

METROPOLITAN BOROUGH OF KNOWSLEY

To: The Mayor and Members of the Council

Meeting: 5 March 2014

Wards Affected: Borough-wide

Portfolio Areas: All

Non-Key Decision

REPORT OF THE DIRECTOR OF FINANCE AND INFORMATION TECHNOLOGY

MEDIUM-TERM FINANCIAL STRATEGY

1. PURPOSE OF THE REPORT

- 1.1 This report summarises the financial issues currently affecting the Council and sets out revised medium-term financial forecasts for the three-year period 2014/15 to 2016/17.
- 1.2 The report also explains the financial context within which the Council is required to set its 2014/15 budget and Council Tax, and sets out an approach for the Council to manage its resources over the coming years in line with the priorities set out in the Council's Corporate Plan (as discussed in a report elsewhere on the agenda).

2. RECOMMENDATIONS

Members of the Council are recommended to:-

- (a) Note the planning assumptions used for the revised medium-term financial forecasts set out in sections 4 to 10 of this report;
- (b) Endorse the approach to reserves and the determination of general balances as set out in section 9.2 of this report;
- (c) Note the medium-term financial forecasts detailed in paragraph 10.2 of this report and the financial context for preparing budget proposals for 2014/15;
- (d) Note the impact of forecast funding reductions on the Council's Medium-Term Financial Strategy as set out in section 12 of this report;

- (e) Endorse the proposed courses of action which will need to be considered to balance the budget in future years as outlined in section 13 of this report; and,
- (f) Approve the proposed Annual Pay Policy as discussed in section 14 and set out in full at Appendix B to this report.

3. BACKGROUND

- 3.1 On 11 December 2013, the Cabinet received an update on the Council's medium-term financial forecasts, which showed projected budget gaps of up to £30m for the period 2014/15 to 2016/17.
- 3.2 The information and assumptions which underpin those financial forecasts as well as the Council's Medium-Term Financial Strategy and Annual Budget Strategy have now been updated further and the resulting revised financial forecasts are set out in detail in this report.
- 3.3 The report also sets out an analysis of the fundamental longer-term implications of the Government's approach to funding local government.

4. KEY FINANCIAL ISSUES ARISING FROM THE LATEST LOCAL GOVERNMENT FINANCE SETTLEMENT

- 4.1 On 18 December 2013, the Government announced the headline figures for the Provisional Local Government Finance Settlement for 2014/15 and 2015/16. The Provisional Settlement formed the basis for the medium-term financial forecasts and budget setting information which were reported to the Cabinet on 12 February 2014. On 5 February 2014 (i.e. after the Cabinet report had been written), the Government subsequently announced the Final Settlement figures, and those figures are now reflected in this report. This Settlement was the latest ever experienced, and therefore caused significant difficulties for local authorities at a time when they are seeking to deal with unprecedented cuts in resources and setting their 2014/15 budgets by the statutory deadline of 11 March 2014.
- 4.2 On the basis of on the Final Settlement, the key outcomes for the Council's financial forecasts are set out below.
- 4.3 *Core Funding – Settlement Funding Assessment*
 - 4.3.1 The Council's funding is based on the level of Business Rates it collects locally, with "top-up" funding then provided to bridge any shortfall against a "baseline" level of funding determined by the Government (known as the Settlement Funding Assessment).

- 4.3.2 In 2014/15, the Council's Retained Business Rates amount has been set at £19.708m. This is based on estimates of the Business Rates payable within the Borough in 2014/15, and there is therefore some risk that the estimated amount will not be fully collected. In addition, the Government continues to announce adjustments to how elements of the Business Rates calculation will be treated, and has also indicated that grants may be awarded to help offset the impact of these. Any surplus grant will be set aside to contribute towards the Council's share of any deficits on the Business Rate Collection Fund.
- 4.3.3 Government funding is provided to the Council through the Revenue Support Grant, which provides the balance of the resources required by the Settlement Funding Assessment. It is this funding that the Government has been cutting each year as national funding for local government has been reduced as part of the Government's national deficit reduction plan. The Final Settlement confirms that Knowsley's Revenue Support Grant allocation will be subject to a 17.9% (£14.762m) cut in 2014/15 and a further 28.9% (£19.543m) cut in 2015/16.
- 4.3.4 The relative importance of the Grant Floor mechanism has again been weakened in the most recent Final Settlement. This mechanism previously protected Knowsley from the impact of funding reductions arising from changes to national grant allocation formulae. The Floor Grant which was set at the start of the new Business Rates Retention System does still protect Knowsley's funding in 2014/15 by £7.824m, but this compares to the protection of £9.530m in 2013/14. This funding protection is subject to the ongoing cuts in the Revenue Support Grant and will over time be fully eroded if the policy is not altered.
- 4.3.5 A summary of the impact of the Final Local Government Finance Settlement on the Council in 2014/15 is set out in the table below. The analysis shows a net reduction in Government Grant funding of £13.702m (10%) compared to 2013/14. Details of the various components are set out in the following paragraphs:-

Settlement Funding Assessment	2013/14	2014/15	Reduction (-) or Increase (+)	
	£m	£m	£m	%
Retained Business Rates	19.332	19.708	0.376	+2%
Top-Up Grant	35.170	35.854	0.684	+2%
Revenue Support Grant	82.446	67.684	(14.762)	-18%
TOTAL	136.948	123.246	(13.702)	-10%

4.3.6 The table below sets out the forecast net Government Grant figures for 2015/16 and 2016/17 based on the lower estimates of funding levels. The analysis shows that the Council's Revenue Support Grant will be cut by 58% (£48.211m) over the three-year period from 2014/15 to 2016/17. With only relatively small indexed linked increases in the other grant elements, the net grant reduction over the three years is estimated at £44.475m (32%):-

Settlement Funding Assessment	2015/16	2016/17	Reduction (-) or Increase (+) since 2013/14	
			£m	%
Retained Business Rates	20.252	20.657	1.325	+7%
Top-Up Grant	36.844	37.581	2.411	+7%
Revenue Support Grant	47.984	34.235	(48.211)	-58%
TOTAL	105.080	92.473	(44.475)	-32%

4.3.7 Localisation of Council Tax Support

The Government has included £3.3bn of funding for the Localisation of Council Tax Support within the overall Settlement, but this funding is not separately identified nor protected within the new funding system. In 2013/14, Knowsley received £15.369m to fund its Local Council Tax Support Scheme. Based on the Final Settlement, this funding will reduce by 11.2% in 2014/15 and by 16.2% in 2015/16. By 2015/16, the Council will have seen the funding for its Local Council Tax Support Scheme fall by £3.922m (more than 25%), which is the largest reduction per head of population of all Metropolitan Boroughs. If these cuts continue into 2015/16 and future years, the Council will have to consider whether it is able to sustain the current level of Local Council Tax Support.

The funding also includes an amount which the Government expects to be passed on to parish and town councils to mitigate any reduction in their tax bases due to the Local Council Tax Support Scheme. The funding is not ring-fenced because the amount which different parish or town councils need changes as caseloads and schemes evolve. As noted above, this element of the funding will also reduce as a result of the Final Settlement. The 2013/14 funding was £0.337m, so the overall cuts cause a reduction of £0.038m in 2014/15 (to £0.299m) and a further reduction of £0.048m in 2015/16 (to £0.251m).

The amount actually required to mitigate the Council Tax Base reduction for the Borough's five Parish and Town Councils in 2014/15 is £0.322m. If this amount was transferred, it would place a new pressure of £0.023m on the Borough Council in 2014/15, which (assuming no change in the same tax base) would rise to £0.071m in 2014/15. On 29 January 2014, the Borough Council therefore agreed that the funding actually provided by the Government after reflecting the above cuts (£0.299m) would be transferred to Knowsley's Parish and Town Councils in 2014/15 as detailed in the table below. The Council will continue to lobby the Government to protect this element of funding so that it can fund the amount required by Parish and Town Councils in future years in full without risk of it being an additional pressure on the Borough Council's budget:-

Parish/Town Councils	Council Tax Base Reduction £m	Grant Transferred £m	Difference £m
Cronton	0.001	0.001	0
Halewood	0.075	0.070	-0.005
Knowsley	0.125	0.116	-0.009
Prescot	0.066	0.061	-0.005
Whiston	0.055	0.051	-0.004
Total	0.322	0.299	-0.023

4.3.8 *Council Tax Freeze Grant*

The Government has confirmed that the Council Tax Freeze Grant previously provided to local authorities in 2011/12 and 2013/14 will be protected and built into future funding baselines (even though the Government has made no change to the 2012/13 grant, which will still be treated differently and as a one-off allocation). As Knowsley accepted the Freeze Grant in both of these years, £1.835m of funding is protected in the Final Settlement and is now reflected in future funding forecasts. The Government has also confirmed that the 2014/15 and 2015/16 Freeze Grants will be built into future baselines.

4.3.9 *Early Intervention Grant*

The Early Intervention Grant remains separately identifiable in the Settlement Funding Assessment and reduces from £8.142m in 2013/14 to £7.511m in 2014/15 and to £6.869m in 2015/16. This equates to a cut of £1.273m (15.6%) over the two-year Settlement period. As this element is now included within the Council's overall core funding, these reductions represent a significant pressure within the overall financial forecasts.

4.3.10 *Learning Disability and Health Reform Grant*

The Learning Disability and Health Reform Grant also remains separately identifiable in the Settlement Funding Assessment and increases slightly from £7.111m in 2013/14 to £7.178m in 2014/15. The amount for 2015/16 is £7.175m.

4.3.11 *Funding Withheld by Government*

The Government also withholds amounts for certain purposes from the Settlement Funding Assessment and then redistributes that finding on a different basis. This is often described as “top-slicing” the funding allocation.

The Government has confirmed that it intends to redistribute £28m of funding which was originally withheld to fund potential capitalisation requests. However, the £28m will only be returned to local authorities after the Government has reallocated £22m of it to fund rural areas (via the Efficiency Support Grant) and safety net payments, none of which Knowsley can access. As a result, Knowsley will only get back £0.146m of its total top-slice of £0.261m, with the remaining £0.115m having been reallocated by the Government to other local authorities.

The Business Rates Retention System has a safety net mechanism to protect authorities which lose significant amounts of Business Rates in any year. After a £25m top-slice to fund the initial year of the scheme, the Government’s intention was that it would in future be self-funded by charging a levy to authorities which benefitted from significant growth in Business Rates income. However, it is now expected that the cost of historic appeals which still remain with local authorities will be too high to be funded within the new system and the Government is therefore proposing a further top-slice of £120m in 2014/15 to fund the safety net. This has effectively reduced Knowsley’s funding by £0.628m and is funding which Knowsley cannot access.

4.4 *Core Funding - New Homes Bonus*

- 4.4.1 The Final Settlement confirmed that Knowsley will receive £0.441m in New Homes Bonus in 2014/15, which means that the Council will now receive £1.305m after four years of the New Homes Bonus scheme. The 2014/15 amount is an improvement on previous years, mainly due to the one-off impact of technical changes which reduced the number of empty property exemptions. It is important that the underlying growth in housing numbers in Knowsley improves in order to sustain this level of New Homes Bonus in future years.

4.4.2 A nationwide total of £38m of the New Homes Bonus has been withheld by the Government in previous years and has not yet been redistributed to local government in 2014/15. It is understood that this withheld funding will be redistributed to local authorities in 2014/15 with a forecast one-off allocation of £0.191m for Knowsley.

4.4.3 Since the introduction of the New Homes Bonus, Knowsley has lobbied the Government on the unfair distributional impact it has on the local government finance system. New Homes Bonus is funded by a top-slice of £700m of Formula Grant previously allocated to fund statutory services. It is estimated that Knowsley has contributed £3.947m to the top-slice. Therefore, for every £1 contributed Knowsley receives 33p in New Homes Bonus. The imbalance is illustrated by the fact that Basingstoke & Deane receives £20.97 for every £1 contributed, while Mid-Sussex receives £18.08 for every £1 contributed.

4.5 *Core Funding - Business Rates Cap Funding*

In the 2013 Autumn Statement, the Chancellor of the Exchequer announced a below-inflation cap of 2% on Business Rates increases in 2014 (a cap of 3.2% would have been in line with inflation). As the cap restricted the growth in the Business Rates tax base and thus top-up payments, the Treasury agreed to fund the balance outside the Business Rates Retention System. The details of the calculation remain unclear, but the Government has indicated that Knowsley will receive £0.590m in permanent Government Grant funding. Whether this funding represents full compensation for the impact on actual business rates yield will only be clear at the end of 2014/15.

As noted in section 4.3 above, any surplus grant from this source will be set aside to contribute towards the Council's share of any deficits on the Business Rate Collection Fund.

4.6 *Core Funding - Summary*

The summary position and forecasts of Core Funding for the Council are set out in the table below:-

Core Funding	2013/14	2014/15	2015/16 (lower estimate)	2016/17 (lower estimate)	Three-year (Reduction) or Increase	
	£m	£m	£m	£m	£m	%
Settlement Funding Assessment	136.948	123.246	105.080	92.473	(44.475)	-32%
Other Sources:-						
New Homes Bonus	0.864	1.305	1.543	1.781	0.917	106%
New Homes Bonus Refund	0.000	0.191	0.191	0.191	0.191	N/A
Council Tax Freeze Grant	0.000	0.523	1.046	1.046	1.046	N/A
Business Rates Cap Funding	0.000	0.590	0.590	0.590	0.590	N/A
	0.864	2.609	3.370	3.608	2.744	318%
TOTAL CORE FUNDING	137.812	125.855	108.450	96.238	(41.574)	-30%

4.7 Specific Grants

4.7.1 There remain a number of significant gaps in the Government's announcements to date regarding the range of specific grants due to be received by the Council. Details available to date are set out below.

4.7.2 It must be noted that a major assumption in the Council's financial forecasts is that services currently funded by specific grants will be able to manage any reductions in funding by making equivalent reductions in service provision. As the range of specific grants announced by the Government increases, the Council's reliance on those grants also increases, and where the Government makes reductions in those grants there is a consequent risk of increased financial pressure on the Council's budget in future years. The impact of this will be reviewed as part of the Council's ongoing Financial Strategy and reflected in future financial forecasts.

4.7.3 Public Health

The specific grant to Knowsley will be £16.375m in 2014/15. However, there has been no confirmation of funding for 2015/16, as the Government intends to introduce a new funding formula and performance incentives. The Council is likely to lose significantly under the proposed funding formula as it moves from year on year cash increases to a formula linked to morbidity rates. The Council is also therefore likely to be dependent upon funding protection to protect current levels of funding, and is also unlikely to see funding grow beyond the 2014/15 level.

This funding is ring-fenced, but there are significant areas of existing Council services which contribute to Public Health objectives. Wherever possible, options will therefore be identified to use the Public Health funding to commission outcomes from other Council services, so that resources can be released by those services to contribute to the Council's future budget shortfall.

4.7.4 *National Health Service Funding Transfers*

The Department of Health has continued to provide integrated transfer funding to primary care trusts for use by local authorities, specifically for Adult Social Care (£3.664m for Knowsley in 2014/15 compared to £3.497m in 2013/14). This grant has now existed for four years and effectively underpins the Council's Adult Social Care budgets.

There will be a further £0.814m of funding in 2014/15 for implementation of the new pooled Better Care Fund, which the Government is introducing to replace the integrated transfer funding. The full Fund will be introduced in 2015/16 and Knowsley's potential full allocation will be £15.170m, of which £13.420m is revenue funding and £1.750m is capital. The Council is working closely with the Knowsley Clinical Commissioning Group to ensure that these resources are secured and used effectively to support the budget pressures faced by the Council's Adult Social Care services.

It is important to note that this is not new funding but instead incorporates funding which is already committed within the Council and the Clinical Commissioning Group. In order to meet the outcomes of the Better Care Fund, the funding will need to be redeployed from existing services via efficiencies, disinvestment and transformation. If the Better Care Fund Plan does not deliver the efficiencies and ability to reallocate funding, this could add to the budget pressures the Council faces in future years. The fact that a large proportion of the funding is also dependent on performance measures being met adds another risk of these resources being withheld or withdrawn by the Government. It is therefore imperative that the Council and the Clinical Commissioning Group's joint plans for use of the Better Care Fund are realistic, deliverable and closely monitored over the period to mitigate these risks.

4.7.5 *Adult Social Care (Dilnot Review)*

The Government has confirmed one-off specific grant funding for the implementation costs of new Adult Social Care burdens, and Knowsley is expected to receive £1.160m in 2015/16 in this regard. However, there is still much work to be done on evaluating the implications of the new burdens and whether this funding will actually be sufficient to cover all of the resulting implementation costs. No announcements have been made regarding funding for additional care costs which arise from these new Adult Social Care burdens.

4.7.6 *Education Services Grant*

This non-ring-fenced grant is fixed at £1bn nationally and is distributed between local authorities and academies on the basis of pupil numbers. Knowsley is confirmed as having a reduction of £0.300m in grant in 2014/15 due to falling pupil numbers, a reduced distributable amount per pupil, and the conversion of Halewood Academy. This grant will reduce further as other Knowsley schools convert to academies and will be a financial pressure which the Council will need to manage through cost reductions in the services provided to schools where possible.

In the 2013 Comprehensive Spending Review, the Chancellor of the Exchequer announced a 20% reduction in the overall Education Services Grant from 2015/16. Consultation is yet to be undertaken on how these cuts will be implemented, but inevitably these reductions represent a significant pressure within the overall financial forecasts.

4.7.7 *Housing Benefit and Council Tax Support Administration*

The Government has confirmed allocations for 2014/15 only, as the future administration of Housing Benefit is subject to the implementation of Universal Credit. The Government has committed to a fundamental review of the funding arrangements in due course. In 2014/15, Knowsley will receive £1.558m (an 8.4% reduction). In addition, a further £0.143m will be received in 2014/15 to reflect new burdens on the Council. Once again, it is still too early to be clear whether this funding will actually be sufficient to cover all of the resulting cost increases.

4.7.8 *Welfare Fund (Emergency Support)*

The funding provided to the Council for its local Emergency Support Scheme (and the associated administration costs) will no longer be provided as a specific grant in 2015/16. This Government decision was announced without any prior notification or consultation, and the Government had indicated that the funding would in future be included in the Settlement Funding Assessment. However, the Department of Work and Pensions has more recently confirmed that the funding will actually stop completely from 2015/16 and that local authorities will have to decide if they wish to continue such support, in which case they will have to fund it themselves using local funding. For Knowsley, the total loss compared to 2013/14 funding would be £1.264m. The Council will have to consider the future of its Emergency Support Scheme in the light of this additional funding reduction.

4.8 *Impact of the Final Settlement on Council Resources*

4.8.1 A summary of the impact of the Final Local Government Finance Settlement on the Council's funding sources is set out overleaf:-

Summary of Funding	2013/14	2014/15	2015/16 (lower estimate)	2016/17 (lower estimate)	Three-year (Reduction) or Increase	
	£m	£m	£m	£m	£m	%
Core Funding in Medium-Term Forecasts	137.812	125.855	108.450	96.081	(41.731)	-30%
<u>Specific Grants</u> ⁽¹⁾						
Public Health	15.929	16.375	16.375	16.375	0.446	3%
Education Services Grant ⁽²⁾	2.797	2.497	1.998	1.598	(1.199)	-43%
Benefits Administration ⁽³⁾	1.859	1.701	0.320	0.288	(1.571)	-85%
Welfare Fund and Administration (Emergency Support Scheme)	1.264	1.245	0.000	0.000	(1.264)	-100%
Adult Social Care - Implementation Costs ⁽⁴⁾	0.000	0.000	1.160	0.000	0.000	N/A
Other Grants ⁽⁵⁾	0.267	0.257	0.187	0.184	(0.083)	-31%
	22.116	22.075	20.039	18.445	(3.671)	-17%
TOTAL FUNDING	159.928	147.930	128.489	114.525	(45.403)	-28%

- (1) *The Council will also receive funding via the Better Care Fund which is shared with Knowsley Clinical Commissioning Group. This Fund is an amalgamation of existing funding previously provided to both organisations and does not represent any change in comparison to previous years.*
- (2) *No figures yet released for 2015/16 - the figures in the table represent the Council's latest forecast.*
- (3) *Housing Benefit Administration Grant is subject to review due to the implementation of Universal Credit. The remaining Grant is to administer the Local Council Tax Support Scheme.*
- (4) *This grant is funding for the implementation costs arising from new responsibilities and does not therefore represent additional funding for the Council.*
- (5) *Other grants are in relation to extended free rights to transport, lead local flood authority, community right to challenge, community right to bid, and local reform and community voices.*

4.8.2 Uncertainty remains in a number of funding areas, notably how National Health Service allocations for Social Care will be distributed. For 2015/16, the Settlement figures are still indicative, and, given the experience of the last 12 months, there are likely to be significant further changes to what the Government has so far announced.

4.9 School Funding/Dedicated Schools Grant

4.9.1 The 2014/15 Dedicated Schools Grant for Knowsley is £114.647m and is in line with the Council's expectations. Due to a drop in pupil numbers, this represents a 1.7% reduction (approximately £1.600m) for the Early Years and Schools Block funding compared to a 0.7% increase nationally. However, due to the closure of Christ the King Centre for Learning, efficiencies have been released within the Schools Block, which will enable a better settlement to schools than would otherwise have been possible. The Dedicated Schools Grant (including Academies) is split into three elements as follows:-

	2014/15 Allocation £m
Schools Block	86.127
High Needs Block	19.389
Early Years Block	9.131
TOTAL	114.647

4.9.2 The Schools Block is linked to the number of pupils within the Borough as at October 2013. The High Needs Block is based on historic spending and planned High Needs places, and the Early Years Block is based on anticipated numbers of two, three and four-year olds.

4.9.3 The Schools Block mainly funds individual school budgets as well as non-school items, such as school admissions and servicing the Schools Forum. Further detail was presented to the Schools Forum on 16 January 2014. The Schools Block also funds items known as "de-delegated budgets", which are budgets which must go into school budgets, but, as an overall sector, mainstream primary and secondary schools can then "pool" this funding and allow the Council to continue to provide the service. These budgets include:-

- Contingency;
- Behaviour Support;
- Support for Bilingual Learners;
- Free School Meal Eligibility;
- Licences; and,
- Maternity/Trade Union Supply Cover.

4.9.4 Academies cannot pool these budgets and therefore the relevant Council services will need to trade with Academies in order to secure this funding. Any loss of trading would result in a budget pressure to those services, and increases in the number of academies directly increase this risk.

5. COUNCIL TAX PLANNING ASSUMPTIONS

5.1 For planning purposes only, the Council's financial forecasts assume a Council Tax freeze in 2014/15. Final decisions on the level of Council Tax in 2014/15 will need to be taken after considering the factors discussed below.

5.2 Council Tax Base and Council Tax Increases

5.2.1 The 2014/15 Council Tax Base report (approved by the Council on 29 January 2014) confirmed the Council's 2014/15 Tax Base as 30,916 Band D equivalent properties.

5.2.2 The Government's method of controlling the ability of local authorities to increase Council Tax is to require them to hold a referendum if a Council Tax increase is defined as "excessive" by the Secretary of State for Communities and Local Government. The Government's approach is based on a "referendum calculation" which determines whether additional Council Tax resources above a certain level should be returned to Council Tax payers.

5.2.3 The Council has made representations to the Government on this matter, particularly relating to the treatment of levy reductions within the referendum calculation, which the Council believe unfairly penalises low Council Tax Base authorities (where levies make up a large proportion of their Council Tax requirements). The Government's requirements for 2014/15 were announced on 5 February 2014, and include a requirement that any local authority which sets an increase of 2% or more for 2014/15 must arrange for a binding referendum to be held.

5.3 Council Tax Freeze Grant

5.3.1 In previous years, the Government has offered grant support to local authorities which agree to "freeze" their Council Tax. The Government has announced its proposal for 2014/15, whereby it will offer permanent grant support equivalent to a 1% increase in Council Tax to local authorities which freeze their 2014/15 Council Tax at 2013/14 levels. For Knowsley, this would equate to around £0.522m per annum. The Government calculates the amount of Freeze Grant available on a different basis than the calculation of the yield if the Council was to increase Council Tax bills (see paragraph 5.4.1 below).

5.3.2 Knowsley has decided in the past to accept these offers. These decisions have been financially beneficial for the Council due to the relatively low additional yield which the Council would have received from any Council Tax increase due to capping levels and the impact of reducing levies. The decisions have enabled the Council to keep residents' Council Tax bills at 2010/11 levels.

5.4 *Council Tax Planning Assumptions*

- 5.4.1 For planning purposes only, the financial forecasts assume that Council Tax will be frozen in the medium-term and that the Freeze Grant offered for 2014/15 will be taken. If the Council decides to increase its Council Tax rather than accept the Freeze Grant, it can generate an estimated £0.235m of permanent resources for every 1% increase (this is the net figure after accounting for the consequent impact on Local Council Tax Support Scheme costs). The maximum amount which could be generated in 2014/15 without requiring a referendum is £0.468m (i.e. a 1.99% Council Tax increase – see paragraph 5.2.3 of this report above), which is less than the Freeze Grant which has been offered by the Government.
- 5.4.2 The Council will have to take the issues and constraints set out above into consideration when it decides on its Council Tax levels for 2014/15 (as discussed in a report elsewhere on the agenda).

6. LEVIES

- 6.1 The Council pays levies to a number of third party bodies. Levies are set locally and are based on local circumstances and needs. Unlike precepts (which are paid to the Police and Crime Commissioner, the Fire and Rescue Service, and the Borough's five Parish and Town Councils), the cost of levies must be funded by the Council.
- 6.2 The forecast cost of levies from third party bodies is built into the Council's medium-term financial forecasts, and details are set out below. These figures may be subject to change when official notification from the levying bodies is received:-
- The Merseyside Recycling and Waste Authority levy is forecast at £7.393m (an increase of 2.94% on 2013/14);
 - The Merseytravel Passenger Transport Authority Levy is forecast at £13.458m (the same as 2013/14); and,
 - The levies for the Coroner's, Probation and Environment Agency (Flood Defence) services have been included in the financial forecasts at an assumed increase of 3% on the 2013/14 levels.
- 6.3 The Merseytravel Passenger Transport Authority has also confirmed that it will provide grant funding to the Council in 2014/15 and future years to support the maintenance of the Borough's bus highways infrastructure, although the funding itself will be non-ring-fenced. The forecast amount for 2014/15 is £0.733m. This will be an ongoing and indeed increasing grant and is therefore built into the Council's future projections.

6.4 A similar arrangement is expected to be finalised in the coming weeks with the Merseyside Recycling and Waste Authority. It is intended that approximately £3.2m of resources will be transferred to the Council in 2014/15 and that the Council would utilise this for the purpose of delivering its obligations under the Joint Recycling and Waste Management Strategy (which was approved by the Recycling and Waste Authority on 29 February 2012). These resources represent the release of the sinking fund set up through higher levy contributions over a number of years to protect against significant costs rises in relation to waste disposal. The Recycling and Waste Authority's recent finalisation of a new waste disposal Resource Recovery Contract has significantly reduced these pressures and risks.

7. SUPERANNUATION PAYMENTS TO MERSEYSIDE PENSION FUND

7.1 Since 2011/12, the employer contribution to the Merseyside Pension Fund has been split into two elements:-

- a percentage rate levied on the employee payroll to fund the future accrual of benefits by employees; and,
- a fixed amount per year as a contribution towards the accumulated deficit from past service.

7.2 This approach is intended to ensure that sufficient contributions are paid towards repayment of the historic deficit on the Fund (even if the size of the future payroll reduces), and also to make the true cost of admitting new employees to the Fund more transparent.

7.3 The Merseyside Pension Fund is subject to an actuary's valuation exercise every three years in order to ensure that any deficit on the Fund is recoverable over the following 25 years. The most recent valuation exercise was completed in 2013, and resulted in significantly increased contributions for 2014/15 and future years as shown below:-

Superannuation Contributions	2013/14	2014/15	2015/16	2016/17
Variable Rate (Future Year Contributions)	10.9%	12.7%	12.7%	12.7%
Past Deficit Contributions (assumes full payment in 2014/15)	£7.358m	£8.244m	£8.205m	£8.166m

7.4 These contributions have been reflected in the revised medium-term financial forecasts. It should be noted that the Council has achieved a significant saving through a new approach to the past deficit contribution payments.

- 7.5 The original past deficit contribution set by the Merseyside Pension Fund was £26.346m to be paid in three annual instalments over the next three years. However, the Council has agreed with the Fund that the amount can be paid as a single payment in March 2014 (rather than being spread over three annual payments), and that, because the Pension Fund can then invest the money more effectively, the overall contribution will be reduced to £24.615m – a saving to the Council of £1.731m over three years.
- 7.6 The Director of Finance and Information Technology has reflected this approach in the Council's treasury management cash flow forecasts for 2014/15 (i.e. as a reduction in its forecast cash balances). The Council uses its cash balances for day-to-day cash flow commitments arising from the payment of salaries and bills. As these cash balances will diminish due to the payment to the Pension Fund, there may be a need to take out some short-term borrowing at certain times during the year when large payments need to be made. However, the savings which will be achieved from this approach significantly outweigh any potential borrowing costs.
- 7.7 A similar approach has been adopted in relation to the variable rate increase for future year contributions. The actuary's triennial valuation increases Knowsley's variable rate by 1.8%, which can be phased over three years or dealt with fully in 2014/15. The 2014/15 Revenue Budget report elsewhere on this agenda assumes that this increase will be fully funded in 2014/15, which will help to minimise the impact of the next triennial increase in 2017/18 and will also reduce future budget gaps from 2015/16.

8. NEW EXPENDITURE PRESSURES AND INVESTMENT PRIORITIES

- 8.1 The financial forecasts set out in this report do not include the impact of any potential future investments which the Council may wish to consider. When considering these, the Council should always recognise the forecast future budget shortfalls and how the allocation of resources could help to reduce these. Wherever possible, the use of available resources should focus on proactive invest to save strategies which reduce the need for future permanent savings.
- 8.2 Information on available resources for investment and potential priority areas is set out in detail in the 2014/15 Revenue Budget report elsewhere on this agenda. The report includes proposals for new one-off investment using identified available one-off resources of £0.913m, and also a small number of proposals for permanent funding in key strategic areas using identified available permanent resources of £0.507m. For planning purposes only, the proposed investments are included in the financial forecasts set out in this report.

- 8.3 For future years, it will also be important to review previously approved investment allocations to ensure that these continue to be used to the best possible effect.
- 8.4 There will also be a continued need in future for Portfolios to manage unbudgeted or unexpected cost pressures within their existing resources. This could mean a risk of increased budget pressures in future years where an ongoing pressure cannot be funded permanently. To help address this, the Council's Financial Strategy is based on a "single budget" approach, whereby financial issues in any one area will be considered in the light of Council-wide priorities and outturn forecasts.
- 8.5 Potential cost pressures which are currently not reflected in the Council's financial forecasts (as they cannot currently be quantified accurately) but which may need to be reflected in future year budget strategies include:-
- The future impact of changes in Social Care such as the Care Bill and the implementation of the Better Care Fund;
 - The impact of reductions in specific grant funding not being managed within existing resources;
 - The future impact of the Local Council Tax Reduction Scheme on the level of Council Tax receipts and the available Government funding; and,
 - The need to allocate funding to promote local growth, to build local capacity to generate funding, and to help reduce dependency on Council services.
- 8.6 Each of these pressures may require the allocation of resources in future. It may therefore be advisable, where possible, to set aside available resources for the future impact of these and other areas rather than commit them fully at this stage.

9. COUNCIL PROVISIONS, RESERVES AND BALANCES

Earmarked Reserves

- 9.1.1 The Council sets aside resources as earmarked reserves to cover specific initiatives or spending commitments which have already been agreed. Reserves are monitored and challenged during the year by the Director of Finance and Information Technology to ensure that planned expenditure is properly phased and managed, and to ensure that timely decisions can be made on any reallocations.

9.1.2 The Council continues to resist calls for local authorities to use their reserves to plug permanent budget gaps. In line with the views expressed by the Local Government Association and the Chartered Institute of Public Finance and Accountancy, the Council's view is that this approach is fundamentally unsound. The Government's cuts to local authority funding are permanent, but reserves can only be used once. Council services require funding year after year, but reserves are a limited source of money. Using one-off resources to fund permanent pressures would mean the cancellation of previously agreed investment, and would merely delay the need to make savings.

9.1.3 Instead, the Council's Medium-Term Financial Strategy promotes the use of one-off resources for proactive invest to save strategies, which reduce, rather than simply delay, the need for permanent savings, and avoids the cancellation of previously agreed investment.

9.1.4 One measure to achieve this is by using one-off resources for the early repayment of debt, as agreed by the Cabinet on 12 February 2014 and set out in the 2013/14 Budget Monitoring report elsewhere on this agenda. The proposal set out in that report is reflected in the revised financial forecasts set out in this report.

9.2 *Unearmarked Reserves ("General Balances")*

9.2.1 The Council's policy for setting its level of general balances is based on best practice guidance issued by the Chartered Institute of Public Finance and Accountancy. The guidance suggests that the statutory "chief finance officer" should take account of the strategic, operational and financial risks facing the Authority when assessing the adequacy of general balances. This assessment includes consideration of the key financial assumptions underpinning the Council's Financial Strategy, and consideration of the Authority's financial management arrangements. Factors such as the treatment of planned efficiency savings, the availability of funds to deal with major contingencies and future demand-led pressures, and the general financial climate to which the Council is subject should all be considered.

9.2.2 The Director of Finance and Information Technology's assessment is that General Balances should only be used in the event of unforeseen costs or emergencies arising from factors such as:-

- monitoring of the in-year budget position indicating significant unfunded pressures against Portfolio resources;
- significant in-year changes to funding; and/or,
- emergency situations requiring significant expenditure for which there is no budget provision.

9.2.3 Failing to maintain General Balances in this manner would place the Council at risk of having to implement sudden cuts in services to address such problems. General Balances are therefore forecast to stand at £5.270m as at 31 March 2014. Given the increased financial risks due to reduced levels of contingency and increased levels of savings which have to be implemented, the Director of Finance and Information Technology considers that this current level is appropriate and that any 2014/15 budget proposals put forward for consideration by the Council should enable balances to be maintained at this level. The level of General Balances will be kept under review and any proposed changes for future years will be reported to the Cabinet.

10. MEDIUM-TERM FINANCIAL FORECASTS

10.1 Updated Assumptions

10.1.1 For planning purposes, the financial forecasts include “lower” and “upper” forecasts of future funding levels. While the 2014/15 funding position can be based on the Final Settlement announcement, there remain significant unknown variables for 2015/16 and 2016/17, which mean that lower and upper planning forecasts are still required.

10.1.2 Alongside the above information on Government funding and Council Tax levels, there is a wide range of further assumptions which are taken into account in updating the medium-term financial forecasts. They include the latest information on:-

- Pay inflation;
- Price and contract inflation;
- Treasury management interest rates and borrowing requirements; and,
- Potential financial pressures arising from:-
 - The increased cost of existing service levels;
 - The ability to manage legislative and demographic changes; and,
 - National and/or local policy changes.

10.1.3 Full details of the main assumptions are set out in Appendix A to this report. The estimates and underlying assumptions will be continually updated to allow the Council to develop its detailed Financial Strategy.

10.2 Revised Financial Forecasts

10.2.1 Based on the range of information and assumptions set out in the preceding sections of this report, the updated three-year financial forecasts for the Council are set out overleaf:-

Medium-Term Revenue Budget	2014/15 £m	2015/16 £m	2016/17 £m	3-year Total £m
Forecast Shortfall Lower Estimates of Funding	0.000	9.701	15.945	25.646
Forecast Shortfall Upper Estimates of Funding	0.000	9.187	11.655	20.843

10.2.2 On 6 March 2013, the Council agreed a wide range of proposals which were sufficient at that stage to set a balanced budget for both 2013/14 and 2014/15. The revised financial forecasts now confirm that a balanced position for 2014/15 is still achievable, although they also indicate significant shortfalls in future years, with up to £25.646m to be bridged over the two-year period from 2015/16 to 2017/18.

10.2.3 The 2014/15 Revenue Budget report elsewhere on this agenda includes proposals to allocate resources to one-off and permanent investments in 2014/15. As noted in section 8 of this report, the figures in the table above already reflect the impact of those proposals, and therefore any decisions by Members to vary those proposals would require revisions to the forecasts.

10.2.4 The impact of the forecasts on the Council's future Financial Strategy is considered below.

11. THE GOVERNMENT'S APPROACH TO LOCAL GOVERNMENT FUNDING

11.1 Spending Power

11.1.1 The Government's preferred measure of local government funding is known as "spending power per dwelling". Despite the fact that the Council (and many other local authorities) have fundamental concerns about how the Government calculates these figures, the data cannot disguise the fact that the cuts imposed by the current Government have been higher in the most deprived areas of the country.

11.1.2 In 2014/15, Knowsley faces the largest reduction in "spending power" in the country with a cut of £172 per dwelling (5.6%) compared to the average cut across England of £62 per dwelling (2.9%). At the same time, in Windsor and Maidenhead (which is similar in size to Knowsley and has a similar range of services but a much less deprived population) the cuts in spending power are just £5 per dwelling (0.3%). In Wokingham (the least deprived upper tier Council in England), there is actually an increase in spending power of £5 per dwelling (+0.3%).

- 11.1.3 In 2015/16, the inequality is even greater. Knowsley will lose “spending power” of £174 per dwelling (6%) compared to the average cut across England of £37 per dwelling (1.8%). Windsor and Maidenhead, and Wokingham will see “spending power” increase by 2.7% and 3% respectively. Knowsley’s “spending power” has fallen year on year since 2011/12, yet Wokingham’s is now higher than it was in 2011/12.
- 11.1.4 The Government’s policy is to attempt to reduce the differences in “spending power” across the country. The assumption underpinning that policy is that the cost of providing local authority services should be broadly similar across the country regardless of geographical location. However, while this may be true in terms of the day to day costs incurred by local authorities, it fails to recognise that “spending power” also has to reflect differences in spending pressures, and in particular the much greater need to provide services in more deprived areas. The Government’s current funding arrangements will continue to cut “spending power” for the poorest and most deprived councils while increasing it for the most wealthy and least deprived councils.
- 11.1.5 A further feature of the Government’s approach is the year-on-year erosion of those resources which are allocated to recognize a local authority’s inability to generate funding locally through the Council Tax (Council Tax resource equalisation). Council Tax resource equalisation is no longer given the same protection as other resources which have been separately identified, such as the Freeze Grant. The cash protection of the Freeze Grant again benefits the wealthier areas with high tax bases, while the lack of protection for Council Tax resource equalisation disadvantages low tax base areas (such as Knowsley). It is estimated that Knowsley’s Settlement in 2015/16 is around £5m worse due to the lack of protection for Council Tax resource equalisation funding.

11.2 *Increased Focus on Business Rates*

- 11.2.1 Since the Business Rates Retention System was introduced in 2013/14, the collection of Business Rates and the ability to grow or sustain the Business Rates base have become increasingly important to local authorities’ funding. The Government estimates the sum which it expects the Council to collect in Business Rates and a proportion of this is now retained by the Council as an element of its Settlement Funding Assessment (i.e. Retained Business Rates). The Council’s budget must then bear any risk or reward of actual Business Rates collection differing from this “target”.
- 11.2.2 The increased focus on the level of Business Rates collected will have a significant effect on the Medium-Term Financial Strategy and the Council must recognise the importance of generating new business, the risks arising from losing businesses, and the impact of Business Rates appeals, arrears and reliefs.

11.3 *Changes in the Principles Behind the Government's Approach*

11.3.1 The Government's latest announcements continue the fundamental shift away from allocation of local government funding on the basis of need. The Government's focus is local authorities becoming more self-sufficient by providing incentives to grow local economies. This approach effectively rejects the principle that funding should be sufficient to reflect the different needs of communities.

11.3.2 The new funding system fails to recognise the varying requirements on councils in different areas to provide statutory services, or the very different abilities to raise money locally from Council Tax. These were the core principles which underpinned the local government finance system when Council Tax was first introduced in 1993/94. Those principles were aimed at ensuring that any resident anywhere in England would receive a standard level of service to meet their needs with a similar Council Tax charge for a similar property. However, it appears that these principles are now being abandoned (whether by design or by accident).

11.3.3 The Council will continue to lobby the Government for fair funding allocations for deprived areas. The Council's argument must focus on demonstrating why "spending power" in deprived areas must be greater than "spending power" in more affluent areas.

12. IMPACT OF FUNDING REDUCTIONS ON THE COUNCIL'S MEDIUM TERM FINANCIAL STRATEGY

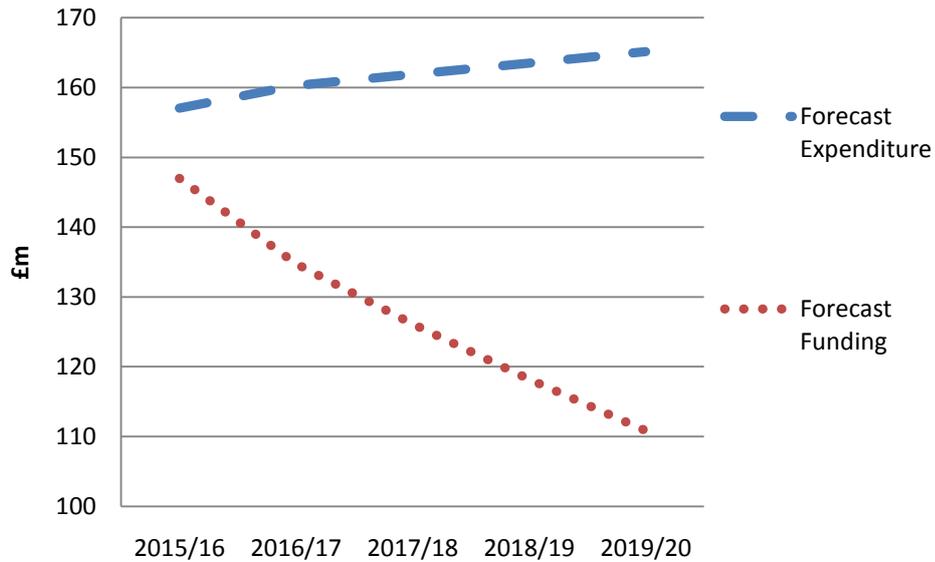
12.1 It is important that the financial forecasts are put into a meaningful context and to recognise that the significance of the funding cuts will affect the Council's ability in future to deliver the range and quality of services which have traditionally been provided.

12.2 If the medium-term forecasts are extended into the longer-term, the impact of the Government's approach is even more significant. The two graphs at paragraphs 12.3 and 12.4 below illustrate this impact (based on a number of assumptions outlined below which are themselves relatively optimistic but are appropriate for illustrative purposes):-

- that Council expenditure increases by only 1% per year from 2015/16 onwards (i.e. including all pay and price inflation and all demographic pressures);
- that Council funding reductions over the longer-term are in line with the current forecasts for 2016/17; and,
- that all pressures caused by reductions in specific grants are self-contained.

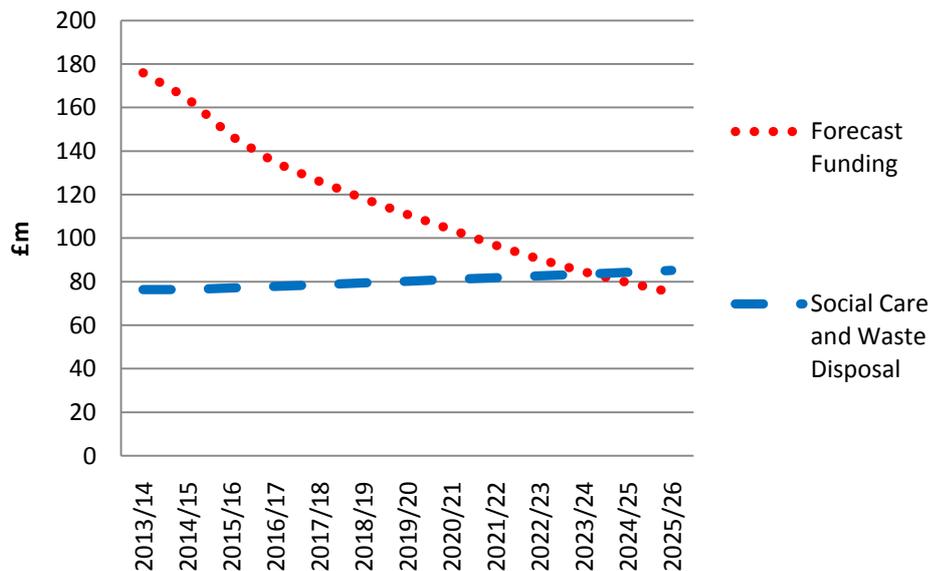
12.3 The first graph is a long-term forecast of the widening gap between the Council's expenditure and its funding. The medium-term financial forecasts indicate that annual savings of up to £23.4m must be achieved by 2016/17. Against the Council's total Portfolio Cash Limits in 2013/14 of £125m, this represents a 19% saving. Without taking action, the Council's financial shortfall will approach £50m (40%) per year within 5 years:-

Long Term Forecast of Budget Gap



12.4 The second graph illustrates how much of the Council's resources will be available to fund the range of services which it currently provides:-

Pressure on Service Provision



- 12.5 Using the approach adopted by the Local Government Association, the graph in paragraph 12.4 above identifies Council expenditure on just two key statutory services – Social Care and Waste Disposal. In 2013/14, around £76m was budgeted for these services, with expenditure on all other Council activities being around £100m. Without taking action, it is estimated that within 10 years there will be no funding for any Council activity other than Social Care and Waste Disposal.
- 12.6 To understand fully the pressure on future service provision, further work must be undertaken to analyse exactly which service activities, and importantly what minimum levels of service, are actually required under statute. This is discussed in paragraph 13.4.2 of this report. When required expenditure on minimum statutory provision is included in the above analysis, the timescale within which funding is fully absorbed by statutory activities will be significantly shorter.
- 12.7 The graphs in paragraphs 12.3 and 12.4 above demonstrate clearly the scale of the challenge facing the Council and the scale of the savings which must be made. The only way in which the shortfalls can be effectively managed is for the Council both to increase future funding and also reduce future costs. The Council must therefore:-
- a) Continue to challenge the inequality of the Government's approach to funding local government and lobby for a return to a needs-based funding allocation which would give Knowsley a bigger proportion of the available Government funding given the Borough's relatively higher costs of demand-led services;
 - b) Reduce costs – ideally, this would be achieved by reducing need and dependency on Council services, but the scale of the required cuts will also mean significant reductions in services, activities and initiatives. The Council's Change and Transformation Programme is key to this cost reduction being achieved on a planned and prioritised basis (as discussed in more detail in section 13 of this report below); and,
 - c) Increase the Council's ability to generate income on a local basis, particularly through increased Business Rates and Council Tax by increasing the number of businesses and houses in the Borough. Additional funding through fees and charges, partner organisation contributions and external funding must also be maximised.

12.8 The cuts to the majority of the Council's funding are general and are not specific to any service. However, this does not mean that all services can or should bear an equal share of future savings. In making savings, there are significant elements of the Council's budget which are allocated to meet statutory requirements, so some areas of the Council's budget cannot necessarily be reduced to the same extent as others.

12.9 The Council must therefore understand clearly what services it is legally bound to provide, and to what standard these services must be provided in order to meet minimum statutory obligations. After determining the funding required for those levels of service provision, all other services must be managed within any remaining funding, and the savings must be made within those non-statutory service budgets.

12.10 The Council must also have a clear and realistic understanding of what kind of impact the scale of the required savings will have on services. The Council must:-

- a) Accept that for many services, the level of required savings may make the service unsustainable. Rather than providing an ineffective and inefficient service, it may be preferable to cease the service provision entirely;
- b) Decide which services should continue to be provided (even at a reduced level) by being clear on which of its priorities are the most important for the long-term sustainability of the Borough;
- c) Recognise that some current priority areas will not be affordable in future years; and,
- d) Recognise that any protection of services beyond the minimum statutory level will increase the need for savings elsewhere.

12.11 The Council's future Financial Strategy must recognise and address these factors if the Authority is to have assurance that sufficient savings can be identified and be properly considered, implemented and managed.

13. KEY FEATURES OF THE MEDIUM-TERM FINANCIAL STRATEGY

13.1 A report to the Cabinet on 11 December 2013 detailed the areas of work which would underpin the Council's Medium-Term Financial Strategy for 2015/16 and future years as follows:-

- a) The Commissioning Ready Work Stream;
- b) The Commissioning Review Process;
- c) Continued Prioritisation of Services and Activities;

- d) Operational Efficiency Targets; and,
- e) Council-wide/Non-Cash Limit Savings and Efficiencies.

13.2 Details of how each of these areas contributes to the Council's Financial Strategy are set out below.

13.3 *The Commissioning Ready Work Stream*

13.3.1 The Council is committed to reviewing all services and business processes, so that all in-house services are "commissioning ready", or as streamlined, efficient and effective as possible, ahead of each being subject to a Commissioning Review. The Commissioning Ready work stream will ensure that services are efficient, fit for purpose, and competitive when compared to alternative delivery options.

13.3.2 Phase 1 of the Commissioning Ready work stream included all services within Children and Family Services and Adult Social Care. Analysis has been undertaken and areas for further work have been identified and incorporated into development action plans. Officers from across the Council are working together to deliver these plans and achieve the required efficiencies.

13.3.3 Specifically, a comprehensive review of all aspects of Children's Social Care is under way and being managed through an Improvement Board led by the Director of People Services. Reviews are under way to quickly deliver improvements and savings, including a full reorganisation proposal.

13.3.4 In terms of Adult Social Care, a comprehensive action plan is under development. This will include a full review of high cost clients and care packages.

13.3.5 Phase 2 of the Commissioning Ready work stream is drawing to a conclusion and has considered all other Council services. Desktop assessments have been undertaken in each area, and the results from this exercise will be used to develop action plans to identify and deliver savings and efficiencies.

13.4 *The Commissioning Review Process*

13.4.1 Following on from the Commissioning Ready work stream, the desktop assessments discussed in paragraph 13.3.5 above will be used to set out the Council's Commissioning Review process. This will review all Council services over a three-year cycle to identify how resources should be invested based on the relative impact and priority of each service. The outcomes of each review will be developed on the following basis:-

- a) The level of outcomes and services which can be provided from a reduced resource base equivalent to 50% of current levels; and,
- b) The additional outcomes which could then be delivered with further incremental allocations of resources from 50% up to current resource levels.

13.4.2 An initial set of commissioning reviews has been identified as listed below:-

- (i) Early Help;
- (ii) Mental Health;
- (iii) Active Leisure;
- (iv) Highways and Transportation;
- (v) Customer Services; and,
- (vi) Commercial Services.

13.4.3 Work is under way to complete the scoping documents for these reviews, which will specify the scope, objectives, scale, overall approach and timescale in each case. Each review will bring proposals forward in September 2014 in order to help to inform the 2015/16 budget setting process.

13.4.4 Members will be involved at key points throughout the process. The methodology for this involvement is being considered as part of the current Scrutiny Review of the Budget Process, which is nearing completion.

13.4.5 The next phase of commissioning reviews is under development, informed by the desktop assessment exercise and emerging opportunities. These reviews will also reach the stage of presenting spending and saving plan proposals by September 2014.

13.5 *Continued Prioritisation of Services and Activities*

13.5.1 To ensure that the Commissioning Reviews are fundamental and thorough, the full programme of reviews will be completed over a three-year cycle. To ensure that sufficient savings options for 2015/16 and 2016/17 are identified while the Commissioning Review Programme is ongoing, all services will continue to identify cost reduction options of 20% over the two years 2015/16 and 2016/17.

13.5.2 Further work will also be undertaken as part of the Change and Transformation Programme to analyse which services, and importantly what minimum levels of service, are actually required under statute. Officers will work to identify which activities are discretionary, and the extent to which savings could potentially be made within statutory areas of service by reducing standards from current levels of provision

to statutory minimum levels, while considering the impact of such service reductions on the community.

13.5.3 The 2014/15 Fees and Charges report elsewhere on this agenda notes that the Council's Costing Policy and Corporate Charging Policy sets the principles according to which fees and charges for services should be calculated and collected. The Costing Policy requires service managers to use the Council's Costing and Charging Framework to ensure that they understand the full cost of their services and that they use that information as the basis for management decisions, including setting fees and charges.

13.5.4 The Costing and Charging Framework seeks to ensure that all appropriate elements of cost are recovered depending on the purpose and context of the charge, and that any decisions to subsidise a service (i.e. not to recover all costs) for market or policy reasons are transparent. This will improve understanding regarding the true level of subsidy that the Council bears when a charge is set.

13.5.5 As part of the identification of cost reduction options for 2015/16 and 2016/17, it is essential that the Costing and Charging Framework is used to underpin the setting of fees and charges. The Director of Finance and Information Technology will work with service managers to support them in developing this key area.

13.6 *Operational Efficiency Targets*

13.6.1 As reported in the 2013/14 Revenue Budget Monitoring report elsewhere on this agenda, the projected budget surplus in 2013/14 is again in line with the pattern seen in recent years, whereby the approach to implementing savings early (along with some unplanned or one-off events) is likely to result in one-off resources being available at the outturn stage. In light of this trend, the Cabinet agreed on 6 November 2013 that this recurring pattern should be reflected in the Council's ongoing Budget Strategy rather than being treated as a one-off "windfall" at the end of each year.

13.6.2 The Director of Finance and Information Technology has therefore determined that an efficiency target will be included as part of the future year Medium-Term Financial Strategy in each Portfolio's annual budget. The financial forecasts set out in this report assume a target in 2014/15 based on 1% of estimated salary budgets. In previous years, this has been referred to as a "vacancy management target", and, while salaries will continue to be the main budget against which this target must be achieved, it is recognised that there are numerous other unplanned or one-off events each year which result in other budget surpluses being achieved to contribute towards this target.

13.7 *Council-wide Efficiency Measures*

Plans to deliver efficiencies on a Council-wide basis will also be identified by the Financial Management service. These plans will focus on the robust challenge of non-cash limit budgets, and the continuation of the proactive use of one-off resources to release budgets on a permanent basis.

14. 2014/15 ANNUAL PAY POLICY

14.1 The Localism Act 2011 sets out requirements for local authorities to determine and publish Annual Pay Policy Statements, which must be approved by the Council prior to each financial year. The Annual Pay Policy Statement must set out the Council's policies relating to:-

- Chief officer remuneration;
- Remuneration of the Council's lowest paid employees; and,
- The relationship between chief officer remuneration and that of other employees.

14.2 The proposed Annual Pay Policy Statement for 2014/15 is attached at Appendix B to this report for the Council's consideration. The legal provisions do not apply to school teaching staff and therefore they are not included in the scope of the Statement.

15. RESOURCE IMPLICATIONS

15.1 Financial

15.1.1 This report sets out the context within which the Council must make its financial decisions for 2014/15 and future years. The report updates the Council's financial forecasts and notes that the three-year budget shortfall to be addressed by the Council is now forecast at up to £25.6m.

15.1.2 The 2014/15 Revenue Budget report elsewhere on this agenda sets out the Cabinet's proposals for setting the Council's 2014/15 revenue budget.

15.1.3 For future years, it is essential that the Council's Change and Transformation Programme identifies savings as early as possible in order to allow the maximum time for implementation and management of the resulting service impact.

15.1.4 In recent years, the Council has adopted a planned approach which has avoided the need for reactive service cuts and ensured that service reductions are targeted as far as possible against lower priority areas. However, it is now essential that the Council develops a clear view on which of its priorities are the most important for the long-term sustainability of the Borough, and, as a result, determines which services should continue to be provided even at a reduced level and which services will not be affordable in future years.

15.2 Human Resources

15.2.1 This report has no direct human resource implications. However, the savings required to balance the Council's budget will require further reductions in jobs. It will become increasingly difficult to deal with these reductions by redeployment and voluntary means.

15.2.2 The early identification of savings by the Council provides a greater opportunity to deal with job reductions through the deletion of vacant posts, redeployment, or voluntary means.

15.2.3 The Council's intention is to continue this planned approach in future years. Discussions will be held with the local trade unions and any affected employees to ensure that they are kept involved and fully informed.

15.3 Information Technology

This report has no direct impact on information technology, but does provide the context for future decisions which could have an impact on the use of technology within the Council.

15.4 Physical Assets

This report has no direct impact on the Council's physical assets, but does provide the context for future decisions which could have an impact on the use of those assets.

16. PERFORMANCE AND RISKS

- 16.1.1 Given the wide range of assumptions set out in this report, there will always be a potential risk that financial estimates are not sufficiently accurate. The most significant risk relates to levels of Government funding, as the position changes continuously due to new announcements, top slices and additional cuts. The 2014/15 position has been confirmed in the Final Settlement announcement. However, the estimates for future years are more uncertain as only indicative funding announcements have been made to date. These estimates will be updated as further information becomes available. The use of upper and lower estimates does enable effective budget planning to be undertaken and has been shown to be accurate in previous years.
- 16.1.2 The Council's ability to maintain sufficient flexibility to ensure that financial pressures can be dealt with will reduce as budgets are reduced and as one-off resources are used. It is increasingly likely that unfunded pressures will have to be funded in the short-term by general balances and/or re-allocated reserves
- 16.1.3 The Council faces significant financial challenges in future years and there is a risk that future budget shortfalls may not be resolved. This could result in a need for reactive service cuts. In order to mitigate this risk, the Council must identify and implement planned reductions in spending in a timely and proactive manner.
- 16.1.4 A critical assumption in setting the budget is that all approved efficiencies and savings will be achieved. It is imperative that robust monitoring of progress against the implementation of each Portfolio's budget proposals efficiency and savings measures takes place, and that plans and timescales for implementation are set out in advance.
- 16.1.5 There will also be a continued need for Portfolios to manage unbudgeted or unexpected cost pressures within their existing resources. This could mean a risk of increased budget pressures in future years where an ongoing pressure cannot be funded permanently. To help address this, the Council's Financial Strategy is based on a "single budget" approach, whereby financial issues in any one area will be considered in the light of Council-wide priorities and outturn forecasts.

17. EQUALITY AND ENVIRONMENTAL ASSESSMENT

17.1 Equality and Diversity

This report has no direct impact on any particular population group, but does provide the context for future decisions which could impact on performance and the delivery of services to the public. Proposed changes in Council service delivery may impact on specific population groups due to changes in service levels and/or frequency of service provision. Equality and diversity impact assessments have been undertaken as part of the Annual Budget Strategy to assess and address the implications thoroughly and are available on request from the Director of Finance and Information Technology.

17.2 Environmental Policy

This report has no direct impact on environmental policy, but does provide the context for future decisions which could have an impact.

18. COMMUNICATION ISSUES

18.1 The information in this report forms the basis for the 2014/15 and future-year budget process, and will be updated and reported to Members as additional information becomes available and as assumptions are clarified.

18.2 The key to the successful implementation of redesigned Council services will be that all stakeholders are involved and have all the required information at the appropriate time. A co-ordinated and phased communications strategy is in place as part of the service redesign process and the communications strategy for the Change and Transformation Programme. This will ensure that communications activity is well planned, sensitive and robust, and will make sure that Members, service users, employees, local trade unions and partner organisations are all kept involved and up to date.

18.3 The communication aspects of the 2015/16 budget process will be informed by the agreed outcomes of the current Scrutiny Review of the information available for Members to allow fully informed budget decisions to be taken.

19. CONCLUSIONS

19.1 The Council continues to face significant reductions in Government funding. Forecasts indicate a budget shortfall of up to £25.6m over the years 2015/16 and 2016/17.

- 19.2 For planning purposes, the forecasts include an assumed Council Tax freeze in each of the next three years, and also the implementation of the permanent and one-off investment options set out in the 2014/15 Revenue Budget report elsewhere on this agenda. The figures will change over time as the various assumptions and influencing factors are clarified.
- 19.3 Future phases of the Change and Transformation Programme will need to focus on the fundamental redesign of front-line service delivery to meet the significant financial challenges in future years.

JAMES DUNCAN
Director of Finance and Information Technology

Contact Officer:- Dan Barlow (0151)-443 3622

Appendices:-

Appendix A Key Assumptions used in Medium-Term Financial Forecasts
Appendix B Draft Pay Policy Statement – March 2014

Background Documents:-

Report to the Cabinet - 11 December 2013 - "Medium-Term Financial Strategy"

APPENDIX A (i)**KEY ASSUMPTIONS USED IN MEDIUM-TERM FINANCIAL FORECASTS**

	<u>2014/15</u>	<u>2015/16</u>	<u>2016/17</u>
Council Tax Planning Assumption	0%	0%	0%
Pay Inflation	1%	2%	2%
Superannuation Past Deficit Contributions (assuming full payment in first year)	£8.244m	£8.205m	£8.166m
Superannuation Rate (future year contributions)	12.7%	12.7%	12.7%
Price/Contract Inflation	Managed within Portfolio budgets		
Income Inflation	Managed within Portfolio budgets		
Merseyside Recycling and Waste Authority Levy	2.94%	2.94%	2.94%
Merseyside Passenger Transport Authority Levy	0%	0%	0%
Other Levies	3%	3%	3%
Contingency for Increased Demand	0	£0.5m	£1m

ADDITIONAL INFORMATION AND ASSUMPTIONS

Cash Limit Budgets

The Council uses cash limits as a control total mechanism for Portfolio budgets which are considered to be within the control of services. Portfolio cash limits are revised during the year (in consultation with the appropriate Portfolio Holders) to take account of in-year adjustments and allocations from approved contingencies.

Non-Cash Limit Budgets

Areas of expenditure and income which lie outside the direct control of services are treated as non-cash limit budgets.

Contingency Budgets

Each year, the Council sets aside limited contingency budgets for expected in-year budget pressures which will need to be funded to maintain approved service levels. These budgets are held centrally and transferred to Portfolio cash limits during the year once the financial impact of each item has been clarified. Decisions on the required level of these budgets will be made as part of the annual budget setting.

Treasury Management Assumptions

A major component of non-cash limit budgets is the cost of the Council's treasury management activity (e.g. the level of interest paid on Council debt and interest earned on Council investments). The forecasts in the revised Medium-Term Financial Strategy reflect the latest estimates of interest rates and expected levels of Council borrowing. Any changes in future rates and future decisions on new borrowing will impact on these costs.

The Council's debt portfolio can be restructured by repaying loans prematurely and refinancing them on similar or different terms to achieve a reduction in risk and/or savings in interest costs. The Council will continue to monitor changes in the market and take advantage of any such opportunities.

Capital Strategy

The Medium-Term Financial Strategy focuses on revenue expenditure and income. The Council's Capital Strategy sets out its approach to capital investment by providing a framework for the allocation and management of capital resources within the Council. The Capital Strategy ensures that the use of capital resources over the medium-term is optimised by allocating funding to those schemes which contribute most to the achievement of the strategic objectives of the Council's Corporate Plan.

The Council's Property Plan sets out which Council-owned assets are earmarked for disposal. Potential capital receipts from these sales will be affected by the economic climate (such as relatively low property prices and low market demand from investors such as housing developers), so it is important that the timing of sales is managed to maximise the receipts which can be realised.

The key factors which the Council should consider include:-

- the Council's priorities in terms of land use across the Borough;
- housing demand in the Borough;
- confidence levels and interest from developers;
- the likelihood of planning permission; and,
- the site conditions and potential problems (e.g. flood areas).

The main limit on the use of general capital receipts arises from regulations which protect school playing fields and land for city academies, and requires any proceeds from the sale of school playing fields to be used to provide outdoor sport or recreation facilities or to improve facilities in older schools. Otherwise, the Council's policy is that all capital receipts will be considered by the Cabinet as part of its overall decisions in funding the Council's Capital Programme.

Given the limited supply of surplus land, and the increasing pressure on the Council's resources, the Council must ensure that the use of capital receipts is managed in a strategic way in order to ensure best value for money and to achieve the Council's priorities.

The Prudential Code for Capital Finance in Local Authorities provides freedoms to undertake additional borrowing over and above the resources announced by the Government. The control of capital spending is centred on the affordability of the revenue consequences of that capital spending, i.e. the financing of debt and depreciation of the asset. Any scope to increase the amount the Council borrows will need to be assessed against the financial constraints currently forecast.

KNOWSLEY METROPOLITAN BOROUGH COUNCIL

PAY POLICY STATEMENT – MARCH 2014

INTRODUCTION

Knowsley Metropolitan Borough Council is committed to transparency and fairness in its payment and remuneration of all of its employees.

In 2013/14, the Council had an overall pay bill of £99.304m (including oncosts) for its workforce. The Council currently has a workforce of 3,091 people. These figures do not include staff employed by the Borough's schools, who are employed independently of the Authority.

The Council continued to review its senior officer organisational structure and the associated pay and grading arrangements during 2013/14. This review has achieved further, permanent savings of £0.5m and follows a reduction in senior management pay costs of approximately £7.5m since 2008/09. The work to date will now be followed by a full senior management pay and grading review (incorporating job evaluation), with the outcome of this review expected to be implemented during 2014/15.

The Authority has already completed a fundamental pay and grading review in relation to all other Council posts (i.e. those not covered by the senior management review mentioned above). Whilst no direct pay savings were achieved from this review, it enabled the Authority to implement an equal pay compliant pay structure, which will also help it to manage future pay costs.

1. Purpose of the Statement

- 1.1 This Pay Policy Statement sets out the Council's approach to pay policy in accordance with the requirements of Section 38 of the Localism Act 2011.
- 1.2 In accordance with legislation, this Pay Policy Statement will come into immediate effect once approved by the full Council and will be subject to review on a minimum of an annual basis, the policy for the subsequent financial year being approved by 31 March each year.
- 1.3 In determining the pay and remuneration of all of its employees, the Council will comply with all relevant employment legislation.

2. Pay Structure

- 2.1 The Council uses nationally negotiated pay rates as the basis for its local pay structure, which determines the salaries of the majority of its workforce.
- 2.2 All other pay-related allowances are the subject of either nationally or locally negotiated rates, having been determined from time to time in accordance with collective bargaining machinery.
- 2.3 In determining its grading structure and setting remuneration levels for any posts which fall outside the scope of nationally set pay grades, the Council takes account of the need to ensure value for money in respect of the use of public expenditure. This is balanced against the need to recruit and retain employees who are able to meet the requirements of providing high quality services to the community.
- 2.4 New appointments will normally be made at the minimum of the relevant pay scale for the grade. From time to time, it may be necessary to take account of external pay levels in the labour market in determining starting salary levels or in order to attract and retain employees with particular experience, skills and capacity.
- 2.5 Following implementation of a Pay and Grading Review during 2013/14, the Authority has agreed a Policy on the Application of Market Supplements. Subject to the satisfaction of qualifying criteria, this Policy allows the Authority to apply a temporary recruitment and retention premium of up to 10% of the basic salary to a particular job. Any such pay supplement is subject to executive approval and periodic review.

3. Senior Management Remuneration

- 3.1 For the purposes of this Statement (other than the reference to senior management pay savings and the Senior Management Pay and Grading Review, both of which affect **all** senior management posts), the Council has defined “senior managers” as including the Council’s Head of Paid Service, Deputy Chief Executive, and Directors. These categories include all of the Council’s statutory chief officers in accordance with the Local Government and Housing Act 1989 and the Localism Act 2011.

3.2 These posts are set out below together with the associated total remuneration:-

Post Title	Salary Band
Chief Executive	£175,492 to £192,028
Deputy Chief Executive	£134,153 to £146,555
Directors	£78,310 to £110,000

3.3 There has been no annual “cost of living” pay award to any of the posts listed above since April 2008. Compared to the Retail Price Index, this equates to a real terms cut in pay equivalent to approximately 20%.

4. Additions to Salary

4.1 In addition to the salaries quoted above, some posts receive additional remuneration as outlined in the table below:-

All officers involved in delivering Local, Parliamentary and/or European Elections and/or Referenda	Duty payments in connection with elections as determined locally and/or by statute depending on the duties concerned.
All eligible employees at all grades	Pension contributions paid to the Local Government Pension Scheme. The contribution rates are set by actuaries advising the Merseyside Pension Fund.

Note:- The arrangements and factors considered in determining an individual's progression through the relevant grade pay scale are based upon their performance and capability in the post. All of the post holders are assessed by their relevant line managers.

- 4.2 Where the Council is unable to recruit chief officers, or there is a need for interim support to provide cover for a substantive chief officer post, the Council will where necessary consider engaging individuals under a “contract for service”. Such contracts will be sourced through a relevant procurement process in order to ensure that the Council is able to demonstrate the maximum value for money benefits from competition in securing the relevant service. In assessing such contracts, it should be noted that, in respect of such engagements, the Council is not required to make either pension or National Insurance contributions for such individuals.

5. Senior Management Recruitment

- 5.1 The Council does not make any “golden hello” payment or any other incentive payment to its senior managers upon recruitment. Where appropriate, the Council pays removal and relocation allowances up to a maximum of £16,981 upon the presentation of approved receipts.
- 5.2 The Council’s policy and procedures with regard to the recruitment of senior managers are detailed within its Recruitment Policy.
- 5.3 When recruiting to all posts, the Council will take full and proper account of all provisions of relevant employment law and its own approved policies.
- 5.4 The determination of the remuneration to be offered to any newly appointed senior manager will be in accordance with the pay structure and relevant policies in place at the time of recruitment.

6. Performance Related Pay and Bonuses for Senior Managers

- 6.1 With the exception of annual progression through the incremental scale of the relevant grade being subject to satisfactory performance, the level of remuneration is not variable dependent upon the achievement of defined targets.
- 6.2 The Council does not currently award any performance related pay or bonuses to its senior managers.
- 6.3 To meet specific operational requirements, it may be necessary for an individual to take on additional duties to their identified role on a temporary basis. Any such arrangements for senior managers would be ratified by the Council’s Employment and Appointments Committee.

7. Payments to Senior Managers on Termination

- 7.1 The Council's approach to these issues is determined by the circumstances of the termination of the employment in each case. For example, this might be via Voluntary Severance, Compulsory Redundancy or Early Retirement.
- 7.2 The Council's approach to statutory and discretionary payments on termination of employment of senior managers prior to reaching normal retirement age is set out within its policy statement in accordance with Regulations 5 and 6 of the Local Government (Early Termination of Employment) (Discretionary Compensation) Regulations 2006. In this respect, the Council's treatment of senior managers is identical to its treatment of any other staff.
- 7.3 Any payments falling outside of these provisions or the relevant periods of notice within the contract of employment shall be subject to a formal decision made in accordance with the Council's Scheme of Delegation.

8. Publication of Senior Officer Remuneration Information

- 8.1 Upon approval by the full Council in accordance with legislation, this Statement will be published on the Council's web site.
- 8.2 In addition, for posts where the full-time equivalent salary is at least £50,000, the Council's Annual Statement of Accounts will include details of:-
- salary, fees or allowances paid to or receivable by the person in the current and previous year;
 - any bonuses so paid or receivable by the person in the current and previous year;
 - any sums payable by way of expenses allowance which are chargeable to United Kingdom income tax;
 - any compensation for loss of employment and any other payments connected with termination; and,
 - any benefits received which do not fall within the above.

9. Lowest Paid Employees

- 9.1 The Council's lowest paid employee is remunerated at an equivalent rate of £12,435 per annum (full-time equivalent). This grade is the lowest rate of pay within the Council's pay scales which follow nationally negotiated pay settlements and awards.

- 9.2 The relationship between the rates of pay for the lowest paid and for senior managers is determined by the processes used for determining pay and grading structures as set out earlier in this Policy Statement.
- 9.3 The median average pay of a full-time employee within the Council is currently approximately £19,317. The mean average is £21,547. These average salary figures do not include staff employed by the Borough's schools, who are employed independently of the Authority.
- 9.4 As part of its overall and ongoing monitoring of alignment with external pay markets both within and outside the sector, the Council will use available benchmark information as appropriate.

10. Accountability and Decision-Making

In accordance with the Council's Constitution, the Employment and Appointments Committee is responsible for decision-making in relation to the recruitment, pay, terms and conditions and severance arrangements in relation to senior managers of the Council.

11. Re-employment/Re-engagement of Former Senior Managers

The Council will not re-employ any senior manager who was previously made redundant by the Council, and will not later re-engage such officers under a contract for service.