Report to Cabinet – 5th December 20111

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AUTUMN BUDGET STATEMENT

Summary
This paper sets out the context, at both the national and local level, within which the County Council's medium term financial plan will be framed over the next three years.

The critical financial issue facing local government at the moment is how to balance additional spending demands at the same time that resources from central government are reducing as it seeks to tackle the national budget deficit. This paper sets out the strategy how Kent County Council should tackle this conundrum.

Recommendations
To note:-

1. **National Context:**
   - Lower economic growth than previous forecasts and slower recovery from the recession
   - Inflation higher than the government's target
   - Rising unemployment
   - Public expenditure reductions
   - Eurozone debt crisis

2. **National Resources Position:**
   - Difference in resources allocation between London/Metropolitan and shire areas
   - Potential changes to the funding for local authorities and schools
   - Potential increases in employee's pension contributions
   - Funding from health authorities to support social care
   - Council Tax freeze and local referendum on excessive increases in future
   - Disparity in grant allocations to south east authorities since 2006/07 compared to the rest of England and impact on Council tax

3. **Kent – Local Resource Allocation**
   - Take-up proposed freeze on Council Tax for a second successive year
   - Launch draft budget and medium term financial plan before Christmas
   - County Council to agree budget on 9th February
   - Further enhancements to transparency of budget
   - Financial outlook based on reduced resources and increased spending demands necessitating significant year on year savings
   - Proposed financial strategy and establishment of Budget Programme Board
   - Financial risks
   - Levels of general reserves

Background Documents: None

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AUTUMN BUDGET STATEMENT

INTRODUCTION

1. This report is a key stage in medium term financial planning. It provides an opportunity to review both the national and local contextual issues that will shape our forward thinking for the next three years. It also gives direction to the necessary actions required to deliver the Council's policies and priorities and sets out the financial framework for the budget and medium term financial plan, which will be presented for formal agreement by Council next February.

2. The report is in two parts. Part 1 sets out the national context for the Council's financial plan over the next three years. In particular it looks at what resources are likely to be available to local government from the national perspective and how the proposed changes to the local government finance system could impact. Part 2 is about delivering the medium term financial plan in KCC within the context of the likely distribution of the total national resource to Kent over the medium term.

PART 1: NATIONAL FINANCIAL CONTEXT: RESOURCES

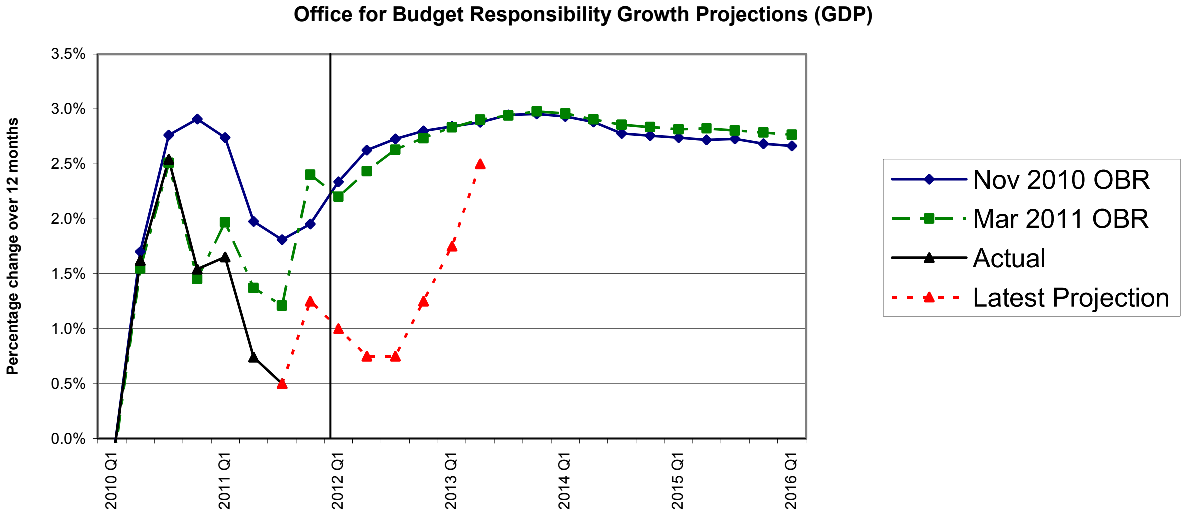
3. Budget planning takes place within the context of the national economic and public expenditure plans. This part of the report discusses the broad national assumptions within which the budget and medium term plan will be framed. The Chancellor of the Exchequer made his Autumn Statement to the House of Commons on 29th November to coincide with the release of the latest economic and fiscal outlook published by the Office for Budget Responsibility (OBR). The Autumn Statement replaces the previous pre-Budget report and provides the Chancellor with the opportunity to give an update on the economy and respond to the OBR report. The timing of the statement means it cannot be included in this report but a verbal update will be provided to Cabinet on the day.

The Economy

4. It has been well documented that the UK economy (along with many others across Europe and the western world) experienced a severe recession during 2008 and 2009. This recession was brought on by a number of factors (not least but not exclusively due to the banking crisis). The economic recovery has been much slower than earlier predictions and the Gross Domestic Product (GDP) is still well below its 2008 pre recession peak as demonstrated in graph 1 over the page. This graph shows the earlier (November 2010) predictions and the latest projections of growth in Governor of the Bank of England's statement on 16th November 2011.

5. In this report from the Monetary Policy Committee (MPC) the Governor of the Bank of England identified that the global economic outlook has worsened, in particular the concerns about the sustainability of the Euro area and that the Eurozone debt crisis was the single biggest risk to the UK. He predicted that the journey to a more balanced world economy would be long and arduous and cut the bank's estimate for economic growth to around 1% for the remainder of 2011 and throughout 2012.

Graph 1



6. The Bank of England (BoE) is responsible for monetary and financial stability in the UK. The main tool at its disposal is to control the price of money through setting interest rates via the BoE base rate. The BoE responded to the recession with successive interest rate cuts in 2008 and 2009 and by March 2009 it was down to 0.5% where it has remained ever since. Many economic analysts are predicting that the rate will have to stay at this historic low for some time until the recovery is well established and growth levels are sustainable. It is feasible the BoE may have to consider further quantitative easing if growth continues to remain weak.

7. Economic performance is essential if the Government is to meet its deficit reduction plans. These were based on a combination of recovering the overall tax yield following its decline during the recession and reducing public expenditure as a proportion of the nation's overall GDP. In reducing public spending the expectation was that the private sector would take up the extra capacity so there would not be an overall reduction in GDP. The sluggish recovery threatens to derail the deficit reduction plans and the government may not meet its target of eliminating the budget deficit by 2015/16

Inflation

8. The government has set a target of 2% for the underlying rate of inflation as measured by the Consumer Price Index (CPI). The annual rate of inflation has been running much higher than this throughout 2011. This has been ascribed to a number of factors including the impact of the VAT increase in January and volatility in commodity prices. Inflation is predicted to fall during 2012 (the impact of VAT increase will cease to be a factor after January 2012) but CPI is not expected to reach the Government's target until into 2013.

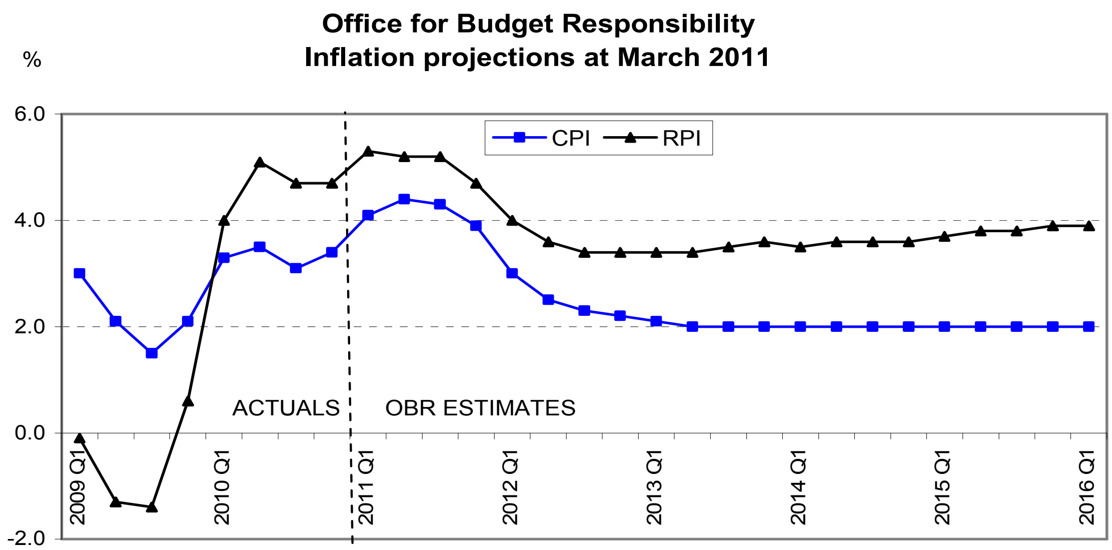
9. The November MPC report predicted inflation had peaked and would fall sharply in 2012 although the extent and pace of the fall remains uncertain. The committee judged that inflation should be below the 2% target in 2013 and 2014 although the scale of the difference would be minimal compared to the uncertainty with the predictions due to the scale of the reduction from recent high levels.

10. CPI in the year to September 2011 showed an increase of 5.2% (up 0.7% on August), RPI was 5.6% (up 0.4% on August). The September indices are important as they are used to

uprate benefits, tax credits and pensions. From 2012 CPI will also be used to uprate tax and national insurance thresholds. The uprating of benefits is important to the County Council as it is linked to the charges we make for social care. The October indices show a slight reduction to 5% (CPI) and 5.4% (RPI) due to food, air travel and fuel prices.

11. Retail Price Index (RPI) is likely to exceed CPI and in many instances is still a key factor in the price we have to pay for goods and services and is written into many of our contracts. The historical rates of inflation and future predictions are shown in graph 2 below.

Graph 2



Pay and Unemployment

12. The latest OBR forecast for earnings published in March 2011 showed an average increase of 2% anticipated for 2011 and 2.2% for 2012. This compared with 1.7% for 2010 and 1.8% for 2009. Public sector pay in 2011 was frozen and it is estimated that this means average earnings in the private sector represent a 2.6% increase. The chancellor's announcement for a public sector pay freeze covered two years (2011 and 2012).

13. Unemployment in September 2011 rose to 2.62 million (8.3% of working age population) up 0.4% on the previous quarter according to data released by the Office for National Statistics (ONS). This takes the unemployment rate to its highest since 1996 and the largest number unemployed since 1994. Unemployment amongst the 16 to 24 range is significantly higher at 23.3% and now exceeds 1 million. Regionally unemployment is highest in the North East (11.6%) and lowest in the South East (6.3%). Unemployment rates rose dramatically during the recession from 5.2% in 2008 to 8% at the start of 2010.

14. The ONS also publish data on pay increases. This showed that in the year to September 2011 average pay (including bonuses) increased by 2.3% (down 0.4% on the three months to August), the increase excluding bonuses was 1.7%.

Public Expenditure

15. The outcome of the Coalition Government's Spending Review (SR2010) was published on 20th October 2010. This set out the total departmental spending plans for 2011/12 to 2014/15 following the Emergency Budget in June which outlined the Coalition Government's deficit reduction strategy. The SR2010 announcement for the Department for Communities and Local Government (CLG) showed some of the largest reductions for any government department, and that reductions in Formula Grant for local authorities would be front loaded with the biggest reductions in 2011/12. Table 1 below shows the spending review totals (note the 2010/11 baseline has been adjusted for the Area Based and Specific Grants transferring into the formula in 2011/12)

Table 1	2010/11 Baseline £bn	2011/12 £bn	Annual Change %	2012/13 £bn	2013/14 £bn	2014/15 £bn
CLG Total Resource	28.5	26.1	-8.4	24.4	24.2	22.9
Formula Grant funding	28.0	25.0	-10.8	23.4	23.2	21.9

16. The overall picture for Formula Grant shows a reduction of an average 21.8% in cash terms over the four year horizon. Within the 2011/12 Formula Grant settlement £19bn was funded from redistributed business rates and the remainder from Revenue Support Grant (RSG). It is anticipated that during the four year spending review period the annual yield from business rates will exceed the amount identified for Formula Grant. Since all business rates must be returned to local authorities by law it is anticipated the surplus will be used to replace other government grants rather than be available to supplement the Formula Grant settlement. The future of Formula Grant and business rates is considered at more length later in this report.

17. In addition to Formula Grant the CLG resource also includes funding for the Council Tax Freeze Grant, New Homes Bonus (NHB) Grant and Transitional Grant. The Council Tax Freeze Grant is fixed for four years to compensate councils for not increasing Council Tax between 2010/11 and 2011/12. Initially it was planned that there would be no extra grant to fund further freezes beyond 2011/12 although the Chancellor has subsequently announced that there will be a one-off grant in 2012/13 to fund a second year of a freeze. The implications of a further freeze are considered later in this report. Transitional Grant was available to a limited number of authorities facing the largest reductions in grants between 2010/11 and 2011/12 (KCC did not qualify for transitional support). NHB grant is allocated to reward new house building and is considered further in paragraph 20 below.

18. The council also receives a number of specific grants and un-ringenced grants from other departments which will also be influenced by spending reductions within departmental totals as a result of SR2010. Unlike CLG grants the totals for these grants have not been separately identified over the four year period and thus it is more difficult to predict likely funding levels beyond the 2012/13 provisional settlement.

19. The provisional Local Government Finance settlement for 2011/12 was published on 13th December 2010 and the final settlement confirmed on 31st January 2011. This provided details of the grant allocations for individual authorities. The settlement gave definitive allocations for 2011/12 and indicative allocations for 2012/13 within the overall amounts outlined in SR2010 (although there were some subsequent late notifications of 2011/12 grants and changes to the 2012/13 indicative allocations after the final settlement was announced). The final grant allocations for 2011/12 and the indicative allocations for

2012/13 are set out in table 2 below. Indicative allocations for 2013/14 and 2014/15 were not announced. We are expecting the updated provisional settlement for 2012/13 to be announced early December and will be factored into KCC's draft budget which we intend to launch before Christmas.

Table 2 Grant Name	Government Department	2011/12 Final £m	2012/13 Provisional £m
Un-Ringfenced Grants			
Formula Grant	DCLG	315.987	289.104
Council Tax Freeze Grant	DCLG	14.342	14.342
New Homes Bonus	DCLG	1.379	
Early Intervention Grant	DfE	50.286	53.159
Learning Disability & Health Reform Grant	DH	34.768	35.594
Local Service Support Grant			
Extended Rights to Travel	DfE	1.546	1.918
Inshore Fisheries	DEFRA	0.138	0.138
Lead Local Flood Authorities	DEFRA	0.260	0.750
Safer Stronger Communities	HO	1.246	0.631
Specific Grants			
Dedicated School Grant	DfE	877.142	
Pupil Premium Grant	DfE	11.976	
Standards Fund	DfE	0.816	
PFI	DfE	16.859	
Environmental	DEFRA	1.205	
Drugs Strategy	DH	2.272	
Asylum	HO	15.111	

20. KCC's NHB grant was used in 2011/12 to support the overall budget rather than for any specific purpose. Nationally £200m was available to fund the grant. The grant was allocated to authorities based on the increase in Council Tax base between 2009 and 2010. It is anticipated that the NHB grant will increase in the coming years to eventually cover the tax base increase over a six year period. Some of this increase will be funded at the expense of Formula Grant although we have no detail how this will work. This could have a significant impact on the County Council as currently the majority of Formula Grant is allocated to upper tier authorities and yet 80% of the NHB grant goes to lower tier councils. Since we know only £250m is available nationally next year there is likely to be some top slice in 2012/13 as the NHB grant could potentially be more than double what it was in 2011/12. As a consequence we are projecting only a small net increase in NHB after allowing for this top-slice.

21. The increases in Early Intervention Grant (EIG), Learning Disability and Health Reform Grant and Lead Local Flood Authorities are already factored into the existing Medium Term Financial Plan (MTFP) and at this juncture we are estimating that these grants will continue at the same levels as 2012/13 in real terms for 2013/14 and 2014/15. We will need to closely monitor EIG as it is feasible that further cuts could be applied in 2013/14 or 2014/15 together with a further round of transitional damping.

22. Overall the authority is facing a net reduction of £22.8m (5.4%) on un-ringfenced grants for 2012/13 (those which we have discretion how to spend). Based on the SR2010 total we can expect a further reduction in Formula Grant in 2013/14 and 2014/15 (estimated £9m and £22m respectively) as well as potential reductions in other grants. These reductions are not as large as the reductions in 2011/12 but nonetheless represent a significant challenge to the authority to reduce costs year on year and provide services more effectively. The proposed strategy to address these reductions is outlined in part 2 of this report.

23. We will continue with the existing strategy that where there are reductions in specific grants we will have to reduce spending on a like for like basis as the authority cannot afford to substitute discretionary funding to replace lost specific grants.

Formula Grant

24. The present formula methodology was introduced in 2006/07 based on the 'four block' system. The model allocates a pre determined sum of money to all local authorities using the following blocks:

   i. Relative Needs Block – worked out using the Relative Needs Formulae (RNF) to determine differential needs across service specific sub blocks measured against the authority with the lowest relative needs
   ii. Relative Resource Amount – deducts funding to take account of the different capacity to raise income through Council Tax compared to the authority with the lowest relative tax base
   iii. Central Allocation Amount – allocated as a common per capita amount according to the functions of an authority
   iv. Floor Damping Block – to ensure that all authorities receive a manageable grant settlement compared to the previous year

25. The four block model has been widely criticised due to its complexity, lack of transparency and potential instability due to the application of relative needs/resources against the lowest ranked authority. There have also been criticisms that some of the individual components favour particular types of authority and that the allocation of resources can be manipulated irrespective of needs. The damping methodology has meant that in effect the four block model has never been fully implemented and authorities are still receiving a damped version of the old Standard Spending Assessment (SSA) model. The four block model was introduced at the same time as the Dedicated Schools Grant (DSG) making comparisons with the SSA system difficult.

26. An additional £4bn of Area Based and Specific Grants were added into the Formula Grant in 2011/12. Many of these grants were added as specific "tailored" allocations reflecting previous grant allocations rather than added to RNF or central formula allocation. The damping methodology was also changed to reflect the overall reduction in Formula Grant with reductions more heavily damped for the most deprived authorities. These changes are in effect a bolt-on to the original model. Table 3 sets out the main components of the formula for 2011/12 and compares the allocations for the Kent area (KCC, Medway, Kent Police, Kent Fire and Rescue and Kent Districts) with the total for all Shire areas (including unitary authorities), Metropolitan areas and London. It also compares KCC's formula allocation with the 16 shire areas without fire responsibilities i.e. comparable authorities in terms of responsibilities.

Table 3		Population (thousand)	Tailored	RNF	RRF	Central	Damping	Total
All England (exc. Scilly)	£m		2,028.1	18,959.2	-6,076.1	9,959.3		24,870.5
	per capita	52,575	£39	£361	-£116	£189	£0	£473
London Area	£m		448.5	4,548.6	-1,279.4	1,489.2	194.2	5,401.2
	per capita	7,868	£57	£578	-£163	£189	£25	£662
Metropolitan Areas	£m		499.7	5,219.9	-682.0	2,160.4	-41.1	7,156.8
	per capita	11,357	£44	£460	-£60	£190	-£4	£634
Shire Areas	£m		1,079.8	9,190.6	-4,114.7	6,309.7	-153.1	12,312.4
	per capita	33,350	£32	£276	-£123	£189	-£5	£374
Kent Area (incl Medway)	£m		53.7	480.6	-244.9	321.4	-12.3	598.5
	per capita	1,694	£32	£284	-£145	£190	-£7	£361
All Shires without Fire	£m		387.1	2,684.6	-1,434.0	1,153.6	-66.9	2,724.4
	per capita	12,910	£30	£208	-£111	£89	-£5	£216
Kent County Council	£m		45.7	337.7	-179.5	128.4	-16.3	316.0
	per capita	1,437	£32	£235	-£125	£89	-£11	£231

27. Table 3 demonstrates the extent to which formula allocations favour London and Metropolitan areas compared to Shires, and that Kent authorities fare slightly less well than the average for all Shire areas. Although we have consistently challenged this formula methodology the consultation on the localisation of business rates explored later in this paper effectively proposes to crystallise the existing pattern of distribution.

Education Funding and Dedicated Schools Grant

28. DSG was introduced in 2006/07 and coincided with the introduction of the four block model for Formula Grant. DSG meant that schools were funded 100% by government grant with no funding from local taxation (Council Tax or business rates). The grant is specific and has to be spent on schools (although local authorities are able to provide a top-up from Council Tax or other local sources).

29. The grant covers both schools' delegated budgets and a range of local authority functions to support schools. The division of responsibilities between schools and the local authority remains a local decision although the range of functions which can be retained by the local authority are prescribed and any spending in relation to schools not included in this prescribed list must be delegated to individual schools. Furthermore the local authority cannot keep a disproportionate amount to fund its non delegated responsibilities compared to the amount allocated to schools without the agreement of the Schools' Funding Forum.

30. The local authority is still responsible for determining the formula used to allocate funding to individual schools, however, this has been subject to a minimum funding guarantee (MFG) which was introduced prior to DSG and ensures a guaranteed increase per pupil. The MFG for 2011/12 was a **decrease** of 1.5% per pupil. The budgets for the majority of schools are still determined by the formula although the existence of MFG makes it difficult to make any significant changes or correct previous inequities (particularly in relation to the allocation of former Standards Fund). The formula is agreed by the local authority following consultation with schools and the Schools' Funding Forum.

31. Ever since DSG was introduced in 2006/07 the amount for individual authorities has been determined according to a guaranteed unit of funding (GUF) per pupil with an overall cash

floor. In 2011/12 the GUF was determined according to the 2010/11 DSG per pupil plus the 2010/11 value of Standards Fund and other grants per pupil transferring into the DSG i.e. no overall cash increase per pupil. In 2011/12 the cash floor ensured no authority lost more than 2% in overall cash terms compared to the equivalent grants for 2010/11. In effect the cash floor provides a cushion against significant falling rolls. Prior to 2011/12 the GUF had percentage uplifts on the previous year's figure, and the floor ensured an overall cash increase.

32. The pupil numbers used for the DSG calculation are based on the full time equivalents in all maintained schools (including academies converting after April 2008), pupil referral units, alternative provision, and Private/Voluntary/Independent Early Years providers. The provisional grant is based on an estimate and allocations are finalised in July following national verification of annual census data. The GUF methodology means that an authority's grant allocation is adjusted annually for the overall change in pupil numbers but not for changes in any other characteristics e.g. age profile, special and additional needs, deprivation, etc. In effect this means the relative distribution of DSG has been crystallised since it was introduced. Table 4 below shows the relative value of GUF by authority area.

Table 4	2010/11 DSG per pupil	2010/11 Transferred Grants per pupil	2011/12 GUF per pupil
London			
Average (mean)	£5,247	£835	£6,082
Minimum	£4,311	£508	£4,944
Maximum	£7,871	£1,502	£9,373
Metropolitan Areas			
Average (mean)	£4,403	£761	£5,164
Minimum	£4,052	£580	£4,652
Maximum	£4,919	£957	£5,876
Shire Areas (incl. Unitaries)			
Average (mean)	£4,196	£622	£4,818
Minimum	£3,888	£491	£4,429
Maximum	£4,843	£870	£5,713
Kent Area	£4,268	£629	£4,897
KCC	£4,251	£634	£4,885

33. The DSG after the GUF and floor calculation is adjusted to reflect the transfer of academies since April 2008. This adjustment is based on the amounts of grant paid to individual academies which includes both the individual schools delegated budget and a pro rata share of the local authority retained budgets. We have consistently questioned the validity of the amounts paid to academies which if disproportionate would leave the remaining schools within the authority disadvantaged.

34. A separate Pupil Premium was introduced in 2011/12. This grant is passed on in full to schools and is allocated at £458 per child eligible for a free school meal or looked after by the authority and £200 per child from armed service families. The Pupil Premium is paid in addition to any additional funding included in local authority formula allocations (or inherent in the transferred Standards Fund and other grants). Since the vast majority of local authority formulae (and many former Standards Fund allocations) include factors to reflect deprivation and other additional educational needs it could be argued the Pupil Premium represents double funding.

35. We have no indication what the GUF, floor protection or MFG are likely to be for 2012/13 or the following two years. This does not have a direct impact on the remainder of the local authority's budget but we remain committed to endeavouring that Kent schools receive a fair and equitable funding settlement. We are anticipating the value of the Pupil Premium will double in 2012/13.

Consultation on Changes to the Local Government and School Funding arrangements

36. During the summer the Government launched three significant consultations affecting local authority and school funding. The deadlines for responses to all three consultations were all in October. The consultations covered the following issues:

- Business Rates Retention
- School Funding
- Localising Council Tax Benefit

Business Rates

37. The consultation on business rates retention proposed in effect to crystallise the existing national redistribution of business rates (as per the 2012/13 damped Formula Grant allocations) through setting each authority a baseline. Local authorities would be allowed to keep any additional business rates growth in future over and above the level assumed in the baseline. Under the proposals businesses would still pay the same rate of local tax which would continue to include the nationally set multiplier, valuations and reliefs. The Localism Bill may allow local authorities some further discretion to apply discounts but the impact would have to be funded out of a council's overall resources and would not attract central government funding.

38. Under the proposals the overall resources available for local government would still be constrained to the level set out in SR2010 (as above). This means the baseline would have to be scaled down from the 2012/13 levels and is likely to mean that in total the assumed level of the business rates within the baseline would be less than the business rates yield. The likely outcome is that for 2013/14 and 2014/15 the excess business rates would be used to fund other grants to local government rather than be available to supplement local government spending. Furthermore, the consultation suggested that from 2015/16 onwards the responsibilities of central and local government will need to be adjusted to reflect the level of business rates yield (this is likely to mean additional responsibilities for local government but these would have to be funded from business rate income rather than government grant). One of the crucial factors in the proposed new system will be the assumed level of business rates within these calculations.

39. The consultation proposals mean that individual local authorities would face potential volatility due to changes in business rates. As it stands the government is suggesting that the tariffs and top-ups would be adjusted for the impact of the annual changes to the national multiplier and mandatory reliefs, and the five yearly impact of the review of rateable values although no decisions have yet been announced. If implemented, individual local authorities would only benefit/suffer from changes in the tax base. The consultation also suggested the introduction of a "shock pot" to help authorities that faced an unmanageable reduction in the tax base and/or low growth combined with significant additional spending needs. This shock pot would be funded either by a levy on all authorities or only from those with excessive increases in the business rate tax base.

40. In our response to the proposals, we welcomed the provision of a stronger incentive for local authorities to promote business growth compared to previous initiatives, and welcomed less reliance on Government grants. We accepted the need for a compromise between full business rate retention and the need to ensure funding for local services in

areas with weak business bases. We also welcomed that the proposals are likely to enable local authorities to be able to borrow against future local tax receipts through tax increment financing (TIF) as currently authorities can only borrow against future savings.

41. We have concerns that the potential volatility could be significant for individual districts in the county, but believe that overall the county is in a relatively good position to benefit from the retention of business rate growth, although the amount of money could be fairly small compared to the financial challenges the authority is facing over the next few years. We are also concerned about the longer term implications of the proposals which could leave local authorities with additional responsibilities without adequate funding.

42. We will continue lobbying to ensure the split of business rate growth between upper tier and lower tier councils is equitable, and we would wish to explore the options for pooling with districts. We remain concerned that crystallising the existing redistribution nationally is unfair (as demonstrated in table 3) and we will continue to campaign for a more equitable distribution. We were also concerned that the consultation does nothing to address the inverse correlation between local business tax and spending on local services or the poor link between the two.

Schools Funding

43. The Government has conducted a two stage consultation about reform of school funding. The consultation took place amid the backdrop of talk of a possible National Funding Formula. It now seems that the government is favouring a national framework with the ability for local variations (with the possibility of an expanded role for the Schools' Funding Forum). The proposals also include a clearer and fairer approach to setting academy budgets.

44. Under the latest proposals the existing system described in paragraphs 28 to 33 above (which essentially provides a single amount per pupil) would be replaced by a grant containing four blocks (schools, high needs pupils, early years and central services).

45. The schools block would presume full delegation to schools and academies although some defined services may be retained locally for maintained schools if approved by the Funding Forum. The schools block would either be built up based on a simple national "shadow" formula for each school or determined in a similar way to the current system as an amount per pupil. The actual budget for each school could still be determined by a local formula although the number of factors would be limited and set nationally and the government is considering setting a national ratio for secondary to primary school funding with limited scope for local variation.

46. The high needs block would provide additional funding for high cost special needs pupils including those in special schools, out county placements and alternative education. The government is considering a simple flat rate with top-ups according to need type. The early years block would cover payments for free entitlement for 3 and 4 year olds. The central services block would cover those services funded out of DSG but not delegated to schools.

47. We are generally supportive of the proposals and in particular tackling the problems with the GUF which only takes account of changes in overall pupil numbers. The four blocks would enable grant allocations to take account of other changes. We have some reservations that if the schools block is based on shadow budgets for individual schools this could raise some school's expectations at the expense of other more deserving schools. We think it likely that the proposals if implemented would require greater delegation to schools (which we are already embarking upon) and will be consistent with the simplifications we have already made to our local formula. Any new system would not be introduced until 2013/14 at the earliest and would include significant damping.

Localising Council Tax Benefit

48. The proposals in this consultation are likely to have a much greater impact on district councils than the County Council but need to be considered in setting out the budget strategy. Currently district councils assess eligibility for Council Tax benefit and claim the full cost of both the administration and the impact on their Council Tax collection funds. In effect this means the full cost of Council Tax benefit is funded by HM Treasury.

49. Under the consultation proposals lower tier authorities would receive a single grant equivalent to current spending on Council Tax benefit in their locality less 10%. The districts would be responsible for determining their own criteria for eligibility for Council Tax benefit. The Government has proposed that the benefit for older people and other vulnerable adults would be protected.

50. The main benefits and risks will fall on district councils although in two tier areas the Government has suggested districts may wish to work in partnership with the upper tier authority to develop joint schemes. The main risk to local authorities stems from the grant being capped but Council Tax benefit remaining demand led. It is understood the government is considering allowing greater discretion on Council Tax discounts which could increase the tax base and go a long way to addressing concerns. Any changes to Council Tax benefit would not be implemented until April 2013.

Local Government Pension Scheme

51. Lord Hutton's review of public sector pensions was published in March 2011. This included 27 recommendations the most significant of which were that in future pensions would be based on average and not final salaries and that retirement age would be increased. Accrued rights for existing staff would be protected. The Government have broadly accepted Lord Hutton's recommendations but it is unlikely that changes will be implemented before 2015.

52. In addition to Lord Hutton's review the Chancellor of the Exchequer announced as part of SR2010 that there would be an increase in employee contributions to public sector pension schemes to deliver an additional £1.8bn saving on public spending by 2014/15. This equates to an increase in contributions equivalent to 3% of pay. The target for the Local Government Pension Scheme (LGPS) is £900m.

53. These changes to pension arrangements could have a significant impact on staff in the LGPS. In particular employee contribution rates are already relatively high by public sector standards and the bulk of staff are low paid. Consultation between employers and trade unions is carrying on but we need to be mindful of the risks and in particular the consequences on the County Council if staff withdraw from the local scheme.

Localism Bill

54. The bill received royal assent on 15th November and is now passed as an act of parliament. The act includes reforms to planning, regeneration and housing responsibilities as well as changes to governance. At this stage we are not anticipating any major additional spending implications arising from the act that will impact on our financial strategy.

55. The act includes provisions to give residents the power to veto excessive Council Tax increases through local referendum and give local authorities more discretion over business rate relief. These powers could influence future budget strategy where they reduce the amount of tax income available to the Council.

Funding for Social Care

56. We are still awaiting the Government's proposals on the future funding for social care following the independent review led by Andrew Dilnot. Currently assistance for council funded social care services is limited to those with under £23,250 of assets (those with assets in excess of this are deemed "self funders"). The review recommended that the threshold should be raised to £100,000 and that the lifetime care costs incurred by individuals should be capped to between £25,000 to £50,000, and ideally set at £35,000 (it is estimated under the current regime one third of those aged over 65 face costs in excess of this figure). The commission also recommended that there should be national standard for eligibility to state funded social care.

57. It has been estimated that nationally the commission's recommendations would add £1.7bn to the £14bn currently spent by local authorities on care services and that in future the additional cost could rise by up to 50% as more people reach retirement age. At this stage there is no funding identified within SR2010 to fund these additional costs should the review's recommendations be implemented during the current spending review period.

Interaction of services with the NHS

Social Care

58. SR2010 included additional funds within the NHS budget to support social care. Nationally £800m was identified for 2011/12 rising to £1bn by 2014/15. The money was intended to be available to break down long-standing barriers between health and social care. At the time we set the 2011/12 budget and 2011/13 Medium Term Financial Plan we had not had confirmation how much would be available in Kent or how much would be available to the County Council or what additional spending requirements may be attached to the funding.

59. We have had confirmation that £32m is available from the East and West Kent PCTs over the two years 2011/12 and 2012/13. This was reported to Cabinet on 19th September which set out the amounts available from health authorities for the development of post-discharge support and reablement, winter pressures as well as the new social care allocations over 2010/11 to 2012/13. The report to Cabinet identified that the new money for social care must be spent on services which also benefit health.

60. The draft budget which will be launched in the next few weeks will set out how we intend to use the extra funding from health. It is our intention that some of this money should be spent on preventative services which will provide long term benefits for both the health authorities and reduce future demographic pressures for the council. Some of the funding will be available to sustain services which would otherwise have to be reduced in light of the overall budget reduction the council faces.

Learning Disability and Health Reform

61. The 2011/12 budget included £35m new grant for Learning Disability and Health Reform. The vast majority of this grant replaced income we previously received from health authorities under section 256 of the National Health Act 2006 to support adults with learning disabilities. Just over £6m was identified for additional responsibilities which transferred from health authorities in 2009 and were governed by separate funding agreements.

62. By and large the new grant matched existing spending commitments. In time we are anticipating that this grant will increase with spending pressures and could transfer into Formula Grant (or whatever replaces Formula Grant with the transfer of business rates).

Public Health

63. Responsibility for public health spending is due to transfer to local authorities in 2013. At this stage we are still in preliminary discussions with health authorities about which staff and budgets will transfer and what mechanisms will be used to transfer funding. It is unlikely we will have any detail to include in the 2012/15 draft MTFP when this is launched in the next few weeks.

Council Tax Increases

64. Council Tax has been increasing at a level significantly above inflation for a number of years. In 2011/12 the Government announced a Council Tax Freeze Grant which was equivalent to 2.5% on Council Tax for any authority which did not increase it above 2010/11 levels. Nationally £652m was made available as part of SR2010 as new money to fund the freeze grant and was available for each year of the spending review period. It was an essential feature of the freeze that the additional funding was available each year as otherwise Council Tax would have to be increased in future years or further savings made to compensate. The consequence of these arrangements meant that all authorities froze Council Tax other than parish precepts. The grant for KCC was £14.3m.

65. In October 2011 the Chancellor of the Exchequer announced that a further £800m would be available in 2012/13 to support a second freeze for a further year. On the face of it this was good news as it would amount to an additional £14.4m for KCC towards balancing the 2012/13 budget. However, unlike the 2011/12 grant this extra money has been found from under spends elsewhere and will not available for future years. This means that if authorities take–up the grant they would only be deferring future savings or Council tax increases. In spite of these difficulties we will be proposing to take-up the grant and freeze the County Council's element of Council Tax for a second year. This will be welcome news to families in these difficult economic times.

66. One of the impacts of the disproportionate allocation of government grants outlined in table 3 means that the government has expected council taxpayers in the South East (excluding London) to bear a much higher and increasing proportion of spending than in other regions, particularly in the North and Midlands. Table 4 shows that the proportion of spending borne by the council taxpayer is significantly higher in the South East (60%) compared to the North East (40%). The table also shows the differential increases in Council Tax since 2006/07

Table 4 Region	Proportion of 2011/12 Budget Requirement met by Council Tax %	Increase in Band D for all tiers since 2006/07 %	Average 2011/12 Council Tax per dwelling £
Kent	**56.1%**	**15.5%**	**1,284.46**
South East	**60.2%**	**15.2%**	**1,373.60**
South West	55.9%	15.9%	1,271.66
Eastern	56.5%	14.7%	1,293.40
East Midlands	49.3%	14.7%	1,139.65
West Midlands	43.8%	13.7%	1,113.90
Yorkshire & Humber	42.6%	14.0%	1,048.09
North West	42.1%	13.9%	1,087.83
North East	39.8%	13.7%	1,060.36
London	37.2%	7.8%	1,213.84
England	47.2%	13.5%	1,195.79

67. This analysis of grant changes and Council Tax demonstrates that the South East authorities have had the poorest deal from central government since the current funding system was introduced and as a consequence Council Tax payers have faced some of the largest increases. In an era when Council Tax is frozen and in effect the existing redistribution of business rates will be crystallised we will be continuing to campaign that these inequities are addressed as part of the review of local government funding.

68. The impact of the inequitable funding system has been partially compensated by councils making the greatest efficiency savings. Whilst this means that KCC is in good shape to tackle the financial challenge of additional spending demands and reduced funding it also means the authority may need more radical solutions than other councils.

PART 2: DISTRIBUTION OF RESOURCES IN KENT

Budget Timetable & Presentation

69. We are proposing to launch the draft 2012/13 budget and 2012/15 MTFP before Christmas. This will enable an adequate period for consultation prior to the budget and financial plans being agreed by County Council on 9th February. This timetable allows for a longer consultation period and earlier agreement of the budget than has been possible in previous years.

70. In proposing this challenging timetable we have been aware of the concerns of both KCC's members (who have previously commented that they do not have adequate time to scrutinise the budget proposals) and district council members (who have previously commented that they cannot set their own budgets until they have the precept from the County Council). We are continuing to explore ways to bring this timetable forward even earlier for future years.

71. We are also proposing to make further changes to the presentation of the budget and MTFP to make it more transparent and to focus on the significant issues. We made some presentational changes in 2011/12 to make the budget more understandable through the introduction of an A to Z of services rather than analysing spending by cabinet portfolio. By and large these changes have been well received and we intend to build on this for 2012/13 so that council members, the residents of Kent and other interested parties have a clearer picture of the proposed budget and how it has evolved from the current year.

Medium Term Financial Outlook

72. We are planning for a net reduction in funding of £11m for 2012/13 after taking account of the anticipated reduction in Formula Grant, additional Council Tax freeze grant, New Homes Bonus grant, Local Service Support Grant, and an increase in number of Council Tax payers. These amounts are our best estimates at this stage and cannot be confirmed until we get the provisional grant settlement and Council tax base estimates from District Councils. This is better than we forecast when we set the MTFP for 2012/13 which anticipated a reduction in funding of £30m. The improvement derives from unexpected changes to Council Tax freeze and Local Service Support grants and using New Homes Bonus to continue to support the revenue budget.

73. We are facing a number of additional spending demands for 2012/13 and the medium term thereafter, the vast majority of which are unavoidable. The latest estimate for these additional spending demands in 2012/13 is £93m. These are identified in appendix 1. This is significantly more than the £35m included in the published MTFP due in the main to the following:

- £15m is presentational as in the published MTFP we offset the reversal of one-off savings for 2011/12 against those savings whereas in 2012/13 we are showing this as a pressure
- £12m is presentational as in the published MTFP we had the removal of one-off funding from previous years shown as a negative pressure which has now been moved to savings
- £22m is pressures on children's services which we could not have foreseen at the time we set the last MTFP relating to the full year effect of addressing issues arising from the OfSTED inspection. This includes additional placements for children as we have cleared the backlog of cases, the recruitment of a full team of children's social workers and the new workforce strategy for children's social care on top of the one-off actions needed to the social care improvement plan which was funded in the 2011/12 budget

74. The impact of the net loss of funding of £11m and the £93m of additional spending demands means that we need to make £104m of savings in 2012/13 in order to balance the budget. This represents a substantial challenge and a savings target of a similar magnitude to the £95m we faced in 2011/12.

75. We have £67m of savings already identified in the current MTFP. £23m of these represent the full year effect of savings we made in 2011/12 and require no additional effort to achieve. Plans are well developed to deliver the remaining £44m of savings identified in the current MTFP (these represent savings which would not start to be delivered until 2012/13) and we are on schedule to meet this target.

76. The proposals for the balancing £37m of new savings will be included in the draft budget due to be launched before Christmas. These will include further efficiency savings and service reviews so that we preserve front line services as much as possible. The savings proposals will be presented consistent with the strategy outlined below and heralded in the Leader's speech to County Council on 21st July. Inevitably this report cannot include details of the proposals prior to the launch of the draft budget later this month.

77. The outlook for the following two years is for further reductions in Government funding consistent with the announcements in SR2010. It is difficult to quantify this with any certainty as provisional settlements have not been announced, the impact of the potential changes to the funding for local government outlined in paragraphs 37 to 42 is not yet

known, and the future of council tax freezes is still uncertain. Our best estimate is that our funding will reduce further by £24m in 2013/14 (£14.4m of which is the effect of one-off funding for Council Tax freeze in 2012/13) and £20m in 2014/15.

78. We estimate that we will face ongoing additional spending demands of between £50m to £60m per annum plus any additional pressures arising for one-off actions taken to balance budgets. The overall impact is that we will be looking for further savings of between £70m to £100m in 2013/14 and 2014/15. Savings of this magnitude are broadly consistent with our estimate 18 months ago that over 4 years savings of £340m would be needed in real terms as a consequence of tacking the national budget deficit.

79. We intend to publish a high level strategic 3 year plan together with the draft budgets for 2012/13 later this month. This plan will set out our best estimates of the financial challenge and our overall strategy to deal with it, whilst recognising that the second and third year estimates could be volatile. Unlike previous plans we are not proposing to break this down into individual portfolios. Setting individual 3 year plans for portfolios at a time when spending was rising made sense, but at a time of budget reductions we think it more important to set out a plan which clearly identifies the overall challenge and our intended direction of travel with more detail about the proposed response set out in the annual budget where estimates of both funding and additional spending demands are more robust.

Medium Term Financial Strategy

80. The general direction to tackling the financial challenge was set out in the Leader's speech to County Council on 21st July. In this he announced that the practice of setting directorates'/portfolios' cash limits is no longer relevant. Instead for 2011/12 we started to evolve a more priority led approach to setting the budget based around key themes such as reducing/managing demand and provision of cash alternatives rather than direct service provision.

81. The strategy for the next MTFP is develop these themes further and to add themes around personalisation, localism and incentivisation. We will undertake a thorough review of all of our current budgets and planned spending with reference to these themes with the aim of quantifying the scope for savings. Having identified the scope for savings, managers will be asked to develop delivery options around the principles of make, buy or sell. These options will identify the available alternatives and the likely impact.

82. We have established a Budget Programme Board chaired by the Cabinet Member for Finance and Business Support which includes the Deputy Cabinet Member for Finance, Cabinet Member for Environment, Highways & Enterprise (who represents Cabinet rather than his own portfolio) and two non executive County Councillors. The board also includes the Deputy Managing Director and Director of Finance & Procurement and is supported by senior offices from Finance and Business Strategy. The role of the board is to review/scrutinise additional spending demands, ensure the delivery of existing planned savings, review savings options under the themes outlined above and to safeguard future budgets and investment for growth.

83. Once the board has accepted that savings proposals should be put forward for inclusion in proposed future year's budgets, managers will develop detailed delivery plans including project initiation documents (PIDs) in advance of the draft budget being published. The board will also be responsible for ensuring there are sufficient options under development to enable a 3 year balanced budget to be presented in the revised MTFP high level plan.

84. The board has agreed a number of key fiscal indicators proposed by the Cabinet Member for Finance and Business Support. These are set out below and will be a valuable guide to the board, Cabinet and County Council to ensure we are on track to meet the financial challenge.

1. Net debt costs should not exceed 15% of net revenue spending.

2. Council Tax increases should be at least 1% less than RPI.

3. Management Overheads should not exceed 10% of net revenue spending.

4. Corporate and Democratic Core (Strategic Costs) should not exceed 1.5% of net revenue spending.

5. Income from commercial and traded activities should make a contribution of at least 5% to overheads, above the total cost of providing the service.

Financial Planning Risks

85. The planning assumptions for 2012/13 are robust as they are based on provisional grant settlements. The assumptions for 2013/14 and 2014/15 are estimates and could change following decisions about changes to the local government funding arrangements. We also have no firm information on future council tax freezes.

86. The biggest risk is the authority's ability to make the necessary savings over the next 3 years. The magnitude of these savings is much greater than we have had to achieve in the past and has to be sustained on a year on year basis. The strain on members, staff and customers will be significant. The strategy outlined in this report together with greater transparency around our budgets, enhanced consultation/communication/impact assessment and more detailed planning on the delivery savings have all been developed to help minimise this risk.

87. It is essential that in focusing on the risk around savings that we do not take our eye off the ball for the rest of the budget. Whilst a huge challenge, the savings only represent just 10% of our net spending and we must not let the other 90% get out of control. We will continue with the existing budget monitoring arrangements in spite of proposed restructuring in finance and in particular we will focus our financial support to managers of the most vulnerable budgets.

88. The overall economy will also still pose an ongoing risk to our planning. If the economy fails to recover from recession as quickly as planned the Government will face a difficult decision whether to delay the deficit reduction plan or make further savings. The latter could mean even greater reductions in local authority funding necessitating even greater savings. If inflation continues to exceed targets this will not only impact on our spending but could also force the government to realign its spending plans from SR2010 particularly if spending on benefits exceeds the SR2010 targets. Unemployment will also be key and the council will need to play a significant role promoting local employment but we also need to be aware of the macro situation and how it could impact on the government spending plans.

89. Table 5 below sets out the overall planning assumptions at this stage. The intention is to launch the draft budget and MTFP before Christmas although these assumptions may change in the meantime.

	2012/13 £m	2013/14 £m	2014/15 £m	3 Year Total £m

Base Budget Requirement	909	898	874	909
Estimated Funding Change	-11	-24	-20	-55
Affordable Budget	898	874	854	854
Base Budget Spending	909	898	874	909
Additional Spending Demands	93	57	52	204
Savings Requirement	-104	-81	-72	-259
Proposed Budget Requirement	898	874	854	854

Reserves

91. The Director of Finance is required to consider the adequacy of the authority's reserves as part of the budget process. Our existing strategy is to take a view about the balance of risk on our medium term financial plans in order that we maintain sufficient levels of reserves to meet such risks. In 2011/12 we increased the totality of general reserves to 3% of gross expenditure to cover unforeseen circumstances. This has been achieved but will be reviewed, as normal, during the budget process.

92. Part of the strategy to balance the budget for 2011/12 was to borrow £14m from long term reserves. As a general rule we would not recommend using such reserves to balance the budget but for 2011/12 we faced large and unexpected grant reductions and needed to borrow in order to buy some time to make the right decisions about where savings need to be made. In future we would not look to reserves to balance the budget as it merely delays the inevitable need to make savings and we would only consider using reserves where there is a need to take time to plan savings, or where those reserves are no longer required due to changing circumstances.

Appendix 1 – Estimated Additional Spending Demands

	2012/13 Restated	2012/13 Updated
	£'m	£'m
Existing categories		
Pay & Prices	7.1	6.9
Government/Legislative	4.5	3.4
Demand/Demographic	8.7	7.3
Service Strategies and Improvements	12.2	12.2
Replace One-Offs	15.4	15.4
Emerging	15.0	15.0
Sub-total	**62.9**	**60.2**
Major new spending demands		
Children's Social Services (see note 1)		19.8
Adults Social Care (see note 2)		9.3
Total Contribution Pay (see note 3)		2.0
Employers NI & staff travel (see note 4)		1.1
Other		2.0
Total pressures	**62.9**	**94.4**

Notes:

1. This additional spending demand reflects the current demand levels for children's social services. Our budget strategy is to use some of this funding to improve prevention services which we believe will over the coming years significantly reduce the number of Looked After Children we support by around 300 to 400. It is anticipated that a significant element of this new pressure will come out of the budget over the medium term, maybe around £10m - £11m.

2. This additional spending demand includes the use of NHS monies to improve prevention services which will provide long term benefits for the health authority and reduce future demographic pressures for the council.

3. Due to lower turnover and an overall reduction in the number of posts within the authority, performance related pay progression can no longer be funded from turnover of staff as it has been historically.

4. Employers' National Insurance contributions are increasing as part of the Government's spending review. In addition, this spending demand includes the additional 5p per mile being paid to casual users as agreed by County Council on 12 May 2011.