

**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 £424.3m.
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 £354.0m. Specific grants are split between non-ringfenced (£128.7m) and ringfenced (£225.3m). 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**

	<b>Adjusted Base Budget 2011/12 £m</b>	<b>Final Settlement 2011/12 £m</b>	<b>Variance 2011/12 £m</b>
Formula Grant			
Revenue Support Grant	16.6	16.6	0.0
Business Rates	53.7	53.7	0.0
Specific			
Ringfenced Grants	225.3	219.9	5.4
Non Ringfenced Grants	128.7	128.8	-0.1
<b>Total Government Grant Funding</b>	<b>424.3</b>	<b>419.0</b>	<b>5.3</b>

*Source: Cheshire East Finance*

4. Ringfenced grants have reduced by £5.4m. This represents a further reduction to DSG funding due to further 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.
5. At the first quarter review, Members approved the return to balances of £0.8m from additional specific grants. At the third quarter, there is also an increase in non-ringfenced grants of £69k due to Warm Homes for Healthy People funding received during the quarter from Department for Health. Development Service is requesting a Supplementary Revenue Estimate for additional expenditure of £69k to be met by this additional grant.

## 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.
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. Table 2 below shows these amounts separately, giving a total collectable amount 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
	<hr/>
	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 £213.8m.
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	99.2%
2010/2011	98.6%
2011/2012	87.8%

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.
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**

	<b>% Collected to date</b>
2009/2010	99.5%
2010/2011	98.8%
2011/2012	86.9%

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. As reported at the mid year review (MYR), the overall saving on the capital financing budget is forecast to be £700k. This largely arises from a reduction in planned repayment of debt due to slippage in the capital programme, partly offset by a small reduction in planned investment income.

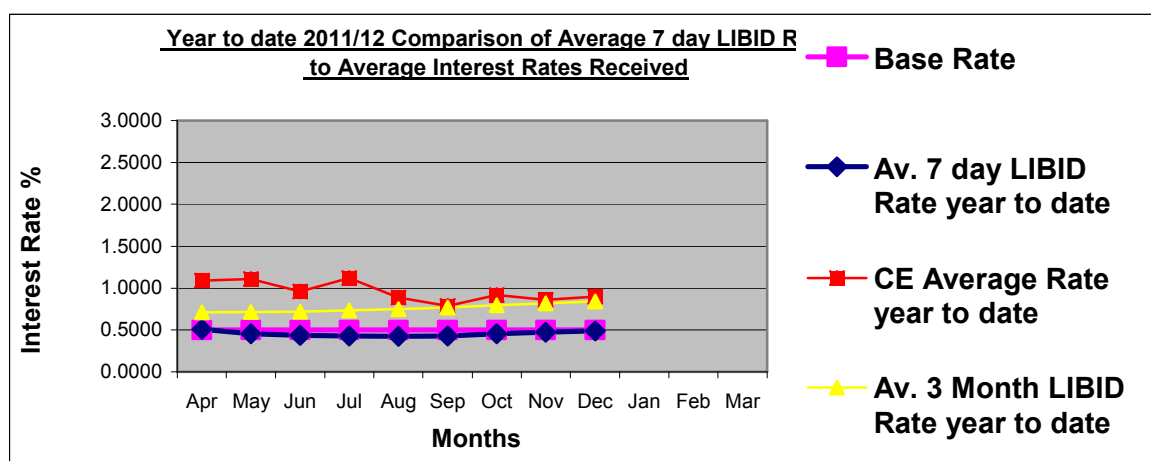
### **Treasury Management**

19. Investment income is currently £109,000 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 for 2 to 3 years. Any budget shortfall on investment interest should be compensated by savings on external interest payments.

- The average lend position (the 'cash balance') including fund manager up to the end of the third quarter was £72.5m.
- The average interest rate received on in house investments up to the end of the third quarter was 1.14%
- The average interest rate received on the externally managed pooled funds up to the end of the third quarter was 0.01%.

20. The Council's total average interest rate up to the end of quarter 3 in 2011-12 was 0.90%. This is favourable when compared to the London Inter-bank Bid Rate for 7 days at 0.49%. The base rate has remained at 0.50% for the quarter.

Comparator	Average Rate Q3
Cheshire East	0.90%
LIBID 7 Day Rate	0.49%
LIBID 3 Month Rate	0.84%
Base Rate	0.50%



### Counterparty Limits and Investment Strategy

21. The maximum amount that can be invested with any one organisation is set in the Treasury Management Strategy Report. 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.
22. 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.

23. During 2011 all UK banks have had their credit ratings reviewed mainly as a response to the debt crisis in the Eurozone. A number of banks, which the Council had been using for investment purposes, were downgraded which and now fall below our minimum investment criteria. Cheshire East has only invested with UK institutions and money market funds. Table 5 below shows the limits relating to each organisation and the investments as at 31<sup>st</sup> December 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 – Investments**

Counterparties	Limits	Investments as at 31/12/11	
<b>UK BANKS</b>			
Barclays Bank	removed 16/12/11	6.7%	£5m
Co-operative Bank:	25% £10m	0.5%	£0.40
HSBC Bank	25% £20m	-	-
Lloyds TSB	removed 13/10/11	10.8%	£8m
Santander (UK) plc	25% £20m	18.8%	£13.9m
Standard Chartered Bank	25% £20m	-	-
<b>Monet Market Funds</b>	50%	36.2%	
Ignis	25% £20m	10.4%	£7.7m
Prime Rate	25% £20m	6.7%	£5m
Scottish Widows	25% £20m	8.1%	£6m
Deutsche	25% £20m	11.0%	£8.1m
Pooled Funds - External Fund Manager	50%	27.0%	£20m
			<b>£74.1m</b>

24. 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.
25. During December 2011, the Prime Rate money market fund was temporarily suspended from our investments following concerns that it may be downgraded. However, ownership of the fund changed and the AAA credit rating was re-affirmed. All funds were withdrawn whilst the uncertainty persisted.

**Performance of Fund Manager**

26. Table 6 below shows the performance of the funds (net of fees) since the initial investment of £20m (£10m in each model) on 27<sup>th</sup> May 2011.

**Table 6 – Funds Performance**

	<b>STANDARD MODEL</b>	<b>DYNAMIC MODEL</b>
<b>June 2011</b>	-0.04%	-0.13%
<b>July 2011</b>	0.21%	0.23%
<b>August 2011</b>	-0.17%	-0.47%
<b>September 2011</b>	-0.09%	-0.24%
<b>October 2011</b>	0.16%	0.28%
<b>November 2011</b>	-0.07%	-0.19%
<b>December 2011</b>	0.09%	0.12%
<b>Cumulative since start</b>	0.10%	-0.40%
<b>Value of Investment at 31/12/11</b>	£10,025,209	£9,976,286
<b>Fees</b>	£15,016	£16,167
<b>Annual Equivalent Rate as at 31/12/11</b>	0.17%	-0.69%

27. Since the last quarter the funds have shown a marked improvement although the Dynamic fund has not yet recovered the losses from August and September. Under-performance in November was a result of the emerging debt crisis in the Euro countries and the question marks over the ability of all parties to agree and act upon a way forward. This led to Corporate Bonds weakening with a higher expectation of default.
28. Market sentiment whether based on fact or rumour, will continue to affect performance which could easily see large swings both upwards and downwards. The fund managers do not share the pessimistic view that recession is a certainty and consider Corporate Bonds to be priced to over compensate investors in the event of default. If proved correct we should see improvements in performance in future months.
29. Whilst the performance of the fund since we joined has not met expectations these investments should be seen as a longer term investment so true performance can only be judged over a longer period of time.

**Treasury Management Advisors**

30. The contract for provision of Treasury Management advice expired on 31<sup>st</sup> December 2011. Following a tendering process, Arlingclose Ltd have been re-appointed to provide treasury advice for another 3 years.

## Central Contingencies

### Pay, Prices and Pensions Inflation

31. Within the 2011-12 budget, £2.1m contingency provision had been retained centrally 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. However, since MYR this has been allocated to services, and is therefore now reflected in service outturn positions.

### Severance and relocation costs

32. 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.
33. Actuarial charges relating to Voluntary Redundancies (VR) 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.
34. The VR 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.
35. The estimated cost of VRs across all services in 2011/12 is £3.8m. These costs are reflected in services' forecast outturn positions. However, the Council has approval to capitalise up to £3m of the statutory element of VR payments in 2011-12. If agreed, this would potentially spread the costs over a number of years, with a resultant reduction in the impact on revenue budgets. It is estimated that the qualifying statutory element of service VR costs above amounts to £2.4m.
36. At year end, capitalised costs will be deducted from services' expenditure, and service outturns will show an improved position as estimated in Table 7 below.

**Table 7 – Impact of Capitalised VR costs**

	Net Projected Variance from Budget	Less Capitalised VR costs	Revised Projected Variance
	£000	£000	£000
Children & Families	1,070	-170	900
Adults	4,175	-1,195	2,980
Places & Organisational Capacity	1,206	-780	426
Corporate Services	1,759	-238	1,521
Cross Cutting Savings	2,812		2,812
Total Services	11,022	-2,383	8,639

37. In addition to the costs above, it is now proposed to take the opportunity to reduce the costs of the organisation and support 2012/13 policy proposals by bringing forward and approving additional VR expenditure in 2011/12 for ICT Shared Service and Adults Transport as set out below.
38. ICT Shared Service intend to reduce baseline costs going into 2012-13 in order to achieve a breakeven position and provide a more flexible and responsive service. The Target Operating Model (TOM) proposals would lead to a reduction of approximately 70 employees. During Phase 1, 35 employees registered an interest in accepting voluntary redundancy, with a financial consequence of £923k. Phase 2 of the VR process has now closed, and it is likely that further employees will be identified for either voluntary or compulsory redundancy. It is therefore estimated that total one-off VR costs will be in the region of £2m. This cost would be shared on a 50/50 basis between Cheshire East Council and Cheshire West and Chester Council in the financial year 2011/12.
39. In 2011/12, the Adults service had a policy savings option of £800k in relation to transport. Following a review of service users, the number of clients using the CEC transport fleet has reduced. Consequently, a decision has been made to release a number of drivers on voluntary redundancy during 2011/12 due to service over-capacity from reduced demand.
40. The total of these additional one-off costs, which are not reflected in service outturn positions, is estimated to be £1.1m. These costs would again be subject to the capitalisation of statutory elements, estimated at £0.5m. The total net cost of VRs (after capitalisation) relating to the above to be incurred in 2011/12 will therefore be £0.6m. It is therefore proposed that a Supplementary Revenue Estimate (SRE) for £0.6m be approved, to be funded in 2011/12 from general reserves.

### **Management of Council Reserves**

41. 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.
42. 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 31<sup>st</sup> March 2012 with a risk assessed minimum level of £14.7m.
43. Planned returns to reserves of £8.3m at MYR comprised a projected contribution from revenue funding of £5.1m, approved transfers of revenue 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. However a review of the capital reserve has identified a revenue funded element of £0.5m which can now also be returned to balances, bringing the total to £8.8m.
44. The potential impact of the service outturn forecast is to reduce balances by £11m. In addition this report requests Council to approve funding from general reserves of £0.6m for one-off VR costs. At MYR Members also approved an SRE of up to £860k for Pay Harmonisation costs.



45. These can be mitigated by £4.4m of service related items in respect of specific grants, capital financing, and capitalised VR costs referred to above, resulting in a net service impact of £8.1m as follows:

	£m
Service Outturn	-11.0
SRE Pay Harmonisation	- 0.9
SRE VR costs	-0.6
Capital financing	0.7
Grants	0.8
Capitalised VR costs	<u>2.9</u>
Total	<u>8.1</u>

46. The potential worse case impact of all the above items on the level of General Reserves is shown in Table 8 below.

**Table 8 – 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	2.4	
Business Financing scheme	<u>0.2</u>	8.8
Service Outturn Impacts		-8.1
Forecast Closing Balance at 31 March		13.2

47. At this stage of the year the forecast is below the Reserves Strategy risk assessed minimum level of £14.7m but forecasts still 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.
48. In October, the Council implemented 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 remain committed to continuing to seek further ways in which to reduce costs or increase income, to bring about an improved outturn position, and achieve a level of reserves in line with the risk assessed minimum level.