Agenda Item 8b

Council – 26 February 2014

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 2014/18, the Revenue Budget for 2014/15, Capital Programme 2014/24, Reserves levels and Treasury Management Strategy 2014/15.

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:

- the robustness of the estimates in the budget.
- the adequacy of the proposed financial reserves.

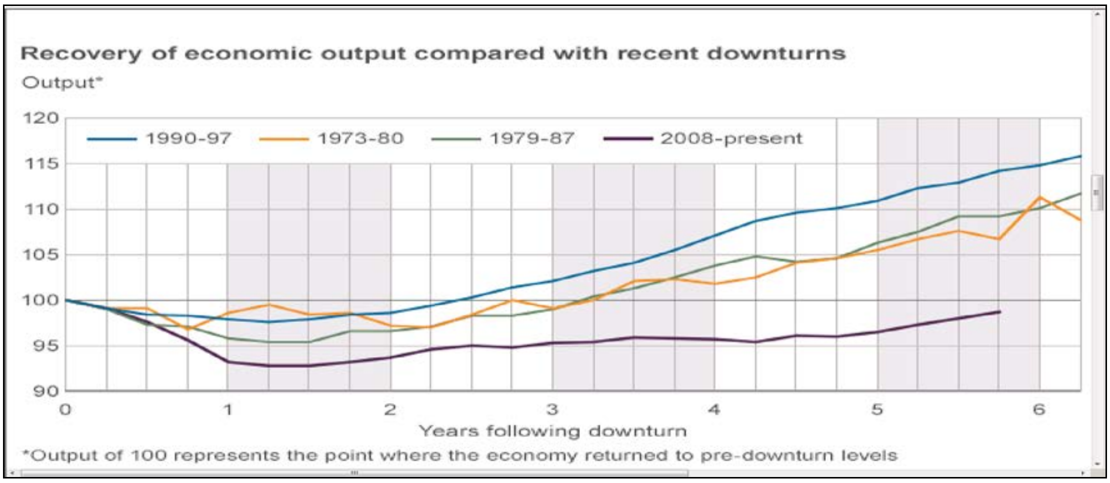
1.2 Section 25(2) of the 2003 Act requires the Council to have regard to this report in approving the budget and Council Tax.

2.0 Context

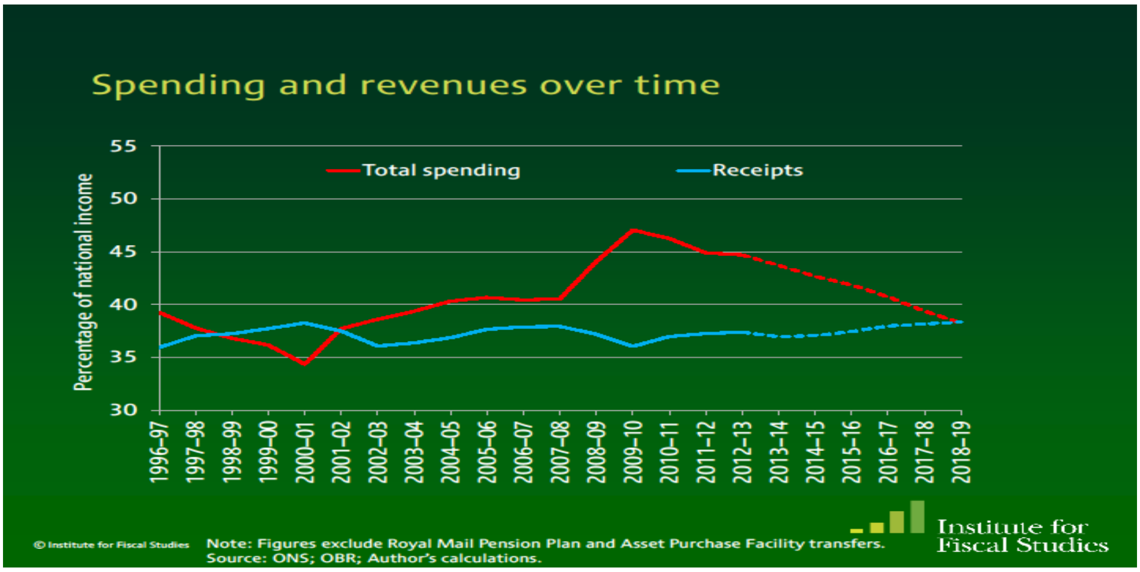
2.1 The Council is setting its budget at a time when it faces significant challenges. In broad terms these can be split into 3 categories; economic, local government and local challenges. Each of these challenges is explored below:

2.2 Economic Challenges
The UK economy over the last 12 months has returned to growth. In 2013 the annual growth in Gross Domestic Product (GDP) was 1.9%. This is the fastest rate of growth since the financial crisis in 2008 and the introduction of austerity measures in 2010. This growth is expected to continue in 2014 with the Office for Budget Responsibility forecasting growth at 2.4%.

2.3 Whilst this is positive news, the UK economy is still below the level of GDP seen in 2008. The period of recession and economic stagnation has lasted significantly longer than in similar recent downturns, where it has take 2-3 years to return to the level of GDP seen prior to the downturn. The recovery from the downturn that started in 2008 it is likely to take 6 years. This is shown in the graph below:



2.4 The UK economy is still operating with an annual deficit, and the Government has stated its commitment to a balanced budget by 2018. Due to the depth and length of the downturn, this is longer than previously envisaged. The graph below from the Institute of Fiscal Studies (IFS) shows how the UK income receipts could steadily increase and public spending is likely to continue reducing over the next 5 years until a balanced fiscal position is achieved. It should also be noted that the rate of decrease in public spending in the next 5 years is at a similar rate to that seen since 2010.



2.5 <u>Local Government Challenges</u>

As announced by Government in its Budget, Spending Round and Autumn Statement during 2013, the austerity measures for the public sector, including Local Government, will continue until at least 2018, rather than 2015 as previously indicated. This follows the Spending Review 2010 (SR10) which identified a 28% reduction in real terms for local government funding. In January 2014, councils received notification of their funding allocations for 2014/15 and an illustrative funding settlement of 2015/16. These confirmed that decreases in funding from Government are set to continue for the next two years at the rates seen over the last 4 years.

2.6 In addition to the continuing austerity measures, councils have implemented significant changes to Government policy, including the localisation of council tax support, technical reforms to council tax discounts & exemptions, keeping council tax increases to a minimum and Business Rates Retention Scheme. Looking ahead, the next Government policy change will be the introduction of universal credit and continued reform of the welfare system.

2.7 From these changes it appears that Government is moving away from the previous needs-based funding of the old formula grant, towards a system where councils are rewarded for growth in house and business numbers. For example, Revenue Support Grant (RSG) is forecast to reduce at significant rates and over the medium term is unlikely to be a primary source of funding for the Council. Its is being replaced by New Homes Bonus and Business Rates Retention, both of which reward those areas which can promote and deliver growth.

2.8 All of these changes present significant risks, as well as opportunities, to the Council over the period of its Medium Term Financial Strategy (MTFS).

2.9 East Northamptonshire Challenges
As noted above, the Council faces significant external challenges that it will need to manage over the medium term. Over the past two budget planning rounds the Council has implemented a financial strategy which addressed a number of specific financial challenges it faces, including an unsustainable revenue budget with an over-reliance on reserves to balance the budget each year, and reducing reserves.

2.10 During 2013/14 the Council has made good progress in delivering its MTFS, the primary areas being:
- Delivery of revenue budget savings and operating within its revenue budget for 2013/14.
- Delivering large scale capital investment to improve the offering for customers of council-owned leisure centres. The Council is starting to see a return on this investment through increased client numbers and income streams.
- The successful resolution of the legal action to recover costs of the defective roof at the Nene Centre.
- Implementation of enhanced capital governance arrangements.

2.11 However, there are still a number of actions that are in the process of being implemented (e.g. sales of assets), further large savings are still required in the future and there are new risks to manage. As I mentioned last year, the MTFS is only a plan. The biggest challenge will be for the Council to deliver it.

3.0 Medium Term Financial Strategy (MTFS) 2014/15 to 2017/18

3.1 The MTFS is a key part of ensuring the Council's future. The approach during the 2013/14 budget planning round has been to update the previous year’s MTFS for any changes to assumptions, local policy changes, national policy changes and known risks. The Council’s Corporate Management Team has been maintaining a constant eye on the MTFS since March 2013 and has taken action to reduce costs, increase income and make the organisation more efficient. Councillor involvement in this refresh has been through the Finance Sub Committee meetings in November 2013 and February 2014, as well as a Member Budget Workshop held during January 2014.

3.2 Assumptions
Section 5 of the Budget Report presented to the Policy and Resources Committee on 10 February 2014 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 as per notified Government allocations for 2014/15 and the illustrative settlement for 2015/16; from 2016/17 reductions are 13% per annum. Although an illustrative settlement has been provided for 2015/16 it could be subject to change, particularly because there will be a general election in May 2015. After the election, the incoming Government will need to review and confirm its spending plans for the period until 2018.

- **Business Rates Retention**. The current assumption is for the level of business rates in 2014/15 to grow to £21.3m, from a baseline of £19.3m. The Council is likely to retain around £0.4m with a further £0.170m generated by "pooling" with other councils in Northamptonshire. The actual level of business rates for 2014/15 will not be known until after the end of the financial year. This presents the Council with a new risk to manage, as previously all Government funding was certain at the time of setting the budget. This risk is being managed by a proportion of the anticipated increase being held in an earmarked reserve until the amount is clear. Beyond 2014/15 no further growth in Business Rates is factored into the MTFS. The Council has developed an approach to forecasting its level of Business Rates over the medium term. However, there are uncertainties over the level and timing of this growth, particularly in relation to the proposed development at Rushden Lakes which is currently subject to a decision by the Secretary of State.

- **Localisation of council tax support (CTS) and council tax technical reforms (discounts & exemptions)**. The current assumption is that the shortfall arising from the Government funding for CTS in 2014/15 will be met from council tax discounts/exemptions and a 12.5% council tax liability for those entitled to CTS. The actual position will be known at the end of the financial year. Beyond 2014/15 it is assumed any additional costs arising from reduced government funding are mitigated by reductions to the CTS scheme.

- **Universal credit**. The picture for implementing universal credit, including the single fraud service, is starting to emerge. However, the implications for the Council's finances still remain unclear.

- **Council tax.** The Council's strategy with regards to council tax is unclear and this does not help medium term financial planning with any certainty. As such, two options for council tax to fund the 2014/15 budget are proposed for Council to consider. Firstly, a council tax freeze, for which the Council would receive a grant from the Government of around £38k, equivalent to a 1% rise. The Government has also stated that this grant will be incorporated into the baseline funding position in future years, which is a change from previous years when the money has been one-off. It should be noted that, although this money is incorporated into the baseline funding, it will be subject to decreases in future Government funding. The second option is an increase in council tax to the maximum level without it being considered as "excessive" by the Government and without triggering a local referendum. For 2014/15 the criterion is if it is 2% or more. This is a subtle change from 2013/14 when an "excessive" increase was defined as a rise of no more than 2%. As such the second council tax option is for a 1.99% increase. In the medium term it is assumed council tax will increase by 1.99% per annum.

- **Council Tax Support (CTS) Grant to Town & Parish Councils**. The proposed budget assumes the CTS Grant is <u>not</u> passported to Town and Parish Councils. This is based on the position the Council took last year, when it was clear in its stance that the grant was likely to be one-off in nature and all but two Town and Parish Councils increased their precepts in excess of inflation to recover any lost impact of CTS on a permanent basis. The grant in 2014/15 equates to around £180k in the Council's proposed budget.

  If the Council adopts a different strategy to that set out in the proposed budget it will not only need to identify further savings to bridge any increased funding gap, but also to mitigate the additional risks it will place on the MTFS.

3.3 Across the period of the MTFS the level of savings required to be delivered is £2.2m per annum by 2017/18. This is significant in the context of the savings the council has already made since 2010. In 2014/15 the savings included in the budget total £0.6m; each of these is a specific proposal within the budget and each has a clear plan about how it will be delivered.

3.4 However, in years 2-4 of the MTFS a further £4.7m of cumulative savings still need to be identified, including £1m in 2015/16. The Council needs to identify and develop plans for how these will be achieved. The position the Council is facing with the need to make substantial savings from its revenue budget is similar to other councils.

3.5 To achieve these savings the Council will face tough decisions about the way in which it provides services, the level of services it provides and its appetite for risk. In short, the Council cannot continue its current trajectory and needs a transformation to ensure it can serve the residents of East Northamptonshire within its available resources. This work needs to commence immediately following the setting of this budget and should have clear input from councillors at an early stage.

3.6 Delivering the MTFS

The MTFS requires a number of key actions to be implemented in order to achieve a stable and sustainable financial position for the Council. These include implementing savings plans, identifying further savings, selling assets and increasing revenues by encouraging more businesses into the district. 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.
- monies need to be set aside to support these programmes on an invest to save basis, with clear criteria and expectations of return.
- progress against savings plans is regularly monitored, with variances and any mitigating actions reported to Finance Sub Committee.
- 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.

3.7 The Long Term Financial Position

As noted in the Budget Report to Policy & Resources Committee on 10 February 2014, the long term financial position for the Council continues to show costs increasing at a faster rate than funding. The potential gap between expenditure and income could be around £3m per annum in 10 years based on the assumptions used. The Council will need to be cognisant of this position when making strategic and policy decisions in the future. The likely solutions to this shortfall will be around increasing revenues through the Business Rates Retention scheme by growth in the number of businesses in the district and reducing costs by operating more efficiently, effectively and innovatively.

4.0 Revenue Budget 2014/15

4.1 The revenue budget 2014/15 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 confident that financial targets are achievable. During the 2014/15 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. The Finance Manager has also challenged current practices, improved the budgeting process and provided assurance around the robustness of budget estimates.

4.3 Councillors have been involved in the budget process through the Finance Sub Committee, the Policy & Resources Committee and the Member Budget Briefing held in January 2014.

4.4 Budget Proposals

The budget includes £600k of savings, many of which have already been delivered as part of the in-year savings programme for 2013/14. The remaining savings proposals are considered to be low risk in terms of delivery. However, there is one proposal which merits specific mention due to its risk:

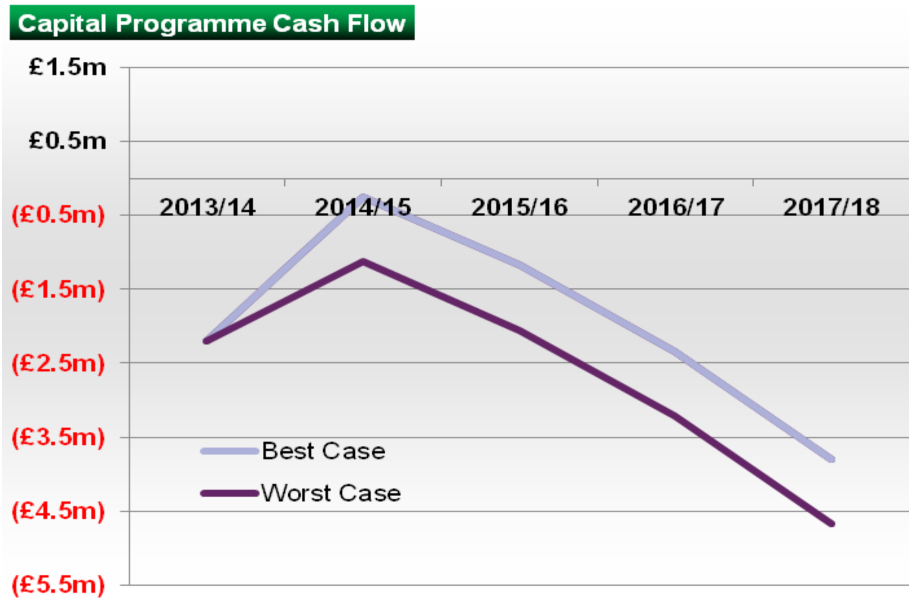
- Nene and Pemberton Centre additional income. This proposal is based on the recent investment of capital monies into the leisure offering, which is anticipated to generate additional membership income of £100k in 2014/15 rising to around £400k per annum by 2015/16. The risk is that the additional income 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, and regular meetings with CCP to assess and monitor progress. Despite these mitigations this proposal carries a higher than normal level of risk for 2014/15. This is due to a number of uncertainties, including levels of expected demand for the new facilities performing in line with forecasts. As such there will be close monitoring of the financial progress of this proposal during the year.

5.0 Draft Capital Programme 2014/15 to 2023/24

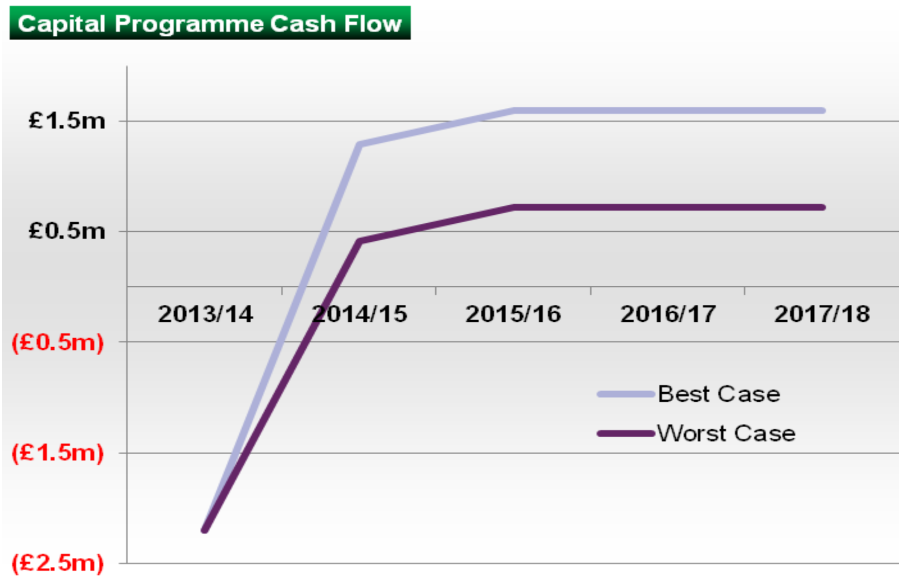
5.1 Historically the Council's Capital Programme has been funded from capital reserves, which accrued from the sale of housing stock in 2001. Two years ago it was recognised these reserves would run out and new funding sources would be required to fund capital investment. A key aim of the Council has been to ensure it does not undertake any long term borrowing to finance its capital expenditure. As such in 2012 it agreed to embark on a strategy to dispose of surplus assets and expected, at the time, to generate around £5m to finance capital investment. As it would take time to sell these surplus assets, the Council would undertake short term borrowing, ideally using its own surplus cash rather than borrowing from financial institutions, to manage the timing difference between spending on the capital programme and the cash being realised from asset sales. It should be noted that, wherever the monies are borrowed from, they needs to be repaid and there is a cost of doing this, either in interest paid on borrowings or interest foregone on investments. This approach meant the Council could continue to undertake capital investment without borrowing until around 2016.

5.2 There has been steady progress in the sale of surplus assets programme. Of the 6 sites, 1 has been sold realising £0.085m, 3 are in the final stages of being sold and 1 site is unlikely to be sold as there is insufficient interest from the market. It is expected that by early in 2014/15 the Council will realise the majority of the value of the assets identified as surplus. However, it is envisaged the total level of monies to be raised will be less than previously assumed in capital programme plans. This was noted as a specific risk in this equivalent report 12 months ago and is now likely to become reality. The current estimate for the proceeds from the sale of surplus assets is £3-4m.

5.3 This has a major impact on the Council's capital programme as, if the Council were to continue with all its capital spending plans as included in the Agreed Capital Programme and Development Pool, it is unlikely to be in a positive cash-flow position and would be borrowing monies to finance capital spending, a position it has stated it categorically does not want to consider in the period of this administration. The impact of a best case (£4m) and worst case (£3m) for capital receipts is show in the graph below:



5.4 As can be seen from the graph above it would be imprudent to release any further schemes which do not have a clear funding source as it cannot be guaranteed the Council would not end up in a borrowing position inadvertently. If the Council only released those schemes from the Development Pool which have a clear funding source from an external party (e.g. Government Grant or Contributions from third parties) the cash flow position would be as shown in the graph below:



The graph clearly shows that monies forecast to be raised from asset sales would pay off the current estimated short term cash flow borrowing (forecast to be £2.4m at 31/3/14) and provide a surplus of between £0.6m-£1.6m to invest in capital schemes going forward. However, there is little certainty of this until the monies from asset sales have realised and are in the Council's bank.

5.5 The Council has made its intention clear that it does not want to enter into long term borrowing to finance capital investment.

5.6 Due to:

- the likely estimated reduction in the level of capital receipts,
- the uncertainty of the timing of capital receipts,
- the current forecast short term borrowing level, and
- the strategy of not borrowing for the long term

capital schemes will only be released from the Development Pool into the Approved Capital Programme where a clear and sustainable funding source is identified.

5.7 This approach will ensure the Council does not over commit its capital investment and lead to a position of long term borrowing. However, the Council should note there could be implications on service provision of such an approach. For example, property or IT systems assets may not perform at the desired levels which may result in inefficiency, and therefore cost, as well as impacting on the customer experience of the end user.

5.8 To seek to mitigate these impacts a review of all capital schemes in the Development Pool will be undertaken early in 2014/15. The review intends to classify all schemes into categories (statutory, contractual, business critical, invest to save & service enhancement), prioritise the schemes, identify alternative funding sources, identify alternative delivery mechanisms and consider options for financing the programme from the Council's resources.

5.9 There is a real danger that the Council is not willing to invest sufficient resources in its capital programme. This could negatively impact on service provision and the ability to deliver the further efficiencies the Council needs if it is to deliver its revenue budget savings targets. The options the Council will explore to finance its capital investment plans include:

- Maximising external funding (e.g. Government Grant, European Funding & Lottery Funding).
- Shifting the burden of capital investment to those who receive the benefit.
- Sharing the costs of investment with partners.
- Creating a Council Improvement Reserve to provide invest to save funding (subject to strict business case criteria) to enable revenue savings to be delivered.
- Realising monies from further asset sales, although it should be noted these will be minimal.
- Council resources, namely the revenue budget. This could be through a "pay as you go" approach or through borrowing monies over the useful life of the asset. Either option would require savings (over and above those required to balance the existing gap identified in the MTFS) to be found from the revenue budget to fund it. The key difference will be the timing of those savings, e.g. £1m of capital investment on a "pay as you go" approach would require £1m of savings to be identified in one financial year, whereas borrowing could spread this cost over the life of the asset and therefore have a lower impact on the revenue budget each year.

5.10 During the last 12 months the focus on the Council's capital spending has been through major investments in repair and improvement works to the Nene & Pemberton Leisure Centres. To provide a greater focus and transparency on capital investment, enhanced governance arrangements have been implemented to improve capital planning, monitoring and the control environment. This solid platform for capital governance places the Council in a good position to manage the pressures it faces on its capital investment at the present time.

5.11 To summarise, the following risks continue to exist in the capital programme and Council needs to be aware of them:

- As noted above the programme assumes around £3-4m of capital receipts will be realised by selling surplus assets.
- Borrowing to finance the capital programme and development pool in the short term to cover the timing differences until capital receipts are realised.
- A clear and sustainable funding source from the Council's own resources to finance future capital investment.

6.0 Annual Treasury Management Strategy 2014/15

6.1 The Council's Treasury Management Strategy has been updated to reflect the latest borrowing requirements of the capital programme and latest interest rate forecasts, and to update the credit criteria to reflect the changing banking environment whilst ensuring the security of the Council's investments continues to be maintained.

6.2 Forecasting the Council's future short term 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 previous years to finance the deficit on the revenue budget and to fund the capital programme. In response to this the MTFS approved in February 2012 planned to:

- reduce the reliance on reserves to finance the revenue budget from over £1m in 2011/12 to nil by 2015/16. This was achieved ahead of schedule in 2013/14.
- Utilise the remaining Capital Programme reserves and replace this funding stream with capital receipts by utilising the Council's surplus assets. This strategy is part way through its execution.

These were key elements of the MTFS to ensure the Council's finances remain stable and sustainable in these times of austerity. However, there are still a number of significant risks, which I have referred to earlier in this report, that still face the Council and need to be mitigated with an appropriate level of reserves.

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 – throughout the period of the MTFS there is no planned requirement to fund revenue spending from reserves. It should be noted the Council faces significant shortfalls in funding over the medium term and it is assumed these will be achieved by reducing costs and increasing income to ensure a stable and sustainable budget is maintained.
- Capital - the capital reserve was fully utilised in 2013/14. The Council needs to identify further funding sources to finance its capital expenditure commitment and plans.

7.3 Minimum reserves

The minimum level of reserves, as assessed after considering the risks facing the Council over the medium term, is £1.75m. This is a reduction from £2m in 2013/14 to reflect reduced risks. The £1.75m 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 of £0.75m to reflect the uncertainties currently facing the Council. These uncertainties include the delivery of a cost reduction programme to ensure on-going revenue spending is sustainable, generation of additional income from leisure centre investment, new risks around the implementation/early operation of recent Government policy changes (business rates retention, localisation of council tax discounts/exemptions and council tax support), the introduction of universal credit and planning-related activities.

The additional £0.75m to cover short to medium term risks will be reviewed, along with the underlying minimum level, on an annual basis.

7.4 Earmarked Reserves

The number, type and level of earmarked reserves have been reviewed in light of the risks faced by the Council. As part of this review a Council Improvement Reserve has been created. This reserve is being set aside to provide the investment the Council is likely to require to transform itself in order to deliver the savings to balance its revenue budget. The use of this reserve will be on strict criteria linked to a business case and will require sign-off by the Chief Finance Officer and Finance Sub Committee.

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

11.1 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

14.1 That Council notes the S151 Officer's opinion set out in paragraph 8.1 and carefully considers the content of this report prior to recommending the approval of the Council's Medium Term Financial Strategy 2014/18, the Revenue Budget for 2014/15, Capital Programme 2014/24 and Treasury Management Strategy 2014/15.

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

<table>
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<tr><td colspan="5">Other considerations: Constitution</td></tr>
<tr><td colspan="6">Background Papers: Reports To Finance Sub Committee and P&R; precept notifications</td></tr>
<tr><td colspan="6">Person Originating Report: Glenn Hammons, Chief Finance Officer.
☎ 01832 742267 ✉ ghammons@east-northamptonshire.gov.uk</td></tr>
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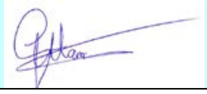
18.02.2014</td><td></td><td>DMO
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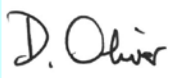
18.02.2014</td><td></td></tr>
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