ANNEX 1

FINANCIAL STABILITY

Government Grant Funding of Local Expenditure

1. Cheshire East receives two main types of Government grants, formula grant and specific grants. The overall total of Government grant estimated for 2011/2012 is £450.1m.

2. In 2011/2012 Cheshire East Council's formula grant will be £70.3m and specific grants were budgeted to be £373.8m based on Government announcements to February 2011. Further announcements have revised this figure to £379.8m. Specific grants are split between non-ringfenced (£128.7m) and ringfenced (£251.1m). Spending in relation to ringfenced grants must be in line with the purpose for which it is provided.

3. The table below is a summary of the budgeted and updated position for all grants in 2011/2012. A full list of grants is provided at Annex 1, Appendix 1.

Table 1 – Summary of Grants to date

	Adjusted Base Budget 2011/12 £m	**Final Settlement 2011/12 £m**	**Variance 2011/12 £m**
Formula Grant			
Revenue Support Grant	16.6	16.6	0.0
Business Rates	53.7	53.7	0.0
Specific			
Ringfenced Grants	251.1	225.3	25.8
Non Ringfenced Grants	128.7	128.7	0.0
Total Government Grant Funding	**450.1**	**424.3**	**25.8**

Source: Cheshire East Finance

4. Ringfenced grants have reduced by £25.8m. This includes a reduction of DSG (£20.3m) and Sixth Form grant (£5.5m) due to a number of schools converting to Academy status. Funding for Academies is passported to them through the Young Peoples' Learning Agency and the reduction therefore does not impact on the main budget position. There has also been the introduction of pupil premium grant of £2.1m for 2011/2012 to offset this reduction.

5. At the first quarter review, Members approved the return to balances of £0.8m from additional specific grants. Since then, non-ringfenced grants have only increased by £12,000. The additional grant will be held corporately and will assist with the corporate mitigation of the possible overspend.

Collecting Local Taxes for Local Expenditure

6. Cheshire East Council collects Council Tax and National Non Domestic Rates (NNDR) for use locally and nationally.

Council Tax

7. Council Tax is set locally and retained for spending locally. Council Tax was frozen for 2011/2012 at £1,216.34 for a Band D property. This is applied to the tax base.

8. The taxbase for Cheshire East reflects the equivalent number of domestic properties in Band D that the Council is able to collect Council Tax from (after adjustments for relevant discounts, exemptions and an element of non collection). The taxbase for 2011/2012 was agreed at 146,899.21 which means that the expected income for the year is £178.7m. The total number of actual domestic properties on the tax base is 165,293 of which c.30% are entitled to single person discounts (this has the effect of reducing the amount collected by c.£14m).

9. In addition to this, Cheshire East Council collects Council Tax on behalf of the Cheshire Police Authority, the Cheshire Fire Authority and Parish Councils. The amounts are shown below, giving a total of £213.1m.

Table 2 – Precept Amounts for 2011/2012

Cheshire East Council	178.7
Cheshire Police Authority	21.2
Cheshire Fire Authority	9.8
Parish Precepts	3.4
	213.1

Source: Cheshire East Finance

10. This figure may vary slightly during the year if more discounts and exemptions are granted, or more properties are built.

11. The Council expects to collect at least 99% of the amount billed, but will always pursue 100% collection. However, to allow for any delay in collection the amount billed should therefore be slightly more than the actual budget. The amount billed to date is £214.3m.

12. Table 3 shows collection rates for the last three years, and demonstrates that 99% collection is being achieved within three years.

Table 3 – 99% of Council Tax is collected within 3 years

	% Collected to date
2009/2010	99.0%
2010/2011	98.3%
2011/2012	62.4%

Source: Cheshire East Finance

National Non Domestic Rates (NNDR)

13. NNDR is collected from businesses in Cheshire East based on commercial rateable property values and a nationally set multiplier. The multiplier changes in line with inflation and takes account of the costs of small business rate relief. The inflation factor used is 4.6% which reflects the Retail Price Index as at September 2010. NNDR is set nationally and paid over into the NNDR pool to be re-allocated across the country according to need.

14. The small business multiplier applied to businesses who qualify for the small business relief has been set at 42.6p in 2011/2012. The non-domestic multiplier has been set at 43.3p in the pound for 2011/2012.

15. The amount collected does not relate to the amount that is redistributed to the Council but it must be noted that the total collected includes amounts that will be distributed to police and fire authorities as well as local government. The Government have recently consulted on enhancing the amount of business rates to be retained locally, which is an approach supported by Cheshire East Council.

16. Table 4 demonstrates how collection continues to improve even after year end. The table shows how over 99% of non-domestic rates are collected within three years.

Table 4 – Over 99% of Rates are collected within 3 years

	% Collected to date
2009/2010	99.4%
2010/2011	98.5%
2011/2012	58.8%

Source: Cheshire East Finance

CENTRAL ADJUSTMENTS

Capital Financing Costs

17. The capital financing budget includes the amount charged in respect of the repayment of outstanding debt and the amount of interest payable on the Council's portfolio of long term loans. These budgeted costs are partly offset by the interest the Council anticipates earning from temporary investment of its cash balances during the year.

18. Cheshire East has an inherited debt position and the balance outstanding on external loans is currently £132m as at 30th September. Since 1 April 2009 the Council has been in a position to borrow from internal cash balances to fund the capital programme and therefore no further external borrowing has been required; this is not expected to continue into 2012/13.

19. In 2010/11 opportunity was also taken to restructure £50m of debt which will generate savings over the next ten years of £4.47m of which £0.8m will be achieved in 2011/12. The savings on interest costs have already been reflected in the net budget for 2011/12 of £13.9m. Due to slippage in the capital programme in 2010/11 the amount required for the repayment of debt will be lower than forecast.

20. Investment income is anticipated to be £255k less than the original target assuming that average investment rates remain at around 1.10% and the pooled investment fund also returns 1.10%. However, the revised impairment for Heritable Bank from 85 to 88% will result in a reversal of impairment of around £200k.

21. Taking the above factors into account the overall saving on the capital financing budget is forecast to be £700k.

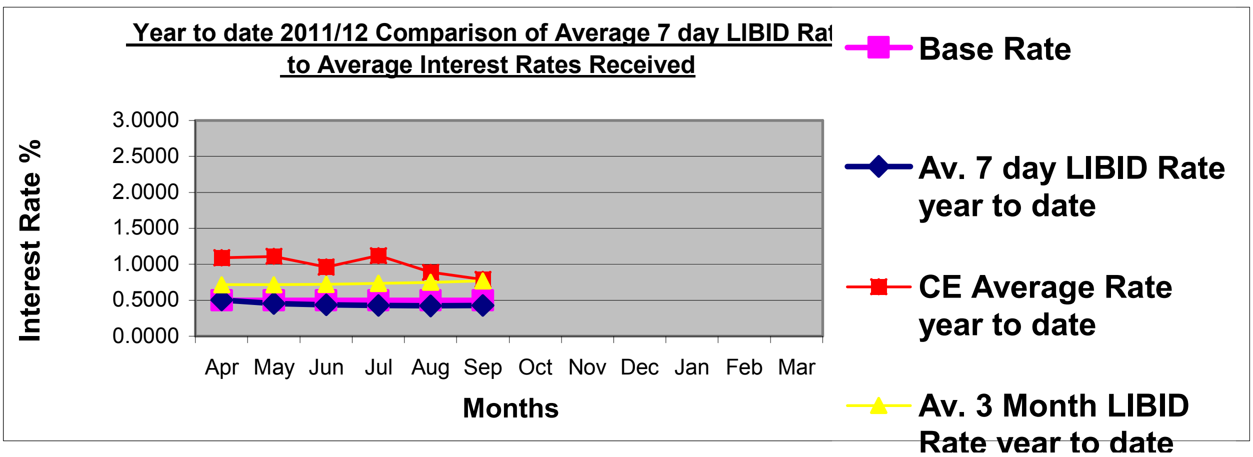
Treasury Management

22. Investment income is currently £78k lower than budgeted. The original budget of £0.8m was based on falling balances available for investment and interest rates starting to rise mid way through 2011/12. Based upon the current economic forecasts, investment interest rates are not now expected to increase during this financial year. In this period of historically low interest rates investment income will not achieve the levels seen in previous years by the former councils.

- The average lend position (the 'cash balance') including fund manager up to the end of the second quarter was £73.3m.
- The average interest rate received on in house investments up to the end of the second quarter was 1.15%
- The average interest rate received on the externally managed Investec fund up to the end of the second quarter was -0.83%. This represents a fall in value.

23. The Council's total average interest rate up to the end of quarter 2 in 2011-12 was 0.79%. This is favourable when compared to the London Inter-bank Bid Rate for 7 days at 0.43%. The base rate has remained at 0.50% for the quarter.

Comparator	Average Rate Q2
Cheshire East	0.79%
LIBID 7 Day Rate	0.43%
LIBID 3 Month Rate	0.77%
Base Rate	0.50%



Counterparty Limits and Investment Strategy

24. The maximum amount that can be invested with any one organisation is set in the Treasury Management Strategy Report. This is currently under strong review. For named UK banks (except Co-operative Bank), building societies and Money Market Funds this has been set as 25% of our total investments subject to a maximum value of £20m. The Co-operative bank has a lower limit of £10m due to its lower credit rating and is included on the list as they hold our main bank accounts. These limits apply to the banking group that each bank belongs to. There is also a maximum that can be invested in all Money Market Funds at any one time of 50% of the value of all investments.

25. There is a different limit that applies to foreign banks which is 15% of our total investments subject to a maximum value of £15m. Although Santander is a Spanish owned bank, Santander (UK) which is owned by Santander is separately licensed in the UK so is treated as a UK bank as it is covered by the UK Government guarantee scheme. Similarly Yorkshire Bank (a part of Clydesdale Bank) is owned by an Australian bank but is separately licensed in the UK so is also treated as a UK bank.

26. In 2010/2011 investments had been limited to a maximum period of 1 year. Since the sovereign debt problems in Spain have become an issue, investments in Santander (UK) had been limited further purely as a precautionary measure; the credit rating of Santander (UK) remains high.

27. On 28th September, the rating assigned to Clydesdale Bank (inc Yorkshire Bank) was downgraded and fell below our minimum criteria. The Council had funds on 15 day notice which have now been recalled.

28. During October 2011, the credit rating agency, Moody's, completed their general review of UK banks which resulted in a number of banks being downgraded due to the perception that the UK Government may be less willing to support them in the event of financial difficulties. The result was that Royal Bank of Scotland, National Westminster Bank and Nationwide Building Society no longer had credit ratings consistent with the minimum criteria recommended by our treasury advisors and specified in our Treasury Management Strategy. The Council does have funds invested with Royal Bank of Scotland and notices for withdrawal (30 day and 60 day) were placed immediately after the downgrades were announced. At the same time, Santander (UK) was also downgraded but remained within our investment criteria. On 12th October, the credit rating agency, Standard & Poors also downgraded the long-term rating of Santander (UK) but not below our minimum criteria. However, as stated, all our funds are under strong review.

29. On 13th October, the credit rating agency, Fitch, downgraded Royal bank of Scotland and Lloyds TSB also in response to the reduced likelihood of Government support. The effect of this is that Lloyds TSB also falls below the Councils minimum criteria. The Council does have existing time deposits with Lloyds TSB which will be allowed to run until maturity between December 2011 and April 2012.

30. In October, the maximum maturity period of new investments was reduced to 6 months with the exception of Santander (UK) which was reduced to 3 months. Since 14th November, in response to sovereign debt issues and instability of the

Euro the maximum maturity period for new investments has been reduced further to 3 months (1 month for Santander (UK)).

31. Cheshire East has only invested with UK institutions and money market funds. The table below shows the limits relating to each organisation and the investments as at 21st October 2011. Where counterparties have been removed from our list then no new investments are being placed and funds already with those institutions are being recalled in line with the terms of the investments.

Table 5 – Investment Limits

Counterparties	Limits		Investments as at 21/10/11	
UK BANKS				
Barclays Bank	25%	£20m	8.6%	£5m
Clydesdale - part of National Australia Bank (Australia)	removed 28/09/11		-	
Clydesdale Bank	removed 28/09/11			-
Yorkshire Bank	removed 28/09/11			-
Co-operative Bank	25%	£10m	0.8%	£0.5m
HSBC Bank	25%	£20m		-
Lloyds Group:	removed 13/10/11		19.0%	
Bank of Scotland	removed 13/10/11			-
Lloyds TSB	removed 13/10/11			£11m
RBS Group:	removed 07/10/11		9.5%	
National Westminster Bank	removed 07/10/11			-
Royal Bank of Scotland	removed 07/10/11			£5.5m
Santander (UK) plc - part of Santander Group (Spain)	25%	£20m	15.5%	£9m
Standard Chartered Bank	25%	£20m		-
Building Societies				
Nationwide Building Society	removed 07/10/11			-
Monet Market Funds	50%		12.1%	
Prime Rate	25%	£20m	6.0%	£3.5m
Scottish Widows	25%	£20m	2.6%	£1.5m
Deutsche	25%	£20m	3.5%	£2m
Investec - External Fund Manager	50%		34.5%	£20m
				£58m

32. The effect of removing counterparties from the lending list and limiting the duration of new investments will reduce the amount of interest received from future investments.

Performance of Fund Manager

33. The Council placed £20m with Investec on 27th May 2011 for them to manage in pooled funds. There are two investment models which are exposed to different degrees of risk and volatility with £10m invested in each. Under-performance in June was offset by higher than average gains in July. However, in August the funds were adversely affected by nervousness in the markets caused primarily by poor

economic data from the USA and continued worries over the stability of the European banks, particularly the French banks. These problems persisted in September fuelled by delays in approving the bail out for the Greek economy and worries of a return to recession both in the USA and in Europe. The Target Return Fund to which the dynamic model has greater exposure has been worst affected.

34. Whilst the performance of the fund since we joined is not encouraging these investments should be seen as a longer term investment so true performance can only be judged over a longer period of time. However, we have undertaken a full market review of our invested funds to evaluate our rates of returns.

Central Contingencies

Pay, Prices and Pensions Inflation

35. The 2011-12 budget contains contingency provisions to meet the potential impact of general inflation on service budgets, and to meet estimated costs of increases in Employer National Insurance and Pensions contributions. It is estimated that £2.1m of these contingencies is available to mitigate service overspending.

Severance and relocation costs

36. Actuarial charges relating to voluntary redundancies totalling £3.9m have been allowed for in 2011/2012. It is estimated that the actuarial charges will be broadly in line with the provision.

37. The voluntary redundancy scheme is continuing into 2011/2012 but the costs are now being funded by individual services rather than from a corporate reserve so will need to be met from existing service budgets. The Council has approval to capitalise up to £3m of Voluntary Redundancy costs in 2011-12. If agreed, this would potentially spread the £3m cost over a number of years, with a resultant reduction in the impact on revenue budgets.

38. It is anticipated that the provision of £0.3m made in the budget to meet continuing relocation costs arising from Local Government Reorganisation will be fully required.

Pay Harmonisation

39. The implementation of the agreed Pay Harmonisation proposals and the increment freeze in November and December will have both a permanent budgetary impact as well as generating one-off costs. The permanent budgetary position is explained in the HR – Cross Cutting savings part of this report in Annex 2, which confirms that permanent savings of around £550k will be delivered against the planned savings target of £2.4m in 2011-12.

40. One-off costs will be incurred in 2011-12 to cover the following items:

- Congleton Back Pay
- Base Pay Protection costs
- Mitigation costs for those staff who lose more than 5% from certain changes

41. It is estimated that total costs of £860k will be incurred in 2011-12 across these areas, and a Supplementary Revenue Estimate for up to this amount is requested, to be funded from general reserves. Wherever possible costs will be absorbed within existing budgets.

42. At the end of the financial year 2010-11 specific earmarked reserves totalling £698k were available to meet the likely one off costs of the package.

Management of Council Reserves

42. Due to the improved outturn position for 2010/2011 the opening balance of the Council's General Reserves increased from a projected £6.7m to an actual position of £12.5m.

43. The Council's Reserves Strategy 2011/2014 states that the Council will maintain reserves to protect against risk and support investment. The Strategy forecasts an increase in the level of reserves to £15m by 31st March 2012 with a risk assessed minimum level of £14.7m.

44. Planned returns to reserves of £8.3m comprise a projected contribution from revenue funding of £5.1m, transfers of earmarked reserves of £1.9m, VAT repayments of £1.1m (increased from the original estimate of £0.7m), and Business Financing scheme repayments of £0.2m.

45. The potential impact of the service outturn forecast is to reduce balances by £16.0m. In addition this report requests Council to approve funding from reserves of up to £0.86m for one-off pay harmonisation costs.

46. These can be mitigated by £6.6m of service related items referred to within central adjustments above, resulting in a net service impact of £10.3m as follows:

	£m
Service Outturn	-16.0
SRE Pay Harmonisation	- 0.9
Contingencies	2.1
Capital financing	0.7
Grants	0.8
Capitalised VR costs	3.0
Total	-10.3

47. The potential worse case impact of all the above items on the level of General Reserves is shown in Table 6 below.

Table 6 – Change in Reserves Position

	£m	£m
Opening Balance at 1 April 2011		12.5
Planned Contribution to reserves	5.1	
Fleming VAT claims	1.1	
Contribution from earmarked reserves	1.9	
Business Financing scheme	0.2	8.3
Service Outturn Impacts		-10.3
Forecast Closing Balance at 31 March		10.5

48. At this stage of the year the forecast is below the Reserves Strategy risk assessed minimum level of £14.7m but forecasts need to be treated with some caution. Services continue to face challenges in delivering planned savings, and there could be further emerging pressures, but additional significant mitigating proposals are underway and further measures are being developed.

49. On 17th October, the Chief Executive announced some immediate austerity measures to begin the process of further reducing expenditure. These comprised a recruitment freeze, stopping all non-statutory advertising and publications, and the cessation of expenditure on non essential supplies and services. Members and Officers are committed to continuing to seek further ways in which to reduce costs or increase income. Although the impact of all these measures has yet to be quantified, it is probable that further significant and wide-ranging measures that have an immediate impact on spending or income levels would be required in order to make significant in-roads to achieving the risk assessed minimum level of reserves.