesses will not continue to be attracted to the region accordingly basing the budget provision on the minimum sum anticipated is considered to be prudent at this stage.

- **Council Tax Income**

Income from council tax has been included in the model assuming a 2.5% increase, in line with general inflation, whilst it is assumed the Government will maintain the capping rules with increases limited to 4.99. The Model also assumes that there will be no surpluses or deficits to be declared on the Collection Fund.

Risk assessment

Again assuming council tax increases in line with inflation is considered to be prudent and does provide for scope to raise further sums, up to the capping limit, should the need arise.

What if

Below is the effect of a different outcome to that used in the Plan.

Effect of a change in Council Tax Level for 2007/08.

Lower	Model	Higher
-0.5%	2.5%	+2.49%
£6,243,969	£6,274,579	£6,427,003
-£30,610	-	+£152,424

- **Other issues.**

There a few other issues to note regarding the Plan, these being:

- i. There is a base income figure included in the 2006/07 estimates and carried forward to future years of £140,000 for Planning Development Grant (PDG). PDG will come to an end with 2007/08 being the last year of grant monies. However, this level has been left in the Model as indication from Government is that this funding will be replaced with the ability for Council's to raise their charges to cover the loss.

Risk assessment

The impact would be a loss of £140,000 in income; however the likelihood that this would not be replaced with increased income in fees is small as the Government has already stated that this is their intention.

- ii. The Land Charges budget in 2006/07 is estimated to bring a net income to the Council of £144,620. This sum has been carried forward to future years of the Plan, updated for inflation. There has been some discussion that Government is considering to instruct Councils that they should not be making a “profit” on these activities and should do no better than break-even. We are awaiting official confirmation of this and because of the effect this will have on this Council and other Councils it is envisaged that there will be a period of consultation, at that stage the MTFP will be updated accordingly.

Risk assessment

The impact could be a loss of £144,620 in income; however if this change was implemented the Council would ensure that full costs are appropriately charged to this service before calculating any “profit” to ensure this sum is kept to a minimum.

- iii. Currently the 2006/07 refuse and recycling budget includes a sum of £105,430 as a waste performance and efficiency grant from DEFRA. A slightly higher sum has been announced for 2007/08 and this grant has again been left in future year projections at this stage, when further details are known in the future the Model will be updated.

Risk assessment

The impact would be loss in income, and although this would cause a problem it would not be material compared with the overall budget of the Council.