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Meeting	Cabinet Resources Committee
Date	10 February 2005
Subject	**Government consultation paper – three-year revenue and capital settlements**
Report of	Cabinet Member for Resources
Summary	Government plans to introduce three-year revenue and capital settlements for local authorities, police authorities and fire and rescue authorities in 2006/07 and is seeking views from local authorities and other stakeholders on proposals for implementing this. The consultation period ends 11 March 2005.

Officer Contributors	Borough Treasurer
Status (public or exempt)	Public
Wards affected	N/A
Enclosures	None
For decision by	Cabinet Resources Committee
Function of	
Reason for urgency / exemption from call-in (if appropriate)	N/A

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Beacon Council
2002-2003
Improving Urban Green Spaces
Libraries as a Community Resource
2002-2004
Community Cohesion

1. RECOMMENDATIONS

1.1 That the Borough Treasurer be instructed to respond to the Office of the Deputy Prime Minister (ODPM) along the lines set out in this report.

2. RELEVANT PREVIOUS DECISIONS

2.1 None.

3. CORPORATE PRIORITIES AND POLICY CONSIDERATIONS

3.1 Improvements in the way Government announces grant settlement could have a significant impact on the council's ability to do effective forward planning.

4. RISK MANAGEMENT ISSUES

4.1 Government grants are a critical funding element of local government. Fixing funding for three years will increase stability and predictability at the expense of accuracy of grant allocated based on the most up to date information. This will result in grant losses or gains when compared to grant allocations based on annually updated data.

4.2 The council will therefore need to decide whether it supports increased certainty in its grant allocations with the risk that there may be a loss (or gain) of grant if the most up to date information had been used.

5. FINANCIAL, STAFFING, ICT AND PROPERTY IMPLICATIONS

5.1 None.

6. LEGAL ISSUES

6.1 None.

7. CONSTITUTIONAL POWERS

7.1 Constitution, Part 3, Section 3 – Responsibilities of the Executive.

8. BACKGROUND INFORMATION

8.1 A consultation on proposals for giving authorities greater certainty and stability in funding was published on 15 December by the Office of the Deputy Prime Minister.

8.2 Government plans to introduce three-year revenue and capital settlements for local authorities, police authorities and fire and rescue authorities in 2006/07. As part of taking this forward, the Government is seeking views from local authorities and other stakeholders on proposals for implementation. A copy of the consultation paper has been placed in the Group rooms and can be viewed at http://www.odpm.gov.uk/stellent/groups/odpm_localgov/documents/page/odpm_locgov_033478.pdf

8.3 The consultation paper also contains proposals requiring local authorities to publish forward indications of budget levels and council tax. The final chapter considers current reforms including the Lyons review of local government funding, the Gershon efficiency agenda, ring fenced funding for schools, a new central and local government strategy, local area agreements, regional funding, the HRA and legislation requirements.

8.4 The remainder of this report summarises the content of each chapter of the consultation document. The boxes following each section set out comments on the proposals and outlines the intended response to Government.

Chapter 1 - The Government's overall approach to three year settlements

Government outlines the current regime and its views on the limitations of annual allocations:-

- Authorities have little time to plan budgets with certainty.
- Changes to functions and corresponding finance are made late in the day.
- Specific grant allocations may come too late to be taken into account in budget setting decisions.
- Grant is based on the latest available data but annual settlements hinder effective medium term planning.
- It is difficult to take decisions on longer term projects.
- Council tax rises can be volatile due to the inability to plan.
- Voluntary and community sector bodies cannot rely on long term funding from local authorities.

Government has set the following key objectives for three-year settlements:-

- Greater certainty for funding local services. Authorities to have as much certainty as possible about funding second and third years of the Government's Spending Review period.
- Authorities to use this greater certainty to strengthen financial management, forward planning and more efficient use of resources.
- Authorities should introduce multi-year funding for external organisations and projects. Government agencies should also introduce tree-year funding certainty.
- Better local management of risk and greater stability in council tax.

To meet the objectives, Government considers the design arrangements should meet the following principles –

- The approach will mirror the Spending Review so that Departments cascade their own three-year settlements to authorities as far as possible.
- The approach applies to both capital and revenue unless there is a clear rationale for not doing so.
- Resources should be allocated in as transparent a way as possible.
- Authorities should publish three-year budget plans and consequences for council tax in these years.
- Changes in responsibilities should be aligned to the Spending Review and not made during the three-year period.

Government plans to move to three year settlements in 2006/07 so that revenue and capital allocations for 2006/07 and 2007/08 are made in Autumn 2005. An added complication is that the 2007/08 formula grant will need to reflect council tax revaluation but draft valuations from the Valuation Office Agency are not due until September 2006. So as not to delay the introduction of three-year settlements, provisional allocations will be announced to be amended as a result of the revaluation.

Function changes would only be undertaken as part of the Spending Review process so that firm three-year formula grant settlements can be delivered (although funding changes may be in years two or three of the review). Any unplanned function changes within a three-year period will be funded by specific grant on the basis it will be rolled in revenue support grant at the next opportunity.

Unforeseen circumstances will need to be addressed from an authority's reserves subject to major emergencies subject to Bellwin grant.

There must be a rolling three-year forecast, not simply a fixed three year forecast linked to each Spending Review. Without this, forward planning only has any meaning in Year 1 of the fixed three year approach. A fixed three-year settlement is also contrary to the Prudential Code, which is supported by the Government and rightly sees ongoing financial forward planning as a three to four year rolling forecast as a minimum.

Government proposes retention of its capping powers, which would not improve stability as Government is still not prepared to pre-announce capping criteria. It also poses unanswered questions about how an a council would be capped at any point in the three year period, and how this would impact on future year's' budget projections and service plans. An example best illustrates the dilemma – would a council planning a 5% rise in Year 1 followed by a planned 1% increase in Year 2 be capped the following year (a compound increase of 6.05%) whereas a council planning a 3.5% rise in both years (a compound increase of 6.09%) escape capping? Government should scrap capping and allow authorities the freedom to undertake meaningful financial forward planning.

If Government intend to retain capping, whilst extolling three-year financial forward planning, they must publish their capping levels and criteria for the three-year period to enable authorities to plan with greater certainty.

Chapter 2 - Formula Grant Settlement

Government sets out two options for providing three-year formula grant settlements, both of which use grant floors as a central element and include advance announcement of grant floors for each of the three years.

This is a positive move away from equalising council tax at the level of Formula Spending Shares (FSS) and notional assumptions about the relative cost of providing services. Greater certainty in the level of future years' grant has to be welcomed.

One option is to redesign the grant system to offer each authority a minimum fixed increase (equivalent to the floor), with two variable top-ups representing relative service costs calculated by formula and resource equalisation. The top-up would lend itself to marginal funding for new functions but reduces perceived equity of the current system.

A second approach might simply involve a flat rate percentage increase over the three years. Alternatively there could be differential increases between groups of authorities.

A third option could be a simpler formula using only three to four indicators.

The first option involving floors and top-ups appears the most complex but may enable some fine tuning of the three-year settlement. Any decision on the method of top-up must be fully explored with the Local Government Associations and consulted on before implementation. There is a risk that Ministerial judgment may be introduced and this would not be welcomed.

Whilst three-year settlements would result in some loss of accuracy (insofar as national indicators can ever be accurate proxies for local spending needs), every effort should be made to incorporate as much fairness into allocations as possible, even if this involves a more complex formula. Certainty of grant is maintained by the top-ups being calculated for three years and not changed for that period.

Councils might be willing to trade some grant increase for greater certainty if that enabled them to improve financial forward planning and make more effective decisions on resource allocation across services.

Government propose issuing three-year settlements in line with Spending Reviews so that the third year becomes the first year of the next. The third year's grant would still be fixed with any new funding in that year distributed as specific grant, however, the third year's formula grant (the first year of the new Spending Review) would be recalculated for data and formula changes thereby creating a notional base to allocate the grant for years two and three.

The first year of the new Spending Review would be the logical point at which to up-date data.

Government are considering only updating data at the point that formula and grant totals are revised. The alternative approach proposed would be to use forward projections of population and council tax base and freeze other data items.

Some forward projection of population data would appear reasonable, but the updating of the council tax base is not supported unless it merely involves a national uplifting of all authorities tax bases in order to calculate the Assumed National Council Tax without affecting distribution patterns between authorities.
It is difficult to see how the proposed ring-fenced school grant would be calculated for three years. It is assumed that this will be addressed as part of the DfES paper in 2005.

The longer data is not updated the greater the potential volatility in grant when data is finally updated. Government is against retrospective distribution adjustments and suggest setting floors at higher levels in the change years to negate the need for special treatment of the worst affected authorities.

Retrospective amendment to formula grant is not supported as this would effectively represent no change to having annual grant settlements.

A key risk is the turbulence caused by updating the grant redistribution following a long period of stability. The use of higher floors may be the only acceptable method to avoid significant variations in grant for authorities. In such cases, Government should announce the floors as soon as possible or authorities will face major difficulties in forward planning for the new three-year period.

Government recognises the trade off of in stability for three years at the expense of fairness and accuracy. It may be that some form of modelling of options using assumed three year estimated data compared to act ual data for recent years could be used to quantify the divergence of grant allocations and methods of stabilising distribution when new Spending Reviews are undertaken.

Chapter 3 - Specific Grants

Specific grants represent a significant element of local authority finance and will, wherever possible, be included in three-year settlements. The exceptions proposed are:-

- **Grants paid on an expenditure basis** (including housing and council tax benefit subsidy) although the rules and criteria and how grant will be calculated will be announced on a three-year basis.

- **Bid-based grants** which are subject to government assessment of which projects offer best value.
- **Grants based on performance** such as Public Service Agreements reward grant and Planning Delivery Grant.
- **Pilots** are grant funded for testing new approaches and depends on local outcomes.

Specific grants supporting annual expenditure must be incorporated into three-year settlements otherwise authorities will still be faced with uncertainty each year in funding ongoing services. This is especially true of the significant sums allocated via education and social services grants (and to an increasing extent Planning Delivery Grant), where short notice of annual allocations causes extreme difficulty in annual budgeting and makes it almost impossible to budget for future years.

The bid-based, performance and pilot grants outlined in the consultation paper should only relate to one-off expenditure or investment and can therefore be excluded from detailed three-year allocations subject to the Government making clear announcements at each Spending Review of amounts, criteria and timing of allocations for one-off grants.

Chapter 4 - Capital allocations

Government provides support for borrowing costs through Formula Grant based on notional debt including capital allocations and also capital grants. It proposes that, as far as practicable, there should be firm three-year capital allocations following a similar timetable to announcements on formula grant allocations.

Bid based programmes would cover the three years. This would restrict the introduction of new initiatives to every two years instead of annually. However, advantages are predicted in greater joined up funding, more time between bids being approved and starting with less abortive work and better cost effectiveness.

As with revenue, there is still the issue that programmes are not based on rolling three year plans, but instead three year fixed periods, which creates uncertainty towards the end of each Spending Review period. It may be that indicative allocations are provided for years 4 and 5 to at least provide some guidance that can be used in rolling three year capital programmes.

Despite there being no individual capital performance reward grants at present, Government mentioned these as being less immediate if subject to three-year allocations.

These principles appear reasonable, although the issue arising from introducing Prudential Borrowing of whether Government funding of capital should be provided by revenue support or capital grant has not been re-opened. Greater certainty is provided through capital grants and this case could be remade to the Government in this response.

Government propose retaining an element of funding to deal with emergencies, otherwise any cost would fall wholly on the authorities affected. This would cover transport, safety issues in schools, remedial works on contaminated land and tackling air pollution hot spots. Specific sums would be set aside for three-year periods based on actual demand.

Retention of funding by the Government to meet specific problems is acceptable provided any surplus resources are retained for local authority purposes in later years if not previously allocated. An alternative would be for Government to create ring-fenced emergency funds with planned annual contributions to maintain them at an adequate level. Should the funds exceed the required level, reduced or no annual contributions would be required, the provisions for which could be included as additional funds for local authorities.

Large one-off projects including transport schemes and Building Schools for the Future involve switching allocations between projects that slip or whose cost profile reduces materially and those that can be brought forward. Government wish to maintain this flexibility of 'returning allocations to the centre' so as to manage projects more effectively by transferring funding to where it is needed, when it is needed.

Government is unsure as to how to define a 'large project', which might be done by referring to one or more cash value thresholds or a threshold based on an authority's ongoing capital programme.

In contrast, small-scale bid-based projects might also be considered under a similar process[1] where appropriate.

As the paper states, the size of authorities makes the definition tricky. A simple cash threshold would bar smaller authorities from taking advantage of opportunities so a variable threshold by class of authority would seem more appropriate. However, it would need to be adjusted for regional variations by a form of Area Cost Adjustment.

It may be that a £10m threshold could be set for counties and this is set for other classes of authorities pro-rata to ANCT$_{(1)}$ or estimated total SCE(R)$_{(1)}$ for each class. Some exemplification of possible options is needed so as to assess the relative effects of the different options.

Thresholds based on a percentage of each authority's ongoing capital programme would create uncertainty and complicate the process in terms of variations in local programmes as major schemes drop out and how the base for application of the threshold percentage is to be calculated. This approach is not supported.

<u>Implications for formula grant</u>
Government believes that emergencies and large one-off projects should be funded by capital grants as the Formula Grant will not be able to take then into account until the next Spending Review. This would be supported by effectively freezing the Debt Charges FSS for three years and only updating it at the beginning of the next three-year cycle.

<u>Housing Capital and Revenue Support Grant interface</u>
This is a technical issue involving the splitting of housing capital financing between the Housing Revenue Account (HRA) and General Fund. Three-year housing capital support will require a change to current practice to enable revenue support to be allocated between HRA subsidy and Formula Grant.

[1] ANCT = Assumed National Council Tax. SCE(R) = Supported Credit approval by revenue support grant.

The Private Finance Initiative (PFI)
Government are concerned that whilst most PFI projects involve three-year lead times, there are a few maintenance projects that are considerably shorter and the scope and funding of some projects may alter. This means it will not be possible to absolutely fix PFI allocations for three years. This also affects the amount of PFI grant to be top-sliced from the Capital Financing FSS although reasonable forecasts should be possible.

Aligning the PFI grant calculation to those used in the Capital Financing FSS may result in gains or losses for authorities due to changes in interest rates in later years. As PFI grant is fixed in the long term it is important that the base year is as accurate as possible. Whilst it is accepted that this approach may cause a mismatch between the calculation of FSS and PFI grant support, the loss to individual authorities undertaking PFI may be critical as opposed to any losses shared over all authorities' FSS. In this case it is suggested that any tilting of the level playing field is made towards authorities undertaking PFI.

Chapter 5 – Three year budget and council tax information
Government wants authorities to publish forward indications of budget levels and, as far as practicable, council tax. It sees this as a way of passing on greater certainty of grant settlements to council tax payers and also of obtaining indications of likely trends in future expenditure and council tax. In support of this move, Government are looking at the option of introducing legislation requiring levying bodies to publish forward projections of budgets.

The publication of additional information should be a matter for local discretion given the political sensitivity of council tax increase and remaining difficulties in predicting future expenditure and income requirements. Best practice guidance based on the Prudential Code could be introduced but local authorities should be free to decide on the extent of publication (see below).

Legislative requirements for indicative projections of levies would assist where they are significant. It may be that levies over a certain threshold would be subject to legislation.

Some levies are significant within their own right, specifically North London Waste Authority and Concessionary Fares, and Government should consider legislation to give them the same status as precepts which would remove the expenditure from authorities' budgets so that they would not impact on the local authorities' own tax increases and capping.

Government believes there should be a legal requirement to publish budget and council tax projections in the information accompanying council tax bills. It is also looking at voluntary arrangements in advance of a statutory basis.

The Prudential Code already requires authorities to produce financial forward plans. These are made available at the annual council tax setting meeting for any interested parties to review and are subsequently available on the internet.

Fixed three-year settlements will secure the accuracy of future years' grant estimates but will not negate the need for grant estimations for year three onwards in order for authorities to produce three year rolling forward plans to comply with the Prudential Code and Comprehensive Performance Assessment.

Consultation is an important aspect of local governance but legislation should not be introduced to force authorities into publishing forecasts as final that will certainly change in the future.

Publication of best practice guidance building on the Prudential Code, which sets out the forward planning requirements might be considered, thereby leaving authorities with the scope to decide on the information published according to local requirements and circumstances.

A section entitled 'Freedom to depart from published figures' looks at alterations to the projections that will be required for unforeseen circumstances (including changes in administration). Controls could be put in place to ensure changes are only made in given circumstances on either a statutory or voluntary basis.

This does not make sense. Financial forward plans cannot be held up as final just because the Government provides three-year grant figures. Just a few examples of variations that will arise over any three-year period:-

- **Future taxbase figures** are dependant on local house building and occupancy levels, and also impact on the share of levies.
- **Inflation and pay awards** can be subject to significant change on an annual basis.
- **Pension costs. Go**vernment is well aware of problems with increases in employer's contributions due to the downturn in the stock market and ageing population.
- **Insurance costs** can be subject to annual variation due to increase claims.
- **Interest rates** can vary considerably over even short periods of time and have a significant impact on the cost of short term borrowing and investment.
- **Adult and childrens placement** costs are spiralling and it is not possible to predict future years' budgets with great accuracy.
- **Demographic changes in population. W**hilst estimates can be made, changes are often unforeseeable and must be dealt with at short notice
- **Levies.** Barnet contributes to the North London Waste Authority (NLWA) and Concessionary Fares Scheme which have shown huge increases in costs in recent years. Whilst NLWA have provided forecasts for several years they have often proved to be inaccurate and resulted in significant changes to the council tax.
- **Loss of income due to changes in circumstances.** This applies to Barnet in respect of land charges fees where the sudden down turn in the property market can result in substantial reductions in income.
- **New initiatives** may be desirable to take advantage of an investment opportunity, e.g. Barnet leased new office accommodation at favourable rates which whilst adding to costs in the short term will provide savings in future years.
- **Impact of legal decisions.** An example here is the Hillingdon judgement which resulted in additional costs.

It makes no sense to suggest that departure from published figures should be limited to a definable set of circumstances. Forward plans must be flexible and subject to updating as more accurate information becomes available.

Government intend retaining its capping powers under a three year-settlement regime but will examine the interrelationship between these and any future statutory requirement for authorities to publish three-year budgets and council tax.

Comments on the issue of capping are dealt with in Chapter 1 due to its importance.

Chapter 6 – Context for implementation

There are several reforms currently being explored by the Government. Brief consideration is given to these areas.

Lyons Inquiry.
This will report on local government funding by the end of 2005, but three-year settlements should not prejudice future decisions.

Efficiency Review.
Sir Peter Gershon saw the cascading down of three-year settlements across the public sector as an important part of the efficiency agenda, especially in supporting partnership working.

Ring-fenced funding for schools.
At present, local authorities will be responsible for distributing ring-fenced government grant between schools at local level and can top-up Schools Budget using their own resources if they want. Government see three-year settlements as a way of providing certainty about the level of any top-up. DfES will issue a consultation paper early in 2005 on the introduction of the ring-fenced grant and three-year, academic year budgets for schools, including transitional protections for authorities currently spending in excess of their formula allocation. No authority will receive less funding than it currently spends.

Strategy for local government.
Government is developing a strategy to be published in 2005 which will provide the framework for a new relationship between central and local government and other bodies having a stake in delivering local services. The strategy will take into account the move to three year-settlements.

Local Area Agreements (LAAs)
These provide a mechanism to bring together the variety of supplementary funding streams that are directed to local authorities (often as specific grants) and other partners. Piloting of LAAs has only just begun and it is not clear whether they will be rolled out across England. Any roll out would align them to the cycle of three-year settlements.

Regional funding
Any new regional funding initiatives would need to recognise three-year settlement for local government.

Housing Revenue Account
The HRA should also move to a three-year settlement arrangement. However, as with Formula Grant, there is a risk of subsidy not matching needs and thereby creating shortfalls. The introduction of damping measures such as floors, ceilings or caps on subsidy, it is suggested, could reduce the risk, as would a move to per-dwelling allowance. Working of HRA subsidy on an annual allowance basis allows the regime to be responsive to changes in housing strategy, so losing the ability to respond annually will require greater flexibility initially

Legislation
Current legislation requires an annual Local Government Finance Report to be approved by Parliament. The NNDR can also only be announced following the availability of two previous September retail price indices (RPI). Despite this constraint, Government can announce future grant allocations at the time of the settlement as its 'firm intentions'. However, under existing legislation the possibility that final allocations might differ from intended allocations cannot be ruled out. Longer term, legislation will need to be adapted to tailor it to three-year settlements including allowing the Secretary of State to set future NNDR distributions, requirements for authorities to publish forward indications of council tax and requirements for forward indications by levying bodies.

8. LIST OF BACKGROUND PAPERS

8.1 ODPM Three-year revenue and capital settlements consultation paper issued 15 December 2004
http://www.odpm.gov.uk/stellent/groups/odpm_localgov/documents/page/odpm_locgov_033478.pdf

8.2 Any person wishing to inspect the background papers listed above should telephone

Clive Medlam

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