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| Committee: Cabinet/ Overview & Scrutiny Committee | Date: 8 th February 2006/ 7th February 2006 | Classification: Unrestricted | Report No: | Agenda Item No: |
| Report of: Director of Resources Originating Officer(s) Martin Smith, Director of Resources & Alan Finch, Service Head – Corporate Finance | | Title: General Fund Budget 2006/2007 Budget Requirement & Council Tax Ward(s) Affected: N/A | | |

1. SUMMARY

- 1.1 Cabinet has previously considered three reports on the 2006/07 General Fund revenue budget. This is the final report and asks Cabinet to:-
- Consider the allocation of funding for committed growth in 2006/07;
 - Agree efficiency savings sufficient to set a robust and balanced budget and meet annual efficiency targets;
 - Recommend a total budget requirement and Council Tax for formal approval by the Council on 1st March.
- 1.2 Calculation of the Tower Hamlets element of the Council Tax for 2006/07 is dependent upon the final announcement of Government grant. This announcement is not expected until after the despatch date for this report. If possible, an update will be circulated as a supplementary item; otherwise details will be provided at the meeting.
- 1.3 The Greater London Authority's (GLA) budget meeting is scheduled for 15th February 2006. The GLA's precept, and the implications for council tax payers in different bands, will be included in the budget papers which are submitted to Council on 1st March.
- 1.4 To inform final decisions on the proposed budget for 2006/07, this report:-
- Reports the outcome of public and business ratepayer consultation.
 - Identifies committed growth and efficiency savings;
 - Refines the medium term financial projection for the period to 2008/09 to take account of detailed information and decisions relating to 2006/07, and the provisional settlement for 2007/08;
 - Considers strategic budget risks and mitigating measures;
 - Reviews the level and planned use of earmarked reserves;

- 1.5 In accordance with the requirement of the Council's constitution this report is also submitted to the Overview and Scrutiny Committee for its comments.

2. RECOMMENDATIONS

Overview and Scrutiny Committee is recommended to consider the contents of the report and make comments to the Cabinet as appropriate.

Cabinet is recommended to:

Budget Consultation

- 2.1 Consider any comments or recommendations of the Overview and Scrutiny Committee.
- 2.2 Consider the outcome of the various consultations carried out in relation to this budget as set out in Section 4.

Committed Growth & Inflation

- 2.3 Consider the proposals for committed growth set out at Section 5 and **Appendix C** and :-
- 2.3.1 Approve the committed growth items to be funded in 2006/07; and
- 2.3.2 Note the financial implications for the Council in 2007/08 and 2008/09.
- 2.4 Agree an updated figure for inflation of £6.152m as set out in paragraph 5.5.

Efficiency Savings

- 2.5 Consider the efficiency savings set out at Section 6 and **Appendix D**, and:-
- 2.5.1 Agree a package of savings for implementation in 2006/07; and
- 2.5.2 Note the indicative additional efficiency savings in 2007/08 and 2008/09.

Housing Stock Reduction

- 2.6 Note that, as a result of housing stock reduction, the level of HRA funding for General Fund services is projected to reduce by £3.696m in 2006/07.
- 2.7 Agree compensating savings arising from workload reductions, efficiency and income generation totalling £1.902m as set out in paragraph 7.7 and **Appendix F**.
- 2.8 Agree to apply £1.8m of the earmarked provision in 2006/07 and note that £3.206m remains uncommitted (paragraph 7.9).

- 2.9 Note that officers will continue to explore options for cost reduction in those corporate and support services where the impact is most significant.

Medium Term Financial Projection

- 2.10 Approve the medium term financial projection for 2006-2009 as set out in Section 9 and **Appendix G** (to follow).

Budget Risk: Reserves, Contingencies & Risk Mitigation

- 2.11 Note the:-
- a. Review of reserves as set out in paragraph 10.2 and further detailed in **Appendix H.**
 - b. Strategic budget risks and assessment of the robustness of the estimates set out in Sections 10 and 11 and **Appendix I.**
- 2.12 Approve risk mitigation measures totalling £0.550m (paragraph 10.9 and **Appendix J.**
- 2.13 Consider the continuation of the strategy of replenishing general reserves, or making contingency provision within the General Fund revenue budget to cover remaining budget uncertainties and strategic financial risks (paragraph 10.12).

Budget and Council Tax 2006/07

- 2.14 Recommend to Council a total budget requirement and Council Tax for Tower Hamlets for 2006/07 (Section 12).

Target Adjustments and Technical Resolutions

- 2.15 Note the target revisions relating to asset rentals and the adjustments for support service charges discussed in Section 14.

LOCAL GOVERNMENT ACT 2000 (SECTION 97)

LIST OF "BACKGROUND PAPERS" USED IN THE PREPARATION OF THIS REPORT

Brief description of "background papers"

Tick if copy
supplied for
register If not supplied, name
and telephone number
of holder

Budget files held in Corporate Finance, 5th floor, Mulberry Place

Martin McGrath
020-7364-4645

Detailed Budget pages for all services have been lodged with the Cabinet Secretary and placed in the Majority and Minority Group offices prior to the meeting.

3. BACKGROUND

- 3.1 Cabinet has already made a number of decisions in relation to the overall budget and the allocation of resources to services in 2006/07.
- 3.2 On 11th January 2005, Cabinet:-
- Agreed revised estimates for 2005/06;
 - Considered the immediate and medium term implications of the provisional Local Government Finance Settlement for 2006 – 2008;
 - Agreed a number of adjustments to budget targets for 2006/07 arising from the provisional grant settlement and other functional changes;
 - Gave initial consideration to budget uncertainty, risk and levels of reserves.
- 3.3 As a result of these decisions the total provisional General Fund budget stands at **£261,098,000**. Analysis of this total is shown in **Appendix A**.
- 3.4 The setting of the Council's budget requirement and the Council Tax is a decision that by law is reserved to the full Council. Cabinet is therefore requested to recommend to Council a General Fund budget requirement and Council Tax for 2006/07.
- 3.5 In formulating its budget proposal, Cabinet will need to determine a package of growth and savings, and consider contributions to reserves and balances, that taken together will establish a balanced and robust budget for 2006/07 and a sustainable medium term financial strategy for the Council.

4. BUDGET CONSULTATION

- 4.1 Formal budget consultation this year has taken a number of forms:-
- Consultation with the Overview and Scrutiny Committee under the Council's constitution;
 - Statutory consultation with the business community;
 - Broad public consultation through:-
 - A survey of the Residents' Panel
 - Consultation with readers of East End Life and other local newspapers
 - A poll on the Council's website.

Overview and Scrutiny Committee

4.2 Budget reports have been considered by the Overview and Scrutiny Committee at various stages of the budget process as part of its constitutional role in relation to the Budget & Policy Framework of the Council, and with a view to:-

- Ensuring the comprehensiveness of the cost pressures and resource issues identified
- Highlighting issues that have emerged from scrutiny work programmes and which need to be taken into account in the Council's medium term financial planning
- Identifying issues that could influence future programmes of scrutiny.

Business Consultation

4.3 The authority is required to consult business ratepayers under s.65 of the Local Government Act 1992. Consequently, six organisations representing local businesses were sent a copy of the Cabinet reports on the General Fund budget and Housing Revenue Account dated 11th January and the Capital Programme report to Cabinet dated 5th October 2005. Advertisements were also placed in East End Life and the East London Advertiser asking interested business people to contact the Council for details of its plans. Details of any responses received will be reported at tonight's meeting.

Public Consultation

4.4 Public consultation this year has taken place using a wide range of media, the press, the Council's website and via a phone poll of the Residents' Panel. The press consultation took place in East End Life, as well as a number of other local English language and Bengali newspapers. Residents were able to respond to the newspaper survey in a number of ways; online, via e-mail, by telephone, by text message, by post, by fax, or by delivering their response to a One Stop Shop. The intention was to reach and encourage responses from all parts of the community.

4.5 Residents were asked:-

- Whether the Council's five Strategic Plan themes are still the right ones.
- To identify the priorities that the Council should focus more on and those that it should focus less on;
- Whether the Council should continue to keep the Council Tax low.

4.6 The results are set out at **Appendix B** and summarised below;

- Residents are supportive of the Council's priorities, in particular those relating to living safely and living well;

- The top three priorities among residents are increased community safety, safer, cleaner streets and improving education;
- The large majority of residents who responded said that keeping Council Tax low was important to them.

4.7 Members will need to take account of the results of these consultations in allocating resources and recommending the total budget requirement and Council Tax for 2006/07.

5. **COMMITTED GROWTH 2006/2007- 2008/2009**

5.1 Committed growth is additional spending that, for all practical purposes, is unavoidable. It includes new statutory requirements, responsibilities transferred from the Government and other bodies, new taxes and demand led growth (which arises when there is an increase in the number of clients requiring statutory services).

5.2 All bids for committed growth have been reviewed collectively by the Chief Executive and Corporate Directors and the following working definition has been applied:-

“Where the Council has discretion over whether it incurs the expenditure, then this should not be regarded as committed growth, regardless of the impact on service performance.”

5.3 Committed growth bids total £10.856m as set out in the table below. A more detailed summary is shown at **Appendix C1**. Cabinet is asked to consider whether to provide funding for these committed growth bids in 2006/2007 and note the implications for 2007/2008 and 2008/2009

| <u>Committed Growth</u> | 2006/7 £000 | 2007/8 £000 | 2008/9 £000 |
|--|------------------------------|------------------------------|------------------------------|
| <i>Social Services</i> | 6,218 | 7,468 | 8,326 |
| <i>Environment & Cultural Services</i> | 975 | 1,739 | 1,908 |
| <i>Corporate</i> | 3,663 | 4,663 | 5,963 |
| <i>Total Committed Growth</i> | 10,856 | 13,870 | 16,197 |

5.4 Details of each committed growth submission are attached at **Appendix C2**.

Inflation

5.5 In considering the Financial Outlook and Review at its meeting in August 2005, Cabinet was advised that the estimated effect of pay and price increases in 2006/07 would be £5.885m. This figure has now been re-examined to take account of the most recent information, and it is now recommended that a provision of £6.152m is included in the budget.

6. EFFICIENCY SAVINGS

- 6.1 The Financial Outlook and Review projected a tightening financial position for the Council for 2006/07 and beyond, principally as a consequence of planned reductions in overall public spending announced in the Government's 2004 Spending Review. This would result in significantly lower Government grant increases than had been experienced in recent years. At the same time the Council would continue to face significant and largely unavoidable spending pressures. The Gershon Review reinforced this position signalling the need to fund new spending pressures from existing resources and setting an annual efficiency target for the Council of £6.4m for a three year period. In addition, half of the total target has to be in the form of cashable efficiencies, i.e. budget savings.
- 6.2 Against this background Cabinet agreed a budget strategy which sought to maximise efficiency savings, established Directorate targets in excess of the minimum Gershon requirements ('stretch' efficiency targets), and required officers to plan on the basis of no net growth and the expectation that unavoidable cost pressures would need to be funded by redirecting resources. In particular, Cabinet requested officers to identify cashable efficiency savings to meet a 2% target, coupled with an additional 2% for non-cashable efficiencies.
- 6.3 The target for each Directorate together with the savings identified is shown below. A more detailed summary is included as **Appendix D1** and details of each efficiency saving identified by Directors are provided in **Appendix D2**. Figures for 2007/08 and 2008/09 are indicative.

| <u>Cashable Efficiency Savings</u> | Savings Target | Efficiency Savings Identified | | |
|---|-----------------------|--------------------------------------|----------------|----------------|
| | 2006/07 | 2006/07 | 2007/08 | 2008/09 |
| | £000 | £000 | £000 | £000 |
| <i>Education</i> | 408 | 408 | 408 | 408 |
| <i>Social Services</i> | 866 | 1,814 | 1,916 | 1,921 |
| <i>Environment & Culture</i> | 1177 | 1,177 | 1,883 | 2,268 |
| <i>Development & Renewal</i> | 71 | 71 | 144 | 218 |
| <i>Housing GF</i> | 133 | 133 | 269 | 678 |
| <i>Chief Executive's</i> | 429 | 535 | 987 | 1,411 |
| Total Efficiencies | 3,084 | 4,138 | 5,607 | 6,904 |

- 6.4 The following non-cashable efficiencies have also been identified. These largely represent productivity gains enabling the delivery of more outputs or better outcomes at current levels of cost. Non-cashable efficiency gains do not therefore contribute to the Council's budget strategy, but do count towards the Gershon target. A more detailed summary of the non-cashable efficiency savings is shown at **Appendix E**.

| <u>Non-cashable efficiency savings</u> | Savings Target 2006/07 | Efficiencies Identified 2006/07 |
|---|-----------------------------------|--|
| | £000 | £000 |
| <i>Education</i> | 408 | 833 |
| <i>Social Services</i> | 866 | 850 |
| <i>Environment & Culture</i> | 1,177 | 2,657 |
| <i>Development & Renewal</i> | 71 | 30 |
| <i>Housing GF</i> | 133 | - |
| <i>Chief Executive's</i> | 429 | 513 |
| Total | 3,084 | 4,883 |

- 6.5 Overall, the budget process has successfully delivered efficiency savings in excess of the Council's Gershon target for 2006/07.

7. HOUSING STOCK REDUCTION - IMPLICATIONS FOR THE GENERAL FUND

- 7.1 The Council is progressing Housing Choice as the best means of generating the investment required in its housing stock and meeting Government targets for achieving the Decent Homes Standard.
- 7.2 Resultant stock transfers, together with the cumulative effect of stock reductions due to Right to Buy sales and consequent housing subsidy adjustments, mean that the turnover of the Housing Revenue Account (HRA) will reduce significantly over the next few years.
- 7.3 This will also have an impact on the finances of the General Fund, through the loss of economies of scale and the impact on corporate and support functions that currently provide services to both the General Fund and HRA. These functions will, as far as possible, need to reduce costs to reflect the reduced turnover of the HRA, although an element of residual cost is likely to remain. Transitional costs are also likely to be incurred in the initial years. These effects are proportionate to the actual and expected gains from the Housing Choice programme.

- 7.4 The Council has been planning for some time to accommodate these changes at both service and corporate level, and has recognised the impact on its medium term financial strategy by establishing a recurrent earmarked provision of £5m in its General Fund budget to fund both the transitional and ongoing costs.
- 7.5 Given that a number of stock transfers have recently been completed and there have been further ballots in favour of transfer, the budgetary impact will reach a material level in 2006/07, and HRA funding for the relevant services is projected to reduce by £3.696m.
- 7.6 Compensating savings will arise in a number of ways. Some of the affected services will be able to reduce in size as a direct consequence of a proportionate reduction in workload, while others will deliver the relevant services in new ways resulting in efficiencies. A number also expect to generate additional trading income. The exact position varies with the nature of the service being provided and the extent to which the costs of that service are fixed or variable in nature.
- 7.7 Officers have examined the detailed position for each of the affected services and have identified savings from workload reduction, efficiency measures and income generation totalling £1.902m in 2006/07 and provisionally £3.461m in 2007/08. Details are set out at **Appendix F2**. The balance of funding will be met from the earmarked provision described above.
- 7.8 The net impact is most significant for the following services and it is recommended that officers should continue to explore options for cost reduction in these areas:-
- Democratic renewal and engagement
 - Environmental services
 - Crime reduction services
 - Human resources
- 7.9 The overall position for 2006/07 is summarised in the following table:-

| <u>Housing stock reduction – General Fund impact</u> | 2006/07 |
|---|----------------|
| | £000 |
| <i>Existing General Fund budget provision</i> | 5,000 |
| <i>Savings from workload reductions, efficiency savings and income generation</i> | 1,902 |
| | 6,902 |
| <i>Less: Projected reduction in HRA funding</i> | 3,696 |
| <i>Uncommitted provision</i> | 3,206 |

8. FINAL FORMULA GRANT SETTLEMENT

- 8.1 As reported to Cabinet on 11th January, the provisional Formula Grant settlement for 2006/07 is £205.487 million. An additional one-off payment of £0.129m will also be made in 2006/07 in respect of amendments to the previous two years' settlements.
- 8.2 The final Formula Grant figure has not been received at the time of finalising this report. It is anticipated that the figure will be available by the time Cabinet meets. Depending on the timing of the announcement, details of the final figures will be provided either in the form of an addendum to the report, or at the meeting.

9. MEDIUM TERM FINANCIAL PROJECTION

- 9.1 The development of the 2006/07 budget has taken place within the context of a longer term service and financial planning process. The Financial Outlook and Review reported to the Cabinet on 3rd August identified the financial pressures facing the Council in the medium term and projected the level of resources that would be available to meet them.
- 9.2 Subsequently, all budget options have been considered in the context of current service performance and direction of travel, and have been evaluated against a range of financial and non-financial information including unit costs, benchmarking data and VFM profiles; residents, user and staff consultation and feedback; core performance indicators and audit and inspection reports; and national and local change drivers.
- 9.3 This approach is designed to ensure that:-
- A forward looking financial forecast influences the development of service plans
 - Service plans identify the financial consequences of proposed actions, including the resource implications associated with achieving the objectives set out in the Strategic Plan.
 - Financial plans allocate resources to address changing community needs and priorities.
 - Resources are directly related to performance improvement in order to maximise value for money.
 - Service and financial plans address key risks to budgets and performance.
- 9.4 Budget options for 2006/07 were largely drawn from the Financial Outlook and Review work reported earlier in the financial year. The detailed budget process has involved refinement of the costs of pressures and options identified. This work, together with the implications of Government grant announcements and the impact of Cabinet decisions in January have been incorporated into an updated medium term financial projection. This is set

out in **Appendix G** [to follow]. Figures for 2007/08 and 2008/09 are projected and decisions on these will be taken as part of future budget rounds.

9.5 The projection carries some health warnings. In particular:-

- There is a tendency for cost pressures to be understated as new responsibilities and issues emerge over the lifetime of a forecast.
- As set out elsewhere in the report, the authority is required to deliver a target for Gershon efficiencies of at least 2.5% per annum up until 2007/08. Indications are that, at the end of that period, new, more stretching targets are likely to be set. The medium term financial projection mirrors this position and identifies a need to continue to set stretch targets for efficiency savings. At this stage these targets are considered to be challenging but not unattainable.
- Financial projections are particularly sensitive to assumptions about Government Grant which finances 77% of the General Fund budget requirement. In this context the Government's introduction of multi-year grant settlements is particularly welcome.

Formula Grant

9.6 This year's Local Government Finance Settlement provided provisional Formula Grant figures for the next two financial years. The introduction of multi-year settlements will be of significant assistance to the Council's service and financial planning process. For the first time, the Council should be able to formulate its medium term financial plans with a high degree of certainty over the financial resources available from the Government. The provisional grant figure for 2007/08 is £213.715 million and this is incorporated in the Medium Term Financial Projection. This represents a 4.0% increase over 2006/07 and continues the anticipated trend of lower rates of increase in Government grant.

9.7 The Government will conduct its Spending Review (SR) for the period beginning in 2008/09 during 2007. Indications are that this will continue the trend established in 2006/07 towards tighter settlements for local government, as the Government bears down on increases in public spending to ensure compliance with its own rules of financial sustainability. SR 2007 is expected to include a more in-depth review of efficiency in Government departments, and that can be expected to have repercussions for local authorities. In general, a series of tighter settlements is anticipated.

9.8 In addition, the 2006/07 Formula Grant settlement reflected changes to the Social Services distribution formula that were detrimental to Tower Hamlets. These are heavily damped in the initial settlement, so that the cash losses are initially minimal, but it is not known how rapidly these damping arrangements will be removed.

9.9 The Lyons Review of local government is due to be published in late 2006, and is expected to make recommendations for further changes to local government finance.

Capital Resources

- 9.10 The authority's revenue budget and its capital programme are closely linked. In policy terms, one supports the other, while in financial terms, there are revenue implications associated with capital investment. Part of the capital programme is directly funded by the revenue budget, while any borrowing undertaken by the authority impacts on revenue through the costs of interest and debt repayment.
- 9.11 The resources available to fund the capital programme are expected to reduce over the next few years. This arises from changes to the rules governing the right to buy Council housing as well as the ongoing reduction in the Council's housing stock. Key strategic decisions will need to be made in setting the capital programme for 2007/08 as to how to address this issue, and one option would be to provide more funding through the revenue budget, providing it is shown to be affordable and sustainable. The Medium Term Financial Projection as yet makes no assumptions on any change in strategy.

Balance Sheet Forecast

- 9.12 The Medium Term Financial Projection includes a summary balance sheet which provides forecast financial information on key asset values, liabilities and reserves for the forthcoming period. The forecast reflects the recommendations made in this report and current capital spending forecasts as previously reported to Cabinet, and prudential borrowing limits proposed elsewhere on this agenda,

Other Resources

- 9.13 The authority successfully completed its first Local Public Service Agreement (LPSA) in March 2005. Following audit, LPSA Reward Grant totalling £7.634m has been claimed in respect of 12 of the 13 stretch targets. Cabinet, in May 2005, allocated £2.256m of the total for Local Priority Schemes; this leaves up to £5.378m still to be allocated. The funding is not ring-fenced to any particular service, but since the Reward Grant is a one-off allocation of funding, it can only prudently be applied to time-limited expenditure items.
- 9.14 The authority is waiting to hear whether it will receive an allocation of funding under the Local Authorities' Business Growth Incentive (LABGI) Scheme. This scheme provides additional funding to authorities where the growth in the non-domestic taxbase over the year exceeds the historic trend, as an incentive to authorities to take a proactive approach to economic development. The recent history of Tower Hamlets involves a high level of business growth, and it is not anticipated that growth in the taxbase over the last year will have exceeded this historic trend. No LABGI allocation is therefore expected in 2006/07.

10. BUDGET RISK: RESERVES, CONTINGENCIES & RISK MITIGATION

- 10.1 Cabinet on 11th January 2006 gave initial consideration to budget uncertainty, risk and levels of reserves. Cabinet resolved to examine these issues again at this meeting in conjunction with the other key budget decisions and in the context of delivering a sustainable medium term financial strategy.
- 10.2 **Appendix H** sets out the position on reserves and balances to take account of the latest information. It also sets out the planned use of the Council's earmarked reserves and highlights the extent to which they are available to support the medium term financial strategy.
- 10.3 **Appendix I** identifies a number of items which have potential cost implications in excess of any provision included in the 2006/07 budget and which need to be considered in assessing the adequacy of financial reserves or the need for a corporate contingency within the overall budget requirement.
- 10.4 The Audit Panel and the Corporate Management Team receive quarterly reports on the key strategic and corporate risks impacting on the Authority. Senior Finance Officers have evaluated these risks to assess their potential financial impact and identify how they should be reflected in the Council's financial planning. Three categories of financial risk are identified:
- Where the implications would be accommodated within existing financial provisions, such as directorate budgets or earmarked reserves.
 - Where specific risk financing arrangements are in place, such as those covered by insurance.
 - Those which need to be taken into account at a corporate level as part of the budget process.
- 10.5 Issues which fall into the final category include:-
- Business continuity issues, such as systems breakdowns, contractor failure or loss of a key administrative building.
 - Risks associated with large-scale projects.
 - Risks associated with the implementation of legislation and guidelines.
 - Strategic financial risks, including changes in budgetary assumptions, overspends and major financial control failures
- 10.6 **Appendix I** sets out those strategic and corporate risks (drawn from the Council's risk register) which would be likely to have a financial impact if they were to materialise, together with the key risk areas in service/Directorate budgets and associated mitigating measures.
- 10.7 There are three ways in which risks can be dealt with within the budget;

- By having regard to risks in setting levels of general balances and earmarked reserves
- Through setting aside specific contingencies within the budget for allocation during the year as and when required.
- By funding specific risk mitigation programmes with the aim of reducing the potential financial impact on the Council in the future.

10.8 These approaches can be thought of in a hierarchy:-

- General balances are used in the main to cover unknown and unforeseen eventualities.
- Earmarked reserves are set aside for specific issues that are more likely to occur, but where the financial impact and the timing is uncertain.
- Contingencies are used for risks that, if they arise, are almost certain to materialise during the next budget year.
- Funding of risk mitigation measures is appropriate for large and relatively certain risks, where it can be shown that allocating funding is likely to prevent larger risks from developing later.

10.9 Officers have reviewed the schedule of risks reported to Cabinet in January and recommend that risk mitigation measures are adopted and funded in respect of the following two risks:-

- Delivery of the Olympic legacy
- Programme & asset management

Details of these proposals are set out at **Appendix J**. The associated cost totals £550,000 which it is recommended should be included within the budget for 2006/07.

10.10 Having regard to the potential for volatility in the medium term financial outlook, the time-limited nature of the Collection Fund surplus (paragraph 12.5), and the strategic financial risks highlighted in this report, it is recommended that Cabinet seeks to maintain general reserves at between 5% and 7.5% of non-schools service spending. This broadly equates to a target range of £12m to £18m.

10.11 A projection of the level of general reserves anticipated as at 31st March 2006 is shown at **Appendix K** and indicates that reserves are currently expected to stand at £13.8m as at 31st March 2006.

10.12 Against this background and the budget uncertainties highlighted earlier in this report, last year's strategy of replenishing general reserves remains prudent and appropriate. Cabinet is therefore asked to consider continuation of the strategy of replenishing general reserves within the 2006/2007 General Fund budget or making contingency provision to cover remaining budget uncertainties and strategic financial risks.

11. BUDGET RISK: ROBUSTNESS OF THE ESTIMATES

11.1 Under Section 25 of the Local Government Act 2003 it is a requirement for the chief finance officer to report on the robustness of the estimates and the budget process. The table below sets out the key strategic budget risks and the principal mitigating measures:-

| Strategic Budget Risk | Principal Mitigating Measures |
|--|---|
| <p>The allocation of resources does not reflect the Council's priorities as set out in the Strategic Plan.</p> | <p>The Council's budget and service planning processes are aligned.</p> <p>Financial plans are developed concurrently with service plans and reviewed against a performance digest that consolidates information on performance and inspection; cost, procurement and value for money; user consultation and feedback; and policy developments and other pressures for change.</p> <p>Annual budget decisions are set in the context of a longer term financial outlook which identifies the resource implications of achieving the objectives set out in the Strategic Plan.</p> <p>All growth and savings options are evaluated for their impact on the Council's key priorities and the Tower Hamlets Index.</p> |
| <p>Net spending exceeds the approved budget.</p> | <p>There are both service level and corporate budget monitoring procedures in place. Responsibility for monitoring budgets and meeting budget targets is clearly allocated in Financial Regulations to Corporate Directors and Service Heads.</p> |
| <p>Core assumptions on pay and price inflation are unrealistic.</p> | <p>Corporate budget preparation guidelines are issued during the summer providing common assumptions about pay and price inflation to ensure consistency between service budgets and between the General Fund and the HRA.</p> <p>The assumptions are reviewed and agreed at a Corporate Financial Services Managers' Forum.</p> <p>Directorate budgets are cash limited.</p> |
| <p>The budget does not incorporate unavoidable cost pressures and known developments.</p> | <p>The medium term financial planning process is now embedded in the Council's strategic management framework and the budget for 2006/2007 has been substantially derived from the Financial Outlook and Review.</p> <p>The Capital Strategy ensures that the revenue impact of capital investment is identified and incorporated in financial plans.</p> <p>There are both service level and corporate budget monitoring procedures. Budget variances in the current year arising from unavoidable cost pressures have fed into the 2006/2007 budget process in the form of committed growth bids.</p> |
| <p>Savings are not achieved and/or budget growth does not deliver the intended service benefits.</p> | <p>The Council has a process of review of budget options firstly by directorate finance managers and secondly by peers overseen by the Corporate Management Team. In addition, Lead Members have individually and collectively performed a rigorous review role.</p> <p>Savings options are reviewed for eligibility and achievability. The service impact of agreed growth will be monitored as part of the 2006/07 Strategic Plan.</p> |

- 11.2 An assessment of the key risk areas relating to individual service budgets has also been undertaken (set out in **Appendix I**) allied to Directorate specific statements of assurance.
- 11.3 Taking account of these measures, the Director of Resources is satisfied that the budget process to date has been sufficiently robust to enable Members to deliver a balanced, sustainable budget.

12. FINAL BUDGET AND COUNCIL TAX 2006/2007

- 12.1 The decisions requested in this report will produce a proposed final budget total for 2006/07. This amount is the Council's "budget requirement" as defined in Section 32 of the Local Government Finance Act 1992. Cabinet is asked to agree and recommend to Council a total budget requirement for Tower Hamlets for 2006/2007.
- 12.2 The total Council Tax for residents of Tower Hamlets comprises:
- ◆ Council Tax set by the London Borough of Tower Hamlets to fund its services, and;
 - ◆ The Council Tax precept for the Greater London Authority (GLA) which includes the Metropolitan Police and London Fire and Emergency Planning Authority (LFEPA).
- 12.3 On 11th January, Cabinet approved a Council Tax base for 2005/06 of 75,522. This is the weighted number of properties anticipated to be liable for Council Tax in 2006/07 expressed as a Band D equivalent, and allowing for a collection rate of 97%.
- 12.4 An increase in the Council Tax of £1 thus raises £75,522. Alternatively expressed, a 1% increase in the Council Tax for the Council, excluding the GLA precept (£7.97 at Band D) raises just over £600,000.
- 12.5 It is estimated that the Collection Fund will have a surplus of £4.0m as at 31st March 2006 which will be available for distribution between the Council and the GLA. A strategy has been agreed with the external auditor to release the surplus over the next two financial years. On this basis, £1.905m will be allocated to the Council in 2006/07 with progressively lesser sums in 2007/08 and 2008/09. The distribution of the surplus serves to reduce the Council Tax and as it ceases to be available this will have a direct impact on the Council's finances.
- 12.6 Based on the provisional Formula Grant settlement and taking into account the approved Council Tax Base and the contribution from the Collection Fund, the Band D Council Tax associated with different budget levels is shown in the following table:-

| Table 9.6 – Council Tax Examples | Budget | Council Tax |
|--|---------------|--------------------|
| | £M | £/Band D |
| ◆ No change (0% increase) | 267.6 | 797.28 |
| ◆ 2.5% increase ('inflation') | 269.1 | 817.21 |
| ◆ 5.0% increase (expected capping limit) | 270.6 | 837.14 |

- 12.7 These exemplifications use the Formula Grant figure from the provisional settlement and may change, dependent upon the final Formula Grant announcement.
- 12.8 The Mayor of London has been consulting on an increase in the GLA precept of 16.6%, although it is widely expected that the Mayor's final proposal will be below this figure. The increase includes 7.8% to help pay for the 2012 Olympics (equivalent to a £20 Band D Council Tax). The GLA does not plan to consider and approve its budget until 15th February 2006. It is not within Tower Hamlets' power to approve or reject the GLA's Council Tax; the Local Government Finance Act 1992 requires only that the Council adds the GLA's Council Tax to its own in order to calculate the total tax liability for residents of the borough. The GLA precept will be incorporated into the report to Council on 1st March.
- 12.9 Legislation enables the Deputy Prime Minister to cap local authority budgets which he deems to be excessive. There are two options open to Ministers; either they can require an authority to recalculate its budget for the year ahead, or they can place an authority on notice that its budget will be capped unless it restrains its budget in the following financial year. The powers have been used in the last two years. This year Ministers have announced that they expect to see average Council Tax increases in each of the next two years of less than 5% and that capping action will be taken if there are excessive increases. Members should be aware of the reserve capping powers and Ministers' statements in considering this year's budget requirement and Council Tax.

13. COUNCIL BUDGET MAKING MEETING ON 1st MARCH

- 13.1 On 1st March, Council will receive the recommendations of Cabinet and will make the formal decisions required to agree the General Fund revenue budget and Council Tax for 2006/2007.
- 13.2 Council will be asked to approve the following:
- a. The budget requirement for 2006/2007;
 - b. Detailed budgets for each Directorate (revised estimates for 2005/2006 and budgets for 2006/2007);

- c. The Tower Hamlets Council Tax for band D and for all other bands;
- d. The total Council Tax for the borough (i.e. including the GLA precept) for band D and for all other bands; and
- e. The statutory calculations required under Sections 30 to 36 of the Local Government Finance Act 1992 *:

* *Note*: These are the calculations which are made by the Chief Financial Officer in order to translate the decisions of Cabinet into a legal budget and Council Tax.

13.3 At the same meeting the Council will also be asked to approve;

- the prudential indicators relating to capital financing for 2006/07.
- the level of any prudential borrowing to be undertaken in 2006/07.

These matters are covered in other reports on this Cabinet agenda. The proposed budget requirement and the Medium Term Financial Projection included in this report are consistent with the capital funding requirements identified in those reports.

14. FINAL TARGETS 2006/2007

14.1 It is now necessary to make some technical adjustments to Directorate targets which have a neutral effect overall:

14.1.1 Asset Rentals

Asset rentals are notional charges for the use of capital assets. This is a purely internal mechanism; charges to Directorates are credited to the Capital Financing budget and there is no impact on the overall budget requirement.

Asset rental charges are currently being updated and it will be necessary to amend Directorate targets accordingly. This transfer will have no effect on the resources available to Directorates. The budget papers which are submitted to Council for formal approval on 1st March will incorporate these adjustments.

14.1.2 Support Services

Local authorities are subject to a Best Value Accounting Code of Practice, the main requirement of which is to show the full cost of services in a standard format, which includes an appropriate allocation of the costs of support services.

Support Services budgets are currently being revised to reflect the budget decisions made by Cabinet on 12th January. The budget pages which are submitted to Council for formal approval on 1st March will incorporate both the support services recharges and the compensating budget transfers. The effect on Directorates will therefore be neutral.

14.2 Cabinet is asked to note that the asset rentals and support services recharges and the compensating budget transfers will be incorporated into budget pages when they are submitted to Council for formal approval on 1st March.

15. COMMENTS OF THE CHIEF FINANCIAL OFFICER

15.1 The comments of the chief financial officer have been incorporated into this report.

16. CONCURRENT REPORT OF THE ASSISTANT CHIEF EXECUTIVE (LEGAL SERVICES)

16.1 The statutory framework by which local authorities must approve their General Fund revenue budget and Council Tax is prescribed (in the main) by the Local Government Finance Act 1992. Additional requirements are also imposed by the Local Government Finance Act 1988 and the Local Government and Housing Act 1989.

16.2 Subsequent Local Government Acts (1999 and 2003) are also relevant to the budget and tax setting process. The 1999 act repealed the previous budget capping legislation and introduced revised powers. The 2003 Act introduced discretion into the award of council tax discounts (mainly in relation to second and empty homes) and imposed requirements on the Chief Finance Officer to ensure that Balances are adequate and estimates are robust.

16.3 Decisions on the budget form part of the Council's Budget and Policy Framework and so need to be taken by the full Council. The Council will meet on 2nd March to consider and approve the recommendations of Cabinet in relation to the issues set out above. This is within the deadline of 11th March imposed by Section 30(6) of the Local Government Finance Act 1992.

16.4 Section 33 requires the Council to approve the detailed calculation of its own basic amount of Council Tax for band D with no discounts. Section 36 requires the Council to approve the same calculation for all other bands.

16.5 Finally, Section 30 requires the Council to calculate the total Council Tax for each property band. The total Council Tax is the aggregate of the amount calculated (under Section 32) as its own Council Tax plus the amounts calculated by the GLA (under Section 47) as its Council Tax.

16.6 The Chief Finance Officer will make the calculations required by statute and will submit them to Council for formal approval.

17. EQUAL OPPORTUNITIES IMPLICATIONS

17.1 Specific comments on workforce to reflect the community, equalities and social inclusion are included in the detailed budget options included with this report.

18. ANTI-POVERTY IMPLICATIONS

18.1 Specific comments on social inclusion and economic impact are included in the detailed budget options included with this report.

19. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT IMPLICATIONS (SAGE)

19.1 There are no specific SAGE implications.

20. RISK ASSESSMENT

20.1 Managing financial risk is of critical importance to the Council and maintaining financial health is essential for sustaining and improving service performance. Setting a balanced and realistic budget is a key element in this process. Specific budget risks are set out in Section 10 of this report.

21. EFFICIENCY STATEMENT

21.1 Notwithstanding the need to identify savings in order to set a balanced budget, the authority is required to meet an annual efficiency target in response to the Gershon report. The target for 2006/07 is £6.4m, with a further £6.4m required in 2007/08, and at least 50% of this must be met in cashable efficiencies (i.e. budget savings). A further target is expected to be set for the period 2008/09 onwards.

21.2 The best authorities set stretch targets which exceed the Government target, and in agreeing its budget strategy the Cabinet has set minimum cashable targets totalling around £3.1m and minimum non-cashable targets totalling the same amount. In addition Directors were requested to identify opportunities for additional cashable efficiencies to fund unavoidable growth.

21.3 The Council is required to consider the value for money implications of its decisions and to secure best value in the provision of all its services. It is important that, in considering the budget, Members satisfy themselves that resources are allocated in accordance with priorities and that full value is achieved. The information provided by officers on committed growth and budget options assists Members in these judgements.

REVIEW OF BALANCES / RESERVES

General Reserves

- 1.1 Local authorities are legally required to set a balanced budget and the chief finance officer has responsibilities to report to Council should serious problems arise (including in relation to the adequacy of reserves). External auditors are responsible for reviewing and reporting on financial standing but are not responsible for recommending a minimum level of reserves.
- 1.2 Under provisions introduced by the Local Government Act 2003, the level and use of reserves must be formally determined by the Council, informed by the judgement and advice of the chief finance officer. When calculating the budget requirement, the chief finance officer must report to Members on the adequacy of reserves. There are also now reserve powers for the Secretary of State to set a minimum level of reserves.
- 1.3 The Council needs to consider the establishment and maintenance of reserves as an integral part of its medium term financial strategy. Reserves are held for three main purposes:
 - As a working balance to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing – this forms part of a general reserve.
 - To hold funds for specific purposes or to meet known or predicted liabilities – these are generally known as earmarked reserves. Schools' balances and insurance reserves are examples of these.
 - As a contingency to cushion the impact of unexpected events or emergencies, including budget overspends – this also forms part of a general reserve.
- 1.4 In order to assess the adequacy of general reserves, account needs to be taken of the strategic, operational and financial risks facing the authority. The level of general reserves is also just one of several related decisions in the formation of a medium term financial strategy and the budget for a particular year. Factors affecting judgements about reserves include the key financial assumptions underpinning the budget and an assessment of the Council's financial health, including:-
 - Overall financial standing (level of borrowing, Council Tax collection rates, auditors' judgements, etc.)
 - The track record in budget management.
 - Capacity to manage in-year budget pressures.

- The strength of financial information and reporting arrangements.
 - The external financial outlook.
- 1.5 There is therefore no 'correct' level of reserves. Furthermore a particular level of reserves is not a reliable guide to the Council's financial health. It is quite possible for reserves to increase but for financial health to deteriorate, if for example, the authority's risk profile has changed.
- 1.6 Financial reserves also have an important part to play in the overall management of risk. Councils with adequate reserves and sound financial health can embark on more innovative programmes or approaches to service delivery, knowing that if the associated risks do materialise the Council has sufficient financial capacity to manage the impact. Conversely, Councils with inadequate reserves can either find it more difficult to introduce change, or in extreme cases can be forced to develop very high-risk service strategies simply in order to restore their financial health.
- 1.7 General reserves are projected to stand at £13.8m as at 31st March 2006, although this is before deducting costs arising from the ongoing Police investigations into earlier financial irregularities.
- 1.8 The Council continues to face a range of uncertainties which carry attendant financial risks. It remains highly dependent upon Government grant and therefore has a high exposure to Formula Grant settlements, changes in specific grant regimes, and/or tightening public finances. The Council also has an ambitious improvement programme, and a number of major and interdependent projects, with significant financial implications, which will come to fruition in similar timescales over the next few years. These factors point to the need for a solid financial position to underpin the risks involved.
- 1.9 Against this background, last year's strategy of replenishing general reserves remains prudent and appropriate.

Insurance Reserve

- 1.10 The Financial Outlook and Review identified continuing pressure on insurance costs to meet both higher numbers of claims payments and higher external insurance premiums. The Council self-insures a substantial proportion of its insurable risks and an external actuarial review of the level of internal insurance reserves is commissioned at regular intervals.
- 1.11 The last review examined current and potential liabilities and established the level of reserves required based on three projections – a minimum level of funding required to maintain solvency, a middle case based on the most likely assessment of future claims, and a high case with a more pessimistic projection of future claims. The recommended values associated with each of these scenarios at current prices was:-

| | £m |
|-------------|-----------|
| Minimum | 16.5 |
| Middle Case | 22.5 |
| High Case | 26.9 |

The value of the Council's insurance reserves and provisions was £23.6m at the end of 2004/05, just above the middle case scenario.

- 1.12 The next actuarial review of the fund is due at the beginning of 2006.
- 1.13 Contributions to the insurance reserve are made by all Directorates based on their relative size, risk profile, and level of claims, together with a corporate contribution related to overall funding levels. Annual contributions currently total £5.9m and no change to this is recommended for 2006/07.

E-Government Loan Repayment

- 1.14 On 6th December 2000, PIC (the former Policy Implementation Committee) provided £2.7m for the Public Service Strategy/E-Government in 2001/2002 on a one-off basis. These proposals entailed the temporary application of reserves and their eventual repayment with interest on the principle of Invest to Save. The repayments were agreed to be made from savings at a rate of £0.65m 2002/2003 and £0.689m each year from 2003/2004 to 2008/2009.

Earmarked Reserve for Housing Choice

- 1.15 The implications of housing stock reduction for the General Fund are set out in the body of this report. The Council has recognised the impact of these changes on its medium term financial strategy and has established a recurrent provision of £5m in the General Fund budget to fund transitional and ongoing costs.
- 1.16 The exact timing and magnitude of any additional costs involved cannot be predicted with certainty, as this will depend upon a range of factors, most significantly the scale, number and timing of stock transfers as determined by the Council's tenants, and also the potential for making compensating cost savings.
- 1.17 The adequacy of the overall provision is subject to regular review. At the present time, the current provision of £5m is considered to be of the right order of magnitude and no change is proposed as part of the 2006/07 budget. However given the actual and expected stock reductions in 2006/07 application of £1.8m of the overall provision to fund General Fund services is recommended. The basis of this calculation is set out in earlier in this report.

Parking Control Reserve

- 1.18 The Parking Control Account (PCA) is ringfenced. The surplus can only be used for transport and highways initiatives, and for re-investment within the services. Tower Hamlets principally uses the surplus to part fund the cost of the concessionary fares scheme.
- 1.19 The PCA and the utilisation of the Parking Control Reserve are reviewed on an annual basis. The Parking Control Account currently contributes £2,510,000 towards the concessionary fares scheme. This is estimated to be the maximum level of contribution available in the next financial year.

Schools' Reserves

- 1.20 Schools' reserves represent unapplied revenue resources accumulated by schools with delegated spending authority. These totalled £17.7m at 31st March 2005. Schools' reserves are technically earmarked reserves of the Council but are controlled by schools and are not available to the Council for other purposes.

Developer Contributions

- 1.21 The Council receives monies under agreements entered into under Section 106 of the Town and Country Planning Act 1990. These agreements specify the purposes to which the monies can be applied. Unapplied sums are held in an earmarked reserve until such time as they are applied.

Service Specific Earmarked Reserves

- 1.22 A number of earmarked reserves are held to meet specific service objectives or fund potential liabilities which do not qualify as provisions for accounting purposes. The principal ones provide for:-
- Dilapidations claims in respect of administrative buildings and premises utilised by the Homeless Persons Unit.
 - Accumulated rate rebates on Education buildings to be applied to fund new capital investment.
 - The carry-over of budgetary underspends from one financial year to the next.

Use of these reserves is subject to specific Cabinet approval. The nature of these reserves means they are not generally available to support the Council's medium term financial strategy.