Appendix 2

FINANCIAL OVERVIEW

The "Macro" Position

1. At the national level, the current Comprehensive Spending Review (CSR) runs to 2006/07 but work within Government is beginning on the next CSR. The economic backdrop to the end of the current CSR and future years looks much more difficult than the recent past. The essential position of increasing resources and investment in the public sector at a much faster rate than the actual economy is growing cannot be sustained over the long term without compensating impacts on tax and/or interest rates (which trigger other impacts). This has, of course, been true for some time but the situation going forward is further complicated by a growing concern for the world economy. In the absence of a sudden economic downturn, the tentative conclusions I would draw are twofold: first, the current CSR projected increases to 2006/07 will be met but further, explicit or implicit, compensating adjustments in wider tax policy may be required. Second, the outlook for the new CSR following 2006/07 is unlikely to see the same scale or rate of increases in resources for public services as has been enjoyed in the first two CSRs.

Local Position - Standstill Pressures

2. The Council's net budget for the current year, 2003/04, is £459m. Some £276m of this is met by general government formula grant with the remaining £183m met from Council tax. The current £459m covers the following key areas:

	£m
Schools budget	200
External Levies	27
Capital Financing	27
Routine and Corporate Waste Costs	20
Single Status, E-Govt, Bed blocking Provisions	5
	279
Highways Maintenance	14
Libraries	6
Social Services	110
Chief Executive, legal, CRD and miscellaneous	18
Central LEA functions	20
Planning, Transport and Environment	12
	459

3. All budgets will attract inflation. Simply applying assumed wage inflation of 3.5% and general price inflation of 2.5% will add some £13m to the current budget in each of the next 3 years. In addition, maintenance of existing policies will add around £9m per year i.e. (in £m):

		04/05		**05/06**		**06/07**
Inflation/ other standstill:		13.2		13.1		13.2
Self funders, Learning disability, other Social Services commitments		2.7		2.7		2.7
Routine waste growth and corporate waste provision		2.8		3.0		3.1
Single Status Costs		1.1		0.6		

Levies and debt charges		1.4		1.1		1.1
Other misc.		0.8		0.5		-0.1
New Risk Provision		1.0		1.0		1.0
		9.8		9.8		7.8
Standstill Growth		23.0		22.0		21.0
		5.0%		4.6%		4.3%

The above assumes Fire, on a prudent neutral basis, becomes a separate precepting authority for 2004/05; if it did not it could add up to £2m, per year, to standstill pressures. The above does not take account of efficiency savings but equally no specific provision has been made for above trend rises in 'real' inflation in certain areas (e.g. special, transport, highways maintenance).

Education Passporting

4. Last year, through a combination of formula changes, technical changes and a minimum guaranteed increase of 3.2% per pupil, the Council was 'forced' to passport some £13m to schools – some £3m more than the general grant floor increase we received overall.

5. Clearly the future schools passporting requirement is a key variable in our future planning. There is, however, considerable uncertainty as to the precise sums involved. The higher the percentage passporting requirement, - in comparison with the general grant floor increase – the greater is the unfunded impact on the council tax or consequential savings required elsewhere across Council services.

6. If the Government maintained the same minimum increase guarantee as introduced for the current year, the schools passporting increase requirement would be 3.2% in each of the next 3 years for the County Council i.e. the passporting increase would be broadly in line with school standstill pressures also at 3%. From the schools' perspective this would be much less than the 6% plus per pupil increase signalled by Government nationally. The issue would be compounded for schools by the forecast reductions in pupil numbers (especially in the primary sector) in future years. The relatively low level of passporting increase for East Sussex going forward (potentially) is because we were badly affected by the formula changes in 03/04. The full impact was partially mitigated by a temporary damping arrangement. As the damping protection unwinds over time, it actually more than offsets any direct gain from our share of the national 6% increase. The result is that East Sussex County Council will be 'dependent' on the minimum increase guarantee set by Government for a number of years.

7. For the current year the minimum guarantee was 3.2%. Given the publicity around Education funding it would be prudent, at least for planning purposes, to assume the Government would force a higher figure. At this stage, despite recent announcements, it cannot be assumed that any higher per pupil figure would be supported by extra grant on a genuinely "extra" basis. If it were, this would assist the Council's overall financial position.

8.For planning purposes it is proposed to assume a minimum per pupil increase guarantee of 4.5%. This would add the following growth increase, on top of school standstill pressures, in each of the next 3 years to achieve passporting.

	04/5	**05/6**	**06/7**

	3.3	0.8	1.5

Note: The estimate for 2006/07 increase is the most variable.

9. The Council compensated for the loss of some £1.5m school standard monies in the current year but on the understanding it could not protect for future losses. Up until the last few days, it was thought that our schools would face a further loss of government grant of £2.8m, in 2004/05 and 2005/06. Recent announcements indicate that the Government have reversed this decision. This will be welcomed by schools.

10. Beyond the above, and at the time of writing, the full detail of the Secretary of State's recent announcements is still being analysed in detail.

Social Services Recovery Investment

11. Last Autumn the Cabinet endorsed giving some indicative increase in funding for Social Services for the 3 years, including 2003/4, to 2005/6 so as to aid better planning. It was clearly understood that this was purely indicative and depended, significantly, on the threatened formula changes not being implemented. As it happens the actual settlement turned out to be as bad as we feared but the Cabinet felt that, nevertheless, it wished to increase investment in 2003/4 in line with it its core corporate priorities. This was one of the significant factors around the council tax increase in 2003/4. (The others being: the general formula change; the unfunded school passporting requirement; and the unfunded increases in waste costs).

12. Some £1.3m per year, on top of Social Services standstill pressures, is required to maintain 7% cash increase (on the 2002/3 base).

Local Government Pension Scheme

13. The County Council administers the Scheme on behalf of all local authorities in East Sussex but including Brighton and Hove. National regulations require the Scheme to be valued every 3 years by an independent actuary; with the employer contributions adjusted as a result. The next valuations will take place during 2004 with the budget impact normally felt in 2005/6 onwards.

14. At the last valuation (2001), the East Sussex scheme performed above average and indeed was deemed to by fully funded. For the 2004 valuation, the ESCC scheme is also expected relatively to out-perform the average local authority fund. The reality, however, is that the market for everyone has dropped, to date, by over 30% and that is also the scale change anticipated by the 2004 valuation. It is inevitable, therefore, that an increase in employer contributions will be required; even for 'above average' funds like East Sussex.

15. The current employer's contributions rate is 13% of payroll (which is below average). Each 1% is some £0.8m of increased cost. Initial advice from the actuary was that employer contribution rates could have to as much as double. Further reflection suggests an increase nearer to 5% to 6% will be more realistic but still significant.

16. For perhaps obvious reasons it would be best to phase the increase in our base to avoid a huge increase in any one year; particularly 2005/6. This is the approach that has been adopted for the Waste PFI. For planning purposes I suggest we plan for the following profile:

	04/5	05/6	06/7	07/8
Pension Increase	£2.0m	£0.9m	£0.9m	£0.9m

<u>Overall Standstill and other Risk Pressures</u>

17.Taking all of the above together, the position for the next 3 years is as follows:

	04/5		05/6		06/7
Standstill - inflation - other	13.2 9.8		13.1 8.9		13.2 7.8
	23.0		22.0		21.0
Additional/ New on top of Standstill:					
Additional schools Passporting	3.3		0.8		1.5
SS Recovery	1.3		1.3		
Pension Increase	2.0		0.9		0.9
	29.6		25.0		24.8

<u>Funding Available</u>

18. It is important to remember that, in underlying terms as a result of the formula changes in 2003/4, the County Council has 'lost', in real terms over £30m over the medium term – compared to what it would otherwise would have received. We are reliant on a minimum floor increase and will be for a number of years. Its level is entirely at the discretion of Ministers. In effect, the higher the floor, the more years over which the real terms loss is spread. Conversely, the lower the annual floor increase the sooner we feel the full impact of the full real terms loss.

19.Under this floor mechanism we received 3.5% or £10m more general grant in 2003/4 (but this was up to less £9m less than we could have otherwise expected in 2003/4). Assuming the Government maintains the concept of the floor increase, each 1% change in the floor increase equates to some £2.8m.

20. The level of the floor increase is financed by putting a ceiling on the rate of gain of the winners under the formula changes. For 2003/4, for counties, the floor of 3.5% was financed largely by putting a ceiling of 8% on the gainers. It is very difficult to predict the level of floor increases going forward. The essential 'political' calculation for Government is the trade off between the rate of gain for the winners and the rate of loss for the losers. Our lobbying strategy must be to argue for, at least, a maintenance of an annual floor increase of, at least, the current position, i.e. 3.5%, for the next few years and proper funcing for schools passporting. Even that, in reality, will only place us in broadly a similar financial position as we faced in 2003/4.

21. It is likely that the floor mechanism will be maintained but it would be imprudent to plan on the assumption of a continuation (or better) of an annual floor increase of 3.5%. Signals from the LGA suggest Government are set to reduce the annual floor increase on a tapering basis. For planning purposes the choice becomes a judgement between government forcing a more or less aggressive tapering in the annual floor increases. At this stage, for planning purpose it is recommended that the following tapering profile is adopted. This is purely a judgement and is neither the best nor the worse case.

	03/4	04/5	05/6	06/7
Floor Increase - %	3.5%	2.75%	2.25%	1.75%
- £m	10	7.6	6.4	5.1

22. In addition to the floor mechanism there are other 'discretionary' technical elements of the new formula which can significantly impact on the overall grant received by the Council; if the Government decides to alter the judgements they made for 2003/04.

Comparing Standstill Pressures with the Possible Funding Scenario

23. Annex A to this appendix compares the standstill and other risks described above with the assumed floor increases over the next 3 years.

24. In determining the way forward it will be important for Cabinet to consider this in a medium term context and to be clear on:-

(a) Preferred level of Council Tax increases

(b) Core policy priorities

(c) Appreciation of difficult/ impossible costs to avoid

(d) Stance on schools passporting

(e) Areas to protects/ areas of further investment

(f) Consequent level of savings required – over the medium term – and their credibility/ deliverability in comparison with the discretionary cost base available.

Outturn – 2002/03

25.The draft accounts, subject to external audit, have now been approved by the Governance Committee. The form and content of those accounts are very prescribed by regulation. A summary of the position, in the usual format considered by Cabinet, is shown in Annex B to this appendix.

Capital – Prudential Code

26. Capital planning, under the Reconciling Policy and Resources initiative is now progressing under the existing arrangements. In essence this involves reviewing the approved rolling 4 year capital programme.

27. An added complication, probably from 2004/05 onwards, is the implementation of the "Prudential Code", which currently forms part of the Local Government Bill before Parliament. In principle the Code confers a significant and genuine freedom on local authorities to determine their own future borrowing needs, and thus the balance between capital and revenue spending, based upon judgements on revenue affordability in particular. At this stage, however, further more detailed guidance is awaited from Government before the full extent of the potential opportunity can be assessed. Implementation of the Code requires a number of tasks as part of the capital planning arrangements. The Council's current planning arrangements already

provide a sound base for this with only relatively minor fine-tuning required to ensure compliance.

28. A fuller briefing on the Prudential Code, including initial planning assumptions on future borrowing, is included at Annex C B to this appendix..