APPENDIX 3

GENERAL FUND FINANCIAL FORECAST 2012/13 to 2014/15

2012/13 General Fund Financial Forecast

1. Each year Financial Planning prepare 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, 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 2011/12 budget in February 2011, the economic outlook for the country has remained pessimistic. Economic growth has been slow and the prospects have deteriorated in recent months from an expectation of modest expansion to the risk of a more difficult and protracted recovery. Inflation remains stubbornly high and unemployment is rising. 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 than was previously predicted.
5. In setting the 2011/12 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 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 last year and the detailed Local Government Finance Settlement 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 are subject to a Local Government Resource Review, the first stage of which is due to finish this month.
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 the exercise of council tax capping powers. In particular, the outcome of the Resource Review currently underway, alongside the Government's funding on Health regarding it's 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, irrespective of the guidance on council tax capping, particularly given the proposals for Council Tax referendum contained in the Localism Bill.
8. No detailed figures have been released for 2013/14 and 2014/15, but it has been assumed for planning purposes that further reductions in formula grant of 7% per annum will be made. It is difficult to predict the future Health funding beyond 2012/13 and at this stage no assumption of continuing funding has been made.

9. The Council has been improving its medium term budgeting approach, re-prioritising expenditure towards stated Council Priorities and driving out significant efficiency savings year on year. Under normal circumstances this improving strategic approach would have continued on an incremental basis. However, the worsening economic situation across the Country and the impact that is having on the Council 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 medium term financial forecast presented to Council in February 2011 highlighted the challenges facing the Authority. The position for 2012/13 and 2013/14 based on a 2.5% Council Tax increase assumed gaps of £12M and £27M respectively.

11. This combined with the potential impact of a difficult economic position made it imperative that proposals for 2011/12 onwards were developed and savings achieved as early as possible. As part of this approach, savings proposals were included for future years. The net impact of these future savings was to reduce the published gap for 2012/13 and 2013/14 to £3M and £13M respectively. For the majority of the proposals the intention was to take steps during 2011/12 to implement the savings so that they would become effective from 1 April 2012.

12. Given the level of certainty, in calculating an indicative Council Tax for 2012/13 it has been assumed that the figures for National Non-Domestic Rates (NNDR) and Revenue Support Grant (RSG) will not change from those announced in 2010. At an assumed 2.5% increase in Council Tax, the budget for the Authority for 2012/13 would be capped at £182,385,200, and this has been used in the overall forecast shown in the table below.

13. The estimated Collection Fund surplus at the end of 2010/11 was £3.8M and this estimated surplus was taken into account in setting the 2011/12 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 2009/10. At the end of 2010/11 the actual surplus was £4.1M and the additional surplus of £296,700 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 £254,100 can be taken into account as part of the 2012/13 forecast.

14. Forecasts of central items such as contingencies and capital financing charges are also built into the figures to provide a Budget Requirement figure.

15. 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 means 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 £5.2M has been included in the forecast to cover such pressures. This sum reflects increasing provision for the impact of the recession on income, inflation on key items such as energy costs, costs for children in care and costs for adult social care.

16. Taking all of these items into account gives a Budget Requirement figure for 2012/13 of £197.9M of which represents what we think the Council needs to spend. Comparing this to the amount we are able to spend provided by an indicative 2.5% council tax increase produces a ‘roll forward gap’ for the year of £15.2M as shown in the following table:-

Portfolio	**Original Budget 2011/12**	**Base Changes & Inflation**	**Roll Forward 2012/13**
	£000’s	**£000’s**	**£000’s**
Adult Social Care & Health	73,969.9	(561.7)	73,408.2
Children’s Services & Learning	65,964.4	(3,183.6)	62,780.8
Environment & Transport	34,304.6	297.0	35,601.6
Housing	10,722.4	(1,044.9)	9,677.5
Leader's Portfolio	9,629.5	(1,111.0)	8,518.5
Leisure & Culture	12,620.7	2,070.3	14,691.0
Resources	12,606.0	5,833.3	18,439.3
Sub-total for Portfolios	**220,817.5**	**2,299.4**	**223,116.9**
Levies & Contributions	593.0		593.0
Capital Asset Management	(11,214.5)	700.0	(10,514.5)
Risk Fund	6,100.0	(900.0)	5,200.0
Non-Specific Government Grants	(18,688.7)	(1,746.8)	(20,435.5)
Council Tax Freeze Grant	(2065.7)		(2,065.7)
Other Expenditure & Income	(5,906.2)	7,384.4	1,478.2
Net General Fund Spending	**189,635.4**	**7,737.0**	**197,372.4**
(Draw from) / Addition to Balances:	1,049.8	457.2	507.0
Budget Requirement	**190,685.2**	**7,194.2**	**197,879.4**
Budget @ 2.5% Council Tax	**190,685.2**	**(8,045.9)**	**182,639.3**
Total Gap	**0.0**	**15,240.1**	**15,240.1**

17. The overall revised gap that needs to be closed of just over £15.2M represents 7.7% of the Budget Requirement.

18. This position shown in the table above represents the ‘base’ position from which all three political groups may develop their own budgets taking into account the proposals for new spending and savings options put forward.

19. In arriving at this ‘base’ position a number of one off funding sources have been utilised which total almost £3.4M. These include contractual savings from the Street Lighting PFI project (1.1M) and the utilisation of the New Homes Bonus for both 2011/12 and 2012/13 (£2.3M). These one off elements, whilst serving to reduce the gap in 2012/13, by their very nature do not impact on the medium term financial position.

Medium Term Financial Forecast 2012/13 to 2014/15

20. Whilst the position for the years beyond 2012/13 is less certain, as outlined in paragraphs 6 to 8, 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 5 takes into account inflation and known base changes.

21. The ‘capping limit’ for each of the years is derived from assuming an indicative 2.5% increase in Council Tax for each year and a further reduction of 7.0% per annum in Government funding for 2013/14 and also 2014/15. The resulting gap each year that results is:

	2012/13	**2013/14**	**2014/145**
	£000’s	**£000’s**	**£000’s**
Budget requirement	197,879.4	217,713.4	227,813.4
Council Tax Increase at 2.50% (Inc additional properties)	(182,639.3)	(177,698.9)	(173,529.9)
Roll Forward Gap	**15,240.1**	**40,014.5**	**54,283.5**

22. 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

23. The Chief Financial Officer (CFO) recommends that the minimum level of the General Fund Balance should be £4.5M, 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 for both adults and children.

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

	2011/12 £000's	2012/13 £000's	2013/14 £000's	2014/15 £000's
Opening Balance	17,393.9	12,927.7	4,509.6	4,457.7
Draws for Strategic Schemes	(6,393.2)	(8,925.1)	(5,051.9)	5,042.3
Contributions from / (to) Revenue	1,927.0	507.0	5,000.0	5,000.0
Closing Balance	12,927.7	4,509.6	4,457.7	4,500.0

25. The above projection includes an addition to the Organisational Development Reserve of £3.1M in 2012/13 and £5.0M in 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.

Assumptions and Risks

26. 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.

27. 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

28. The Aggregated External Finance through the annual settlement (comprising RSG and NNDR) accounts for £97.4M of the Council's budget and for 2012/13 the provision of grant figures as part of a four year financial settlement has limited this risk to a large extent.

29. Two other areas that do still represent a 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 late November.

30. A separate briefing note will be produced in December 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

31. Assumptions have been made in the forecast about the likely level of pay inflation that will apply from 1 April 2012. 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.

32. These risks are eliminated by the announced intention to freeze local authority pay settlements for 2012/13. Beyond 2012/13 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

33. Assumptions have been made in the forecast about the likely level of general inflation that will apply from April 2012. 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.

34. 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.

35. 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

36. 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.

37. There is therefore potential for the figures in the forecast to be adversely affected by changes in interest rates. It was therefore recommended 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. 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

38. 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.

39. 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”.