Agenda Item 7(a)

Council – 29 February 2012

Report by Chief Finance Officer on Robustness of Budget Estimates and Adequacy of Reserves

Purpose of report
To advise the Council on the robustness of the estimates in the budget and the adequacy of the proposed financial reserves before recommending to Council the Council's Medium Term Financial Strategy 2012/16, the Revenue Budget for 2012/13, Capital Programme 2012/22, Reserves levels and Treasury Management Strategy 2012/13.

1.0 Background

1.1 Section 25(1) of the Local Government Act 2003 requires that the Chief Financial Officer (Section 151 Officer under the Local Government Act 1972) reports to the Council when setting its Council Tax on (a) the robustness of the estimates in the budget (b) the adequacy of the proposed financial reserves.

1.2 Section 25(2) of the 2003 Act requires the Council to have regard to this report in approving the budget and Council Tax.

2.0 Context

2.1 The Council is setting its budget at a time when it faces significant challenges. In broad terms these can be split into 3 categories; economic, local government and local challenges. Each of these challenges are explored below:

2.2 Economic Challenges
The UK economy, along with the rest of the developed world, is faced with little or no growth in the near term and the threat of a double dip recession.

2.3 Local Government Challenges
As a result of the Government's austerity measures Local Government in the UK is working in an environment of delivering significant savings. This follows the Spending Review 2010 which identified a 28% reduction in real terms for local government funding. The Government has given councils a two year settlement, of which 2012/13 is the second year, but has not announced funding allocations for the remaining 2 years of the Spending Review. The Chancellor also indicated in the Pre Budget Report that austerity measures would continue into the next spending review period.

In addition to uncertainty around future funding allocations from April 2013, the Government is also planning further changes from this date, including re-localisation of business rates, localisation of council tax discounts, localisation of council tax benefit and the introduction of universal credit. All of these changes present significant risks to the Council over the period of its Medium Term Financial Strategy.

2.4 East Northamptonshire Challenges
As noted above the Council faces significant external challenges that it will need to manage over the medium term. Specific financial challenges I was faced with when joining the Council were an unfunded capital programme, an unsustainable revenue budget with an over reliance on reserves to balance the budget each year, and reducing reserves.

The proposed Medium Term Financial Strategy and associated budgets set out a plan for dealing with each of these challenges. However, it is only a plan. The biggest challenge will be for the Council to deliver it.

3.0 Medium Term Financial Strategy (MTFS) 2012/13 to 2015/16

3.1 The MTFS is a key part of ensuring the Council's future. As part of the 2012/13 budget planning round, the MTFS has received a substantial refresh to ensure the stability and sustainability of the Council's finances over the medium term. In order to ensure all councillors sign up to the financial strategy of the Council, two Member Budget Workshops were held, the first to raise awareness of the financial challenges facing the council and the second to seek decisions in principle around the key components of the MTFS. By involving members in the development of the MTFS this will improve the chances of its successful delivery.

3.2 Assumptions

Section 4 of the Budget Report presented to the Policy and Resources Committee on 13 February sets out all of the assumptions which underpin the MTFS. These assumptions are robust and are based on the most up to date intelligence available. However, as with any assumption, there is an element of risk that the reality will be different. The following assumptions in the MTFS contain the most risk:

- Government funding (current assumption is for a 5% reduction per annum). The Government funding for 2012/13 has been confirmed. However, the funding from April 2013 has the potential to change significantly due to specific allocations not having been given to councils and the impact of Government policy changes such as re-localisation of business rates, localisation of council tax discounts, localisation of council tax benefit and the introduction of universal credit.
- Government Policy changes. It should be noted the above mentioned Government policy changes could also impact on the Council's cost base. For example localisation of council tax benefit could mean higher administration costs.
- Council tax (current assumption is an increase of 3.5% per annum & no local referendum). Whilst the Government has published the criteria for the level above which council tax increase is considered "excessive" for 2012/13 at 3.5%, it has not done so for future years. The Government may change the level in future years. This will need to be reviewed on an annual basis by the Council and further savings will need to be found to bridge any increased funding gap.

3.3 Across the period of the MTFS there are £1.8m of savings proposals to be delivered. The majority of these are in 2012/13 (£1.1m). Each of these is a specific proposal within the budget and each has a clear plan about how it will be delivered. However, in years 2-4 of the MTFS a further £650k of savings still need to be identified. The Council needs to identify and develop plans on how these will be achieved. This work needs to commence immediately following the setting of this budget. A good start in identifying these additional savings is already in place as members have identified an initial list of services to review following the 2nd budget workshop and a number of other areas are already under review. Based on the relatively small level of further savings to be identified, the profile across years 2-4 of the MTFS and the track record in delivering savings over the past 3 years, the Council should be confident these will be achieved.

3.4 Delivering the MTFS

The MTFS requires a number of key deliverables to be achieved and implemented in order to achieve a stable and sustainable financial position for the Council. Key deliverables include implementing savings plans, identifying further savings, selling assets and determining which community projects the Council should invest in. As noted in Section 2 of the report all of these will need to be managed against a backdrop of further significant change to the Local Government sector. To ensure delivery the Council is advised to ensure that:

- project teams are established to deliver the savings programmes, particularly those still to be identified, and that these teams are resourced to the right level.
- progress against savings plans are regularly monitored, with variances and any mitigating actions reported to Finance Working Party.
- members take future decisions that support the aim of maintaining a financially stable and sustainable Council as set out in the MTFS, including a clear funding

source.

4.0 Revenue Budget 2012/13

4.1 The revenue budget 2012/13 is the first year of the Council's four year MTFS. The budget has been developed using a robust process with officer and member involvement.

4.2 Budget Process
An important feature of the budget process is that Heads of Service are responsible, with the support of finance staff, for the preparation and determination of their income and expenditure estimates. The active involvement of Heads of Service in determining their spending plans and income generation estimates ensures ownership of the budget and that the officers responsible for delivery of the services are happy that financial targets are achievable. During the 2012/13 budget cycle all items within the base budget have been challenged by Corporate Management Team (CMT) and any changes to the figures submitted have only been incorporated with the acceptance of the Head of Service.

4.3 Members have been involved in the budget process through the Finance Working Party, who have challenged the proposals, and the two Member Budget Workshops.

4.4 Budget Proposals
The budget includes £1,108k of savings, many of which have already been delivered as part of the in-year savings programme for 2011/12. The remaining savings proposals are considered to be low risk in terms of delivery. However, there are a couple of proposals which merit specific mention due to their risk:

- Pemberton Centre additional income. This proposal is based on investing capital monies into the leisure offering which is anticipated to generate additional membership income of around £400k per annum by 2015/16. The risk is that the additional income does not materialise at this level. However, extensive work has been undertaken to mitigate the risk including a report by external leisure consultants on the potential opportunity and risk sensitivity around likely funding streams. The additional income should start to be received by the Council in 2012/13. However, to minimise the risk to the budget, no income target has been built into the budget until 2013/14, so it is likely that additional income may materialise sooner than this.
- Community Projects. The budget includes £181k being set aside from the New Homes Bonus allocation to fund community projects. The funding source for 2012/13 is secure and confirmed. However, beyond this the funding source is subject to new housing completions and Government funding, which both create uncertainties. The Council is advised to establish clear and robust governance processes for the release of these monies to projects, and to ensure commitments are not made against future years' allocations until the funding source is secure.

5.0 Draft Capital Programme 2012/13 to 2020/21

5.1 The Capital Programme agreed by Council in February 2011, which was due to cost £16m over the next 10 years, is no longer affordable. As such there has been a major review of the Council's capital investment plans. This review has re-focussed the capital programme to focus on the highest priority areas of capital investment and is fully funded.

5.2 Following this review there are new risks that Council needs to be aware of:

- Selling assets to finance the capital programme. The programme assumes around £5m of capital receipts will be realised by selling surplus assets. Given the current state of the economy, and specifically the housing market, the Council need to be aware there are risks in both the timing and level of capital receipts forecast to fund the programme. To mitigate this risk a prudent position has been taken in the expected timing / level of receipts, and temporary borrowing will be utilised to fund any difference in cash flows. In addition, Policy and Resources Committee has approved the Finance Working Party's recommendation to actively progress the disposal of six surplus sites and to achieve the maximum value for these sites.

- Borrowing to finance the capital programme. To finance the capital programme the Council will be required to borrow monies for the first time since the housing stock was sold around 10 years ago. This presents new risks to the Council in terms of interest rates, refinancing, maturity of loans and being able to service the capital financing costs. The borrowing will be both temporary, to mitigate any cash flow timing difference in capital receipts being realised, and permanent, to finance long term assets. These risks will also be managed through the Council's Treasury Management Strategy (see Section 7 below).

5.3 It should also be noted that three capital investment schemes are currently under review and no monies will be spent against these schemes until reviews have been completed. The schemes under review are Nene Centre roof repairs (awaiting confirmation about the potential cost and funding source), investment in the Nene Centre to improve leisure facilities and generate additional income (awaiting confirmation of Nene Centre roof repairs) and Purchase of Company Cars. For prudency purposes the funding for these schemes is factored into the capital programme forecasts. There is a risk that the actual costs or funding sources will be different than those factored into the programme.

6.0 Annual Treasury Management Strategy 2012/13

6.1 The Council's Treasury Management Strategy has been enhanced to reflect the new borrowing requirements of the capital programme and to ensure the security of the Council's investments is maintained.

6.2 Forecasting the Council’s future borrowing and lending costs is always a challenge, but even more so in the current climate of economic volatility and uncertainty. Nevertheless the Treasury Management budget does reflect the capital financing costs to support the approved capital programme and rates of return on investments at this time. The base rate is forecast to remain at its historical low further into the medium term and the budgets will be regularly monitored.

7.0 Forecast Reserves and Balances

7.1 Members will be aware that reserves have been used extensively in recent years to finance the deficit on the revenue budget and to fund the capital programme. This presented one of the challenges to the Council in developing its proposed Medium Term Financial Strategy for capital and revenue spending. In response to this the budget process has focussed on delivering a plan which reduces the reliance on reserves and ensures the Council's finances are sustainable.

7.2 <u>Use of Reserves to Finance Spending</u>
The MTFS assumes the level of reserves fund the revenue and capital budgets as follows:

- Revenue - the level of contribution to finance revenue spending form reserves each year reduces from £545k in 2012/13 to a small surplus (and contribution to reserves) by 2015/16.
- Capital - the current capital reserve is due to be fully utilised in 2012/13.

Given the current expected level of reserves over the period of the MTFS this is considered acceptable. However, Council needs to ensure the MTFS plan is delivered as any variation to the plan will lead to a different contribution from reserves as it is essentially the balancing funding source in the plan. Total reserves, including the minimum level, are forecast to be around £4m over the period of the MTFS.

7.3 <u>Minimum reserves</u>
The minimum level of reserves as assessed after considering the risks facing the Council over the medium term is £2m. The £2m consists of two component parts, namely:

- An underlying minimum level of £1m for the long term, and

- In the short to medium term, a minimum level to £2m to reflect the uncertainties currently facing the Council. These uncertainties include Nene Centre roof, the delivery of a cost reduction programme to ensure on-going revenue spending is sustainable, changes to Government policy which could significantly impact on the Council's funding position (e.g. re-localisation of business rates, localisation of council tax discounts, council tax benefits and the introduction of universal credit)

The additional £1m to cover short to medium term risks should be reviewed, along with the underlying minimum level, on an annual basis.

8.0 Conclusion

8.1 Provided the Council carefully considers and acts upon the above analysis, and officers robustly manage the implementation of the Revenue and Capital Budgets, a positive opinion can be given under Section 25 of the Local Government Act 2003 on the robustness of budget estimates and the level of reserves.

9.0 Equality and Diversity Implications

9.1 There are no equality and diversity implications arising from this report. Separate assessments will be produced as savings plans are developed over the period of the MTFS to deliver the savings yet to be identified.

10.0 Legal Implications

10.1 There are no legal implications arising from the report.

11.0 Risk Management

12.1 This report by its nature considers risk management from a financial perspective.

12.0 Financial Implications

12.1 The report is of a financial nature and the implications are set out within the report.

13.0 Corporate Outcomes

13.1 The Corporate Outcomes that the MTFS seeks to help deliver are:

- Good Quality of Life
- Good Value for Money
- Effective Management
- High Quality Service Delivery
- Strong Community Leadership

14.0 Recommendation

15.1 That Council carefully consider the content of this report prior to recommending the approval of the Council's Medium Term Financial Strategy 2012/16, the Revenue Budget for 2012/13, Capital Programme 2012/22 and Treasury Management Strategy 2012/13.

(Reason: To ensure the Council complies with statute in setting its Budget.)

<table>
<tr><td rowspan="2">Legal</td><td colspan="2">Power:</td><td colspan="3">Local Government Finance Act 1992, Local Government Acts 1972, 2000 & 2003, Localism Act 2011</td></tr>
<tr><td colspan="2">Other considerations:</td><td colspan="3">Constitution</td></tr>
<tr><td colspan="2">Background Papers:</td><td colspan="4">Reports To Finance Working Party and P&R; precept notifications</td></tr>
<tr><td colspan="2">Person Originating Report:</td><td colspan="4">Glenn Hammons, Chief Finance Officer. Tel: 01832 742267
ghammons@east-northamptonshire.gov.uk</td></tr>
<tr><td colspan="6">Date: 18 February 2011</td></tr>
<tr><td>CFO</td><td></td><td>MO</td><td></td><td>CX</td><td></td></tr>
</table>