APPENDIX 2

GENERAL FUND FINANCIAL FORECAST 2013/14 to 2015/16

2013/14 General Fund Financial Forecast

1. Each year the Chief Financial Officer (CFO) prepares a financial forecast for the next financial year that takes into account inflationary pressures, base changes, decisions from previous budgets and assumptions about council tax and grant income from the Government.

2. This forecast forms part of the base assumptions for developing the overall budget, together with unavoidable service pressures agreed by the Management Board of Directors (MBD) that need to be taken into account in the overall budget deliberations.

3. The purpose of this technical financial appendix is to provide details of the financial forecasts and the assumptions that have been used in coming up with the overall base position, together with other factors relevant to the overall budgetary position.

4. Since the Council set its 2012/13 budget in February 2012, the economic outlook for the country has remained difficult. Economic growth has been slow at best and the prospects are that we face a difficult and protracted recovery. Inflation remains sticky and unemployment stubbornly high. There are a range of views as to when the decline will reverse and the Country will begin to see an economic upturn but all opinion points to a longer time frame for recovery.

5. In setting the 2012/13 budget a prudent view was taken but clearly the economic climate has a direct impact upon the Council. Income levels in key areas such as car parking and arts and heritage venues continue to suffer and certain service areas supporting those individuals most affected by the economic climate, such as benefit applications, continue to experience rising demand for services.

6. The Comprehensive Spending Review (CSR) released in October 2010 and the detailed Local Government Finance Settlement that followed confirmed the unprecedented reductions in Local Government Funding over the next four years, which were front loaded. Detailed settlement figures were provided for 2011/12 and 2012/13 but the final two years were subject to a Local Government Resource Review, which will conclude with the announcement of the draft settlement in December.

7. In more general terms, the main impact upon the Council's medium term financial planning relates to the level of Government grant, grant support in respect of capital investment and government policy relating to council tax increases. In particular, the outcome of the Resource Review, alongside the Government's funding on Health and its impact upon Adult Services funding are likely to have a significant impact. The effect on local taxpayers is also a critical element in making decisions on council tax levels, particularly given the legislation contained in the Localism Act which provides local residents with a power to approve or veto excessive council tax rises to be exercised through a binding referendum.

8. No detailed grant settlement figures have been released for 2013/14 and beyond, but it had initially been assumed for planning purposes that further reductions in formula grant of 7% per annum would be made. Uncertainty is heightened as the financial year 2013/14 will see a number of fundamental changes including:

- The retention of Business Rates and the extent to which Local Authorities may benefit or lose from increases / decreases in Business Rate growth.
- The localisation of support for Council Tax including an associated 10% reduction in funding.
- The transfer of Public Health to Local Authorities and its associated funding.
- The introduction of Police Commissioners from November 2012 and the associated transfer of crime prevention responsibilities from Local Authorities.

In addition, it is difficult to predict the future of health funding allocated to Local Government beyond 2012/13 but at this stage it has been assumed that there will be a continuation of this funding in line with the indicative levels set out in the CSR.

9. The, difficult national economic situation and the impact that it is having on the Council's financial situation and the demand for services combined with the challenges presented by the CSR requires the Council to take an extremely robust approach to medium term planning.

10. The budget setting process within the Council has generally been focused on the final decisions made at the February Council meeting, although in reality the development of the budget is a year long activity.

11. In the past there has been a general tendency to wait until the February meeting before progressing new options for spending and saving which can mean that implementation is delayed until later in the financial year depending on the lead in times required for the different proposals.

12. The scale of the financial challenge facing the Council combined with the potential impact of an ongoing difficult economic position make it imperative that proposals for 2013/14 onwards are developed and savings achieved as early as possible.

13. The report to Cabinet and Council on 11 and 12 September 2012 respectively, highlighted the challenges facing the Authority and identified an updated roll forward gap for 2013/14 of £25.8M rising to £57.4M in 2015/16, before taking into account any further revenue developments, pressures or savings.

Update Since September

14. The financial forecast is continually reviewed to ensure that it reflects the most current information and since it was published at the start of September a number of changes have been built into the latest position.

15. Sine the CSR announcement which set out the local government spending control totals there have been subsequent changes in the light of changing government policy and the ongoing difficult economic position. These changes were crystallised in the publication by the Department for Communities and Local Government (CLG) entitled "Business Rates Retention – Technical Guidance" and indicate a reduction in funding in excess of that set out in 2010.

16. The changes include transfers and adjustments to the local government spending control totals, and include proposed methodologies for incorporating those separate grant funding streams into the new business rates retention scheme from April 2013. These changes are set out below:

	2012/13	2013/14		2014/15	
	£M	£M	Year on Year Change %	£M	Year on Year Change %
CSR (1)	23,385	23,196	(0.8)	21,856	(5.8)
Revised Assumption for Pay Award (2)		(240)		(497)	
TIF & New Development Deals (3)		(20)		(20)	
Fire Grants		(50)		(50)	
Neighbourhood Planning		(15)		(20)	
Capitalisation		(100)		(100)	
Safety Net (Business Rates Retention)		(250)		(250)	
New Homes Bonus (Option a)		(1,656)		(1,656)	
Revised Control Total (4)	**23,385**	**20,865**	**(10.8)**	**19,263**	**(7.7)**

[1] CSR adjusted to include neighbourhood planning grant in 2013/14 and 2014/15

[2] The 2011 Autumn Statement set out that, in order to maintain economic stability and meet its fiscal rules, the Government would "set public sector pay awards at an average of one per cent for each of the two years after the current pay freeze comes to an end and that departmental budgets would be adjusted in line with this policy.

[3] Funding (spread over a six year period) will be made available from the local government spending control totals to offset the impact of additional infrastructure spending as a result of Tax Increment Funding 2 and investment in core cities on net public sector debt.

[4] **The above figures include Police and Fire and for Local Authorities the revised reductions in the spending control totals for 2013/14 and 2014/15 are 12.3% and 8.7% respectively which can be compared to original CSR figures of 0.6% and 6.5%.**

17. Given the level of uncertainty, in calculating an indicative Council Tax for 2013/14 it had been assumed that the figures for National Non-Domestic Rates (NNDR) and Revenue Support Grant (RSG) would reduce by 7%. However, in the light of the information set out in paragraph 16, which shows a potential reduction in grant funding of 12.3%, this has been reduced downwards by a further £1M, effectively allowing for an 8% reduction in government grant funding (excluding the impact of New Homes Bonus for which the Council will receive additional funding).

18. The original assumption was for an increase in Council Tax of 2.5% but this has how been reduced to 2.0% in light of the announcement by the CLG that a referendum will be required for increases of more than 2.0%. This has reduced the forecast level of Council Tax by £0.4M in 2013/14.

19. The estimated Collection Fund surplus at the end of 2011/12 was £435,800 and this estimated surplus was taken into account in setting the 2012/13 Council Tax and was shared by the City Council, Hampshire Police Authority and the Hampshire Fire and Rescue Authority in proportion to the precepts levied by each authority in 2010/11. At the end of 2011/12 the actual surplus was approximately £1.7M and the additional surplus of £1.2M has been carried forward and is available to be shared between the precepting authorities in proportion to the precepts levied in this year. Southampton City Council's element which is £1,041,600 has been taken into account as part of the 2013/14 forecast.

20. In previous years, the Council set up a Risk Fund to manage certain potential pressures that may arise in year. The majority of these pressures are volatile in nature and cannot be forecast accurately until data is collected during the financial year on the level of activity and costs. This change in approach has meant that not all of the money set aside for pressures is allocated to Portfolios prior to the start of the year. The individual items are also risk adjusted to reflect the fact that not all of them are likely to materialise during the year. This approach has proved very effective and will be continued, as a result of which a sum of £7.7M has been included in the forecast to cover such pressures. This sum reflects increasing provision for the costs for children in care, the costs for adult social care, the impact of the recession on income and inflation on key items such as energy costs. This figure is £1.2M greater than previously forecast in September.

21. Other changes have been made to the base position to reflect changes in anticipated expenditure and the utilisation of a number of one off funding sources over and above those previously taken into consideration.

22. The changes since September are summarised below:

	2013/14	**2014/15**	**2015/16**
	£000's	**£000's**	**£000's**
Gap in September	25,815.5	42,182.2	57,439.0
Government Grant Funding	1,000.0	1,000.0	1,000.0
Council Tax @ 2.0%	417.0	758.0	1,111.6
Collection Fund Surplus	(1,041.6)		
Increase in Risk Fund	1,200.0	600.0	300.0
Other One off Funding	(6,718.8)	(200.0)	
Other Changes	(1,750.0)	(2,350.0)	(2,350.0)
Updated Position	**18,922.1**	**41,990.2**	**57,500.6**

Unavoidable Service Cost Pressures

23. In addition to the forecast prepared by Officers shown in the table above, the MBD have also been reviewing other service cost pressures and assessing whether or not these are unavoidable and should therefore be added directly to Portfolio Budgets (as opposed to those in the Risk Fund that will be held centrally).

24. These pressures totalling £2.2M which have been signed off by the MBD are £1.2M more than originally allowed for in 2013/14 and include additional resources for:

- children in care and
- additional safeguarding staff resources

25. When these pressures are taken into account the revised gap is approaching £20.2M in 2013/14 as shown below:

	2013/14	**2014/15**	***2015/16***
	£000's	**£000's**	***£000's***
Updated Position	18,922.1	41,990.2	57,500.6
Pressures (over and above £1M)	1,247.0	797.0	497.0
Revised Gap	**20,169.1**	**42,987.2**	**57,997.6**

Base Position 2013/14

26. Taking all of these items into account gives a Council Tax Requirement figure for 2013/14 of £105M which represents what we think the Council needs to spend. Comparing this to the amount we are able to spend provided by an indicative 2.0% council tax increase produces a 'roll forward gap' for the year of just under £20.2M as shown in the following table:

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Portfolio	Original Budget 2012/13	Base Changes & Inflation	Roll Forward 2013/14
	£000's	£000's	£000's
Adult Services	70,082.2	2,426.6	72,508.8
Children's Services	59,590.1	782.6	60,372.7
Communities	6,640.0	(497.1)	6,142.9
Environment & Transport	32,854.5	2,467.3	35,321.8
Housing & Leisure Services	20,461.5	(1,417.6)	19,043.9
Leader's Portfolio	4,513.8	51.1	4,564.9
Resources	16,326.6	(839.8)	15,486.8
Pressures		2,247.0	2,247.0
Sub-total for Portfolios	**210,468.7**	**5,220.1**	**215,688.8**
Levies & Contributions	649.0		649.0
Capital Asset Management	(11,300.6)	1,680.0	(9,620.6)
Risk Fund	6,300.0	1,400.0	7,700.0
Non-Specific Government Grants	(120,810.8)	8,526.2	(112,284.6)
Council Tax Freeze Grant	(2,070.9)	2,070.9	
Other Expenditure & Income	1,003.1	(966.6)	36.5
Net General Fund Spending	**84,238.5**	**17,930.6**	**102,169.1**
(Draw from) / Addition to Balances:	(1,033.0)	3,900.0	2,867.0
Council Tax Requirement	**83,205.5**	**21,830.6**	**105,036.1**
Budget @ 2.0% Council Tax	**83,205.5**	**1,661.5**	**84,867.0**
Total Gap	**0.0**	**20,169.1**	**20,169.1**

27. The overall revised gap that needs to be closed of just under £20.2M represents 19.7% of net General Fund spending.

28. This position represents the 'base' position from which all three political groups may develop their own budgets taking into account the proposals for spending and the savings options put forward.

29. In arriving at this ‘base’ position a number of one off funding sources have been utilised which total almost £7.8M. These include contractual savings from the Street Lighting PFI project (£0.8M), the Collection Fund surplus (£1M), a reduction in the contribution to reserves (£0.2M), use of balances (£0.3M), a one off saving from the Capita contract (£2.8M) and the utilisation of the estimated New Homes Bonus for 2013/14 (£2.7M). These one off elements, whilst serving to reduce the gap in 2013/14, by their very nature do not positively impact on the medium term financial position.

Medium Term Financial Forecast 2013/14 to 2015/16

30. Whilst the position for the years beyond 2013/14 is even more uncertain, as outlined in paragraphs 6 to 8 and also 15 to 18, the intention remains to produce a high level plan containing longer term objectives that can be pursued and a roll forward position has been prepared for a further two financial years. The forecast shown in detail in Appendix 4 takes into account inflation and known base changes.

31. The ‘budget limit’ for each of the years is derived from assuming an indicative 2.0% increase in Council Tax for each year and a further reduction of 7.0% per annum in Government funding for 2014/15 and also 2015/16. The gap each year that results is:

	2013/14	**2014/15**	**2015/16**
	£000’s	**£000’s**	**£000’s**
Council Tax Requirement	105,036.1	129,446.8	146,485.1
Council Tax Increase at 2.00%	(84,867.0)	(86,659.6)	(88,487.5)
Roll Forward Gap	**20,169.1**	**42,787.2**	**57,997.6**

32. This forecast provides an indication of the likely gap that will be faced by the Council each year, but as past attempts have shown it is not an exact science and there are so many variables within the Council’s budget that it is impossible to predict accurately. Nevertheless, the forecast provides a medium term financial forecast to enable Political Groups to consider their financial strategies for tackling the overall position that is presented for future years.

General Fund Balances

33. The CFO recommends that the minimum level of the General Fund Balance should be £5.0M, which has been derived by looking at a risk-based approach to the overall General Fund Revenue Account. This takes into account income volatility, interest rate exposure, new contracts and also potential over spends in demand led areas such as social care and safeguarding both for adults and children.

34. The net effect on balances of the forecasts contained in this appendix is shown in the table below:

	2012/13 £000's	2013/14 £000's	2014/15 £000's	2015/16 £000's
Opening Balance	23,529.6	7,545.8	5,260.9	5,377.2
Draw to Support Capital	(312.6)	(10.0)		
Contributions from / (to) Revenue	(3,999.0)	2,877.0	4,000.0	4,000.0
Draw for Strategic Schemes	(11,672.2)	(5,151.9)	(3,883.7)	(4,074.0)
Closing Balance	**7,545.8**	**5,260.9**	**5,377.2**	**5,303.2**

35. The above projection includes an addition to the Organisational Development Reserve of £4.0M in 2013/14 and each of the following years in order to ensure that adequate ongoing provision is made for the costs associated with the implementation of staff related savings, based on the current redundancy scheme.

36. The minimum level of balances is set at £5.0M and the above prediction indicates that this will be maintained in the medium term. Presently, £593,200 is available within balances of which £290,000 has been factored into the forecast presented in this report. The remainder of £303,200 is a consequence of the forecast position as at Month 6. Given the fact that this is a forecast position it would not be prudent to utilise this amount at this stage of the year.

Assumptions and Risks

37. Local Authority budgeting is by its very nature difficult to forecast with absolute certainty since there are so many variables that need to be assessed and so much of the information is not known until very late in the process.

38. It is important to note that the revised forecast represents the most realistic forecast position moving forward. However, there are a number of risks associated with these revised forecasts, the main risks being as follows:

Local Government Settlement

39. The Aggregated External Finance through the annual settlement (comprising RSG and NNDR) accounts for £97.6M of the Council's budget in 2012/13 and for 2013/14 the lack of any draft figures provided as part of the settlement for local government within the four year CSR period has heightened this risk as has the uncertainty surrounding the impact on Southampton of the Local Government Resource Review and the changes set out in paragraph 8 of this Appendix.

40. Two other areas which represent a further risk within the Council's forecasts are specific grants (which reflect changes in national funding) and transfers of responsibility in and out of Local Government. Details of these changes will not be known until the settlement figures are released in December.

41. A separate briefing note will be produced once all of the information has been received and analysed. This will outline the impact of the settlement compared to the forecasts shown in this report.

Pay Inflation

42. Assumptions have been made in the forecast about the likely level of pay inflation that will apply from 1 April 2013 and the current assumption is for a 1% pay award. Clearly, since a large proportion of the Council's expenditure is pay related, this can have a significant impact if actual rates are much higher than predicted.

43. These risks are reduced by the announced intention to limit public sector pay to no more than 1% on average in 2013/14 and 2014/15. The impact of any award would be picked up in future forecasts. However, given the current economic outlook, it is not anticipated that there will be an unexpectedly high increase for either of these years compared to assumed levels.

General Inflation

44. Assumptions have been made in the forecast about the likely level of general inflation that will apply from April 2013. Given the uncertain economic outlook if inflation were to increase at a higher rate than anticipated then this would have an impact on the Council.

45. This risk has been mitigated by the inclusion of amounts in the Risk Fund to cover key elements of inflation, for example in relation to fuel and energy costs, which can be volatile.

46. Beyond this provision, it is likely that this would be managed as an 'in year' issue and that Directorates would be expected to absorb the difference which may be partly mitigated by improvements in the Council's financial position driven by any economic recovery.

Interest Rate Exposure

47. The Council has a large long-term debt Portfolio and more recently has had significant cash balances available for short term investment. A major debt restructuring exercise was undertaken in previous years in order to take advantage of market conditions. In achieving this, the Council has exposed itself to short term variable interest rate risk and whilst in the current climate of low interest rates this is obviously a sound strategy, at some point when the market starts to move the Council will need to act quickly to lock into fixed long term rates which may be at similar levels to the debt it has restructured. Furthermore, the volatility in the financial markets means that interest costs and investment income will continue to fluctuate for some time.

48. There is therefore potential for the figures in the forecast to be adversely affected by changes in interest rates. It was therefore recommended and approved in the February 2009 Treasury Management Strategy report to Full Council that an Interest Equalisation Reserve be created from any savings arising from the debt restructure to help to manage volatility in the future and ensure that there is minimal impact on annual budget decisions. Albeit that this may not be needed until the later years of our current financial planning horizon due to the likely position that rates will be lower for longer, this has mitigated these risks and in addition, the assumptions built in for both long term borrowing costs and investment returns are prudent going forward.

Further Economic Decline

49. Assumptions have been made about the economic climate and the impact on the Council and its financial position. Whilst all of the assumptions are very prudent and provision has been made to cover key items such as loss of income a further marked decline in the economy presents a risk.

50. This risk will be managed through some of the mechanisms referred to within this Appendix, notably the Risk Fund, and it is likely that any further economic decline would depress inflation, allowing Directorates to absorb any impact and manage issues “in year”.