

MEETING: 16th NOVEMBER 2015

Item 7

SUBJECT: BUDGET PLANNING FRAMEWORK 2016/2017

JOINT REPORT OF THE CHIEF FIRE OFFICER AND THE FINANCE OFFICER

1 Purpose of Report

- 1.1 This report identifies the key factors influencing the development of the Authority's financial plans into the medium term and sets out the Budget Planning Framework for 2016/2017. The report sets out the headlines and context for the Medium Term Financial Strategy 2016/2017 to 2018/2019 which will be formally considered later in the budget cycle.

2 Description of Decision

2.1 Members are recommended:

- To note the contents of the report and the revised estimated funding gap based on the most up to date information we have, recognising that there is considerable uncertainty around government funding allocations;
- To agree the proposed Budget Planning Framework summarised at Section 10 of the report which will guide the preparation of the Revenue Budget for 2016/2017; and
- To note that the full Medium Term Financial Strategy 2016/2017 to 2018/2019 will be presented to the Authority in February 2016.

3 National Economic Context

3.1 Impact of the Deficit Reduction Plan

On 8th July 2015 the newly elected Government confirmed in their Summer Budget Statement that the economy is continuing to grow and that steady growth is projected in each year of the next parliament (2015/2016 to 2019/2020). The Chancellor set out revised high level plans to address the remaining deficit with the aim of generating a budget surplus of circa £10bn in 2019/2020. This is a year later than that announced previously in the Coalition government's March Budget.

The Government set out plans to achieve this position through an updated 'Consolidation Plan' which requires a total of £37bn of savings, £32bn of which will come from public sector expenditure cuts by 2019/2020. This represents an increase in the cuts required across the period of £7bn, compared to that announced in the March Budget. The following table shows where the

Chancellor has indicated the savings will be made and the expected timing of those savings.

	£ billion			
	2016/17	2017/18	2018/19	2019/20
Welfare reform	5	7	9	12
Tax avoidance and evasion	1	2	4	5
Government Departmental Spending	3	11	18	20
Total National Consolidation Plans	9	20	31	37

The extent of the Government Departmental Spending cuts will be determined by the outcome of the Spending Review.

3.2 Inflation

CPI inflation decreased from 0.1% in July 2015 to 0.0% in August 2015, below the Government target level of 2%. While inflation levels may fall further in the short term, within the next two years the Bank of England intends to set monetary policy in order to ensure there is a return to the inflation target of 2%. The low level of inflation is welcomed as the impact of price increases on local government costs is not funded by Central Government and must be contained within the Authority's budget planning.

3.3 Base Rate

The Bank Base Rate has remained at an all-time low of 0.50% since March 2009. The Bank of England Governor has said that a rise in the base rate is "drawing closer".

Financial analysts are speculating on the timing of an increase in the current Bank Rate with most anticipating a rise will not take place until the second quarter of 2016, following which base rates are expected to increase gradually to 1.75% by March 2018. This position will continue to be monitored and reviewed and the impact taken into account in budget planning.

4 Government Core Funding

4.1 At this stage the Government has not published details of funding for local government, either nationally or at a local level, as this will depend on both the outcome of the autumn Spending Review to be announced on 25th November 2015 and the Local Government Finance Settlement expected to be released late December. The following is therefore based on best available intelligence.

4.2 In year Funding Reductions 2015/2016

On 4th June 2015 the government announced £3bn of spending reductions to be achieved in year for 2015/2016. Included within this total was a £230m DCLG saving which is to be achieved mainly through the sale of surplus government assets.

Although the Fire Authority was not affected from any of the in year cuts, there is concern that some of the in year cuts achieved by the government are one-off savings from capital receipts. If equivalent savings need to be found on a permanent basis from 2016/2017, the total departmental savings requirement may have to increase.

4.3 Spending Review 2015 - HM Treasury Guidance

The Chancellor confirmed that some specific public services would be protected or would see their funding increased in real terms as part of the spending review process. These included:

- NHS will receive £10bn additional funding by 2020/2021;
- Defence funding will grow by 0.5% above inflation and security spending will increase by £1.5bn by 2019/2020 to meet the NATO 2% pledge;
- Schools will have their funding 'protected'; and
- Foreign Aid will be increased in line with the growth in GDP.

As a result, the cuts to all non-protected government departments (of which DCLG is one) will need to be higher than those published. As a consequence the Chancellor requested all such affected departments to provide details of cuts of 25% and 40% by 4th September 2015, which was to be followed by a period of discussion and negotiation.

The outcome of the Spending Review 2015 will be announced on 25th November, although the detailed impact on individual Authorities will not be known until late December when the Local Government Finance Settlement is expected to be announced.

4.4 Proposed Changes to Local Government Funding

On 5th October 2015 the Chancellor announced a series of major reforms to local government finance. In summary, these include:

- By the end of this Parliament, local government will be able to retain 100 per cent of local taxes including all £26 billion of revenue from business rates;
- The core (Revenue Support Grant) funding from Whitehall will be phased out and local government will take on new responsibilities.
- The government will abolish the Uniform Business Rate and give local authorities the power to cut business rates to boost economic activity in their areas;

- Local areas which successfully promote growth and attract businesses will keep all of the benefit from increased business rate revenues;
- Directly elected mayors – once they have support of local business leaders through a majority vote of the business members of the Local Enterprise Partnership, they will be able to add a premium to business rates to pay for new infrastructure (up to 2p in the pound has been indicated); and

The Government is to set out further details of these proposals in the Spending Review, including how local government will contribute to the Public Expenditure cuts (fiscal consolidation) over the period of this Parliament.

4.5 Summary Prognosis on Government Core Funding

It is clear that local government is to face at least 4 more years of continuous funding reductions. The scale of the cuts is very difficult to accurately assess at this stage. However, the request by the Chancellor for proposals for cuts of 25% and 40% from departments demonstrates that these are going to be significant over the next 4 years. This comes on top of the sustained cuts already experienced since 2010.

The Summer Budget also included policy measures such as a commitment to the National Living Wage. This will see additional cost pressures to local authority budgets in addition to the proposed cuts to funding and inflationary and demand pressures already faced.

While there is considerable uncertainty on the level of future funding, it is clear that local government is entering the most challenging period yet faced.

5 Other Considerations that could Impact on Longer Term Planning

5.1 Business Rates (Revaluation and Review)

The Government is undertaking a review of the Business Rates system to “make them fit for purpose in a 21st century economy”. The outcome of this review is due to be reported on in the Spring 2016 Budget. The Government has indicated that the outcomes of the review will be fiscally neutral and consistent with the governments agreed financing of local authorities.

The current rating list is based on the 2010 revaluation with a new list due to be introduced from April 2017. At this stage it is not possible to quantify the potential impact on the Authority’s financial position, although it is anticipated that the Government will seek to neutralise the impact via a top-up/tariff arrangement. However, it is expected there will be an increase in appeals following the introduction of the new rating list which will result in additional financial uncertainty.

5.2 Devolution

As part of the Spending Review the Government invited submissions for proposals in line with their Devolution agenda. The North East Combined Authority has responded with a submission based on the principle of subsidiarity with devolution from Whitehall, accompanied by a strengthening of local and community leadership. The proposals include a number of asks from Government relating to both fiscal and financial elements, as well as seeking to deliver an ambitious vision for the social and economic future of the North East.

Discussions with Government are on-going. As the position becomes clearer, the implications for the North East will be taken into consideration as part the Authority's budget setting process and medium term financial strategy.

6 Summary Outlook

6.1 At this stage the outlook for local government funding remains very bleak with continued unprecedented reductions up until 2019/2020 at least, coupled with the unknown impact of the changes proposed to the way local government is to be funded.

6.2 The scale of reductions faced is therefore very uncertain at an individual authority level and detailed funding allocations for 2016/2017 will not be available until late December. Authority planning at this stage currently assumes a 34% reduction in core funding over the medium term, reflecting the trajectory of previous years reductions.

6.3 Therefore, given the significant uncertainties, it is proposed to progress with current planning (of a £2.711m reduction in core funding for 2016/2017) at this stage, subject to the release of more detailed information that will be released in the Spending Review on 25th November 2015 and the Local Government Finance Settlement in December, when the position can be further reviewed.

7 Local Income Position

7.1 Council Tax

7.1.1 The Localism Act provides for the provision of referendums to veto excessive council tax (precept) increases. This effectively places a limit on council tax increases and, if authorities exceed the government limits, the public will be able to vote to agree or veto any considered 'excessive' increase. For 2015/2016 a referendum requirement applied for proposed increases in Council Tax of 2% and above. There is no indication at present as to the proposed limit for 2016/2017.

7.1.2 The Government has given no indication as to whether Council Tax Freeze Grant will be available for 2016/2017 or future years. This is likely to emerge as part of the outcomes of the Spending Review and consideration of this will be taken once the information is available.

7.1.3 The Local Council Tax Support Scheme was introduced from April 2013 and is currently in its third year of operation. A review of the scheme is currently being undertaken to inform whether any changes should be introduced for the 2016/2017 financial year. Depending on the scale of proposed changes, proposals arising from the review will be subject to consultation and the financial impacts will be included in the budget planning as necessary.

7.2 Business Rates

7.2.1 Under the Retained Business Rates funding arrangement for local Government implemented from April 2013, the Authority is currently allocated locally 2% of increased income arising from growth in the Local Business Rates base from its constituent authorities (equally it shares the risk of any under achievement of income targets).

7.2.2 Inherent within the scheme is growth arising from annual inflationary increases to Business Rates. However, there is continuing uncertainty, specifically around appeals and avoidance tactics, which can significantly impact on the level of income achieved. The position will be kept under review and changes to Business Rates income will be reflected in the Budget Planning Framework as appropriate.

7.2.3 It is not clear however if these elements will change under the proposed new funding arrangements.

7.3 Reserves and Balances

7.3.1 The Local Government Finance Act 1992 requires local authorities to have regard to the level of reserves needed for meeting estimated future expenditure when calculating the budget requirement.

7.3.2 In accordance with the approach adopted to date, all earmarked reserves will be revisited and fully reviewed as part of the budget process to ensure they still accord with the Authority's priorities and overall funding position.

8 Spending Pressures and Commitments

It is proposed to take into account the following spending commitments in the Budget Planning Framework for 2016/2017, noting that in a number of cases specific cost details cannot be finalised at this stage and will be subject to further review and refinement throughout the budget setting process:

8.1 Pay and Pensions

8.1.1 Pay

The Government has indicated a limit on public sector pay of a 1.0% pay increase. For planning purposes a prudent provision has been built into the MTFs from 2016/2017.

8.1.2 National Living Wage

The Government's proposal to implement the national living wage of £7.20 rising to £9.00 by 2020 represents an additional cost pressure for all Authorities, both through its own staff costs and any external contract suppliers passing the cost on through increased contract prices.

At this stage there is significant lobbying of government from both public and private sectors on the implications of this policy proposal. Government has indicated they are considering the impact as part of the Spending Review and, as such, this position will be monitored and kept under review.

8.1.3 Pensions

Local Government Pension Scheme

The Triennial Actuarial review of the Local Government Pension Scheme was undertaken in 2013 covering 2014/2015 to 2016/2017. The outcome of the review has been reflected in the planning for 2016/2017. Prudent provision has been included in the MTFs for the potential impact of the next actuarial triennial review due in 2017.

Firefighters Pension Scheme

Government changes to the scheme came in to force from 1st April 2015 with the addition of the new 2015 scheme and Modified Scheme. Changes to both employer and employee contribution rates across the firefighter pension schemes will impact on pension expenditure. The financial implications of this have been estimated and reflected in the 2016/2017 budget and the MTFs. This will be kept under review and amended accordingly.

8.1.4 National Insurance

The Pensions Act 2014 provided for reform of the state pension system, introducing a single tier pension. As part of the reforms, the contracting out for occupational pension schemes from April 2016 will be abolished. For employers, the abolition of contracting out will result in an increased cost of 3.4% on national insurance contributions. The Act provides no method to alleviate the additional financial burden. The impact for 2016/2017 is estimated to be £0.770m and this is now reflected within the revised cost pressures.

8.2 Energy Prices

Energy and vehicle fuel prices continue to be volatile. It is therefore proposed that prudent provision be included for continued annual increases in charges for gas, electricity and vehicle fuel for the medium term. However, it is also important to note that increases are lower than anticipated because of the Authority's proactive approach and actions it has taken in respect of developing and then implementing its carbon management policy.

8.3 Capital Financing

No prudential borrowing has been included within the medium term financial position at this stage, but the position will be continuously reviewed to ensure that the future use of resources reflects best value and can be adapted to enable strategic priorities of the Authority to proceed in the future.

9 Summary Resource, Pressures and Commitments Position

9.1 The total reduction in resources and spending pressures represents the estimated gross funding gap. However at this stage there is significant uncertainty in relation to:

- The outcome of the Spending Review and the level of government funding reductions in 2016/2017 and beyond;
- Settlement confirmation for 2016/2017, probably not available until mid December;
- The full implications to the Authority of the proposed changes to the way in which local government is funded;
- Any impact of devolution on the Authority's resources;
- The outcome of the development of revised funding approaches e.g. Business Rates review and revaluation, and devolution proposals; and
- The general economic position and public sector finances (direct connectivity between the economy and public finances).

9.2 The level of funding reduction, as currently presented, represents a very significant challenge given the already compounded impact of significant reductions and increased cost pressures since 2010. It is clear that further significant reductions will be required year on year over the 2016-2020 period.

9.3 As outlined, the savings requirement for 2016/2017 and beyond remains very uncertain. However high level estimated reductions over the next three years are set out below:

	2016/17 £m	2017/18 £m	2018/19 £m	Total £m
Government Cuts*	2.711	2.363	2.162	7.236
Spending Pressures	1.682	0.920	0.606	3.208
Total	4.393	3.283	2.768	10.444
Less IRMP estimated savings	(1.608)	(1.185)	(1.009)	(3.802)
Less Council Tax and Business Rate growth	(0.287)	(0.290)	(0.295)	(0.872)
Less net efficiencies and other variations	(0.013)	(0.106)	0.000	(0.119)
Funding Gap	2.485	1.702	1.464	5.651
Cumulative Funding Gap	2.485	4.187	5.651	

*high level assumptions at this stage

- 9.4 The figures in the above table do not include:
- Any increase in the council tax precept for 2016/2017 onwards, nor any take up of freeze grant should it be available on the basis these decisions have not yet been agreed and cannot be assumed at this stage;
 - Any budget surplus achieved in year or over the period;
 - Any future savings from the current IRMP actions still to be implemented;
 - Any new IRMP actions that are identified over and above the existing 2013/16 IRMP actions.
- 9.5 Further savings from the IRMP actions implemented are anticipated over the three year period of the Medium Term Financial Strategy (MTFS). These will be generated from additional savings in 2016/2017 made by bringing Control in House, continued phasing in of the Response Model Review up to 2018/2019 and payment of the anticipated surplus on the Trading Company in 2018/2019. The estimated savings have been included in the MTFS.
- 9.6 A further two reviews were agreed by the Authority in November 2014 (IRMP 2014-2017) which relate to an organisational review (including management) and greater collaboration with external partners. These are being developed and progressed and, once completed, will help to address the gap in resources currently identified. However, depending on the amount of savings realised, further IRMP actions will need to be developed by the Authority.
- 9.7 Further budget efficiencies continue to be achieved and it is estimated that initial savings of almost £50k will be made in 2016/2017 as a result of a detailed review of the Lead Authority's SLA charges which has recently been completed. Officers are continuing to work on the details regarding implementation of any necessary changes. Any further savings will be included once the 2016/2017 budget has been finalised.
- 9.8 The revised budget gap into 2018/2019 shows that the Authority's decision to earmark around £6m of its reserves to help support the budget over the medium term until it can implement its IRMP actions, is both necessary on a continuing basis and considered prudent.
- 9.9 These projections however remain volatile due to the significant uncertainty surrounding the settlement and a number of other key financial issues which will become known / available in the next few months and the fact members will have to consider further the council tax precept position. An updated position will therefore be reflected in a revised MTFS to be presented to members in February 2016.



10 Proposed Budget Planning Framework

It is proposed the budget planning framework as set out below is adopted:

- Budget planning to be based on the high level position outlined at paragraph 9 and updated in light of the Spending Review 2015 and Local Government Finance Settlement expected in December;
- Provision for spending commitments to be included at this stage on the basis set out at section 8 and kept under review;
- Budgets to be prepared on the basis that all spending pressures not specifically identified above as commitments be accommodated within existing budgets;
- All commitments against surpluses / reserves to be reviewed;
- The position regarding the Council Tax Precept to be considered as part of the budget process ; and
- Commitments against general balances and earmarked reserves to be updated as necessary throughout the budget process.