Agenda Item 7b

Council – 25 February 2015

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 2015/19, the Revenue Budget for 2015/16, Capital Programme 2015/25, Reserves levels and Treasury Management Strategy 2015/16.

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

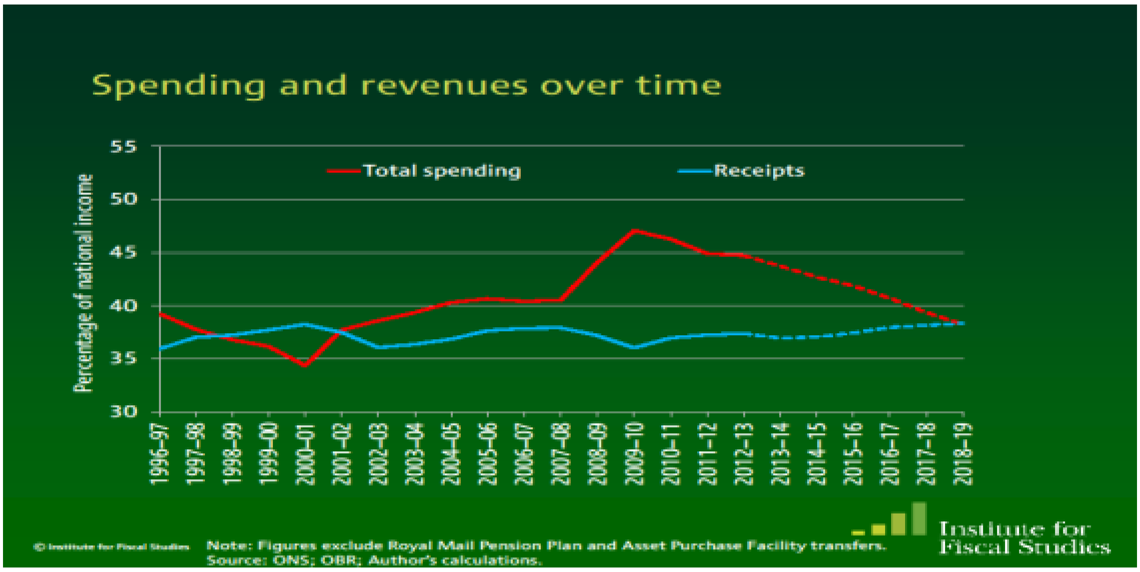
2.1 The Council is setting its budget at a time when it faces significant challenges. In broad terms these can be split into 3 categories; economic, local government and local challenges. Each of these challenges is explored below:

2.2 Economic Challenges
The UK economy has returned to growth. In 2014 the annual growth in Gross Domestic Product (GDP) was 2.4%. 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 2015 with a survey of 25 independent forecasters complied by the Office for Budget Responsibility projecting growth at 2.6%.

2.3 The graph below shows the quarterly growth increase (left hand axis) and total GDP (right hand axis) over the past 10 years. The impact of the financial crisis and recession in 2008/09 is clearly evident. However, since 2013 the economy has grown consistently each quarter and the total level of GDP has risen above pre 2008 levels. This is extremely positive news for the UK economy.

Source: Office for National Statistics

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, although some commentators are suggesting it could be 2020. Due to the depth 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 increase and public spending is likely to continue reducing over the next 5 years.



2.5 <u>Local Government Challenges</u>
As announced by the Government in its Budget and Autumn Statement, during 2014 the austerity measures for the public sector, including Local Government, will continue until at least 2018. Since 2010 Government funding for local government has reduced by approximately 40% in real terms. Although there are no official allocations for local government for the period 2016-2020 latest intelligence from the Local Government Association is suggesting that Government funding will reduce at a similar rate to that seen in the last five 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. During 2015 universal credit will continue to be rolled out across the country and it is anticipated there will be continued reform of the welfare system.

2.7 From these changes it appears that the Government is moving slowly 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 over the medium term and is therefore unlikely to be a primary source of funding for the Council in the future. It 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 However, with a general election in May 2015 there is a lot of uncertainty about how this will impact on local government funding. Latest intelligence from respected local government commentators suggests all the main political parties are signed up to reducing the annual deficit in the UK finances. Where the parties differ is likely to be about how monies within local government are allocated. One area of funding that could come under close scrutiny post the election is New Homes Bonus. Another challenge facing local government is the continued impact of an increasing elderly population and the associated pressures on social care and health services. This may lead to a redistribution, albeit over time, of local government funding. All of these changes present significant risks, to the Council over the period of its Medium Term Financial Plan.

2.9 <u>East Northamptonshire Challenges</u>
Over the past three 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, reducing reserves and an unsustainable capital programme.

2.10 During 2014/15 the Council has made good progress in delivering its MTFS, the primary areas being:

- Delivery of revenue budget savings and operating at a significant surplus in its revenue budget for 2014/15.
- An in depth review by officers and councillors of the underlying assumptions in the MTFS. This, along with significant efforts to deliver continuing costs savings and increases in income, has turned a deficit position twelve months ago into a surplus over the medium term planning period.
- The Secretary of State giving a positive opinion for the Rushden Lakes development to proceed following challenge from a number of neighbouring councils. This has provided sufficient certainty to enable the Council to incorporate forecasts for expected business rates into its MTFS.
- Completion of the asset sales programme which commenced in 2012, and has realised over £4m of receipts to finance the capital programme.
- Unlocking £2.4m of cash on the balance sheet via a technical adjustment to finance the capital programme, reducing the reliance on capital reserves. Over the last three years the viability of the funding position of the capital programme has been extended.
- Embedding and operating enhanced capital governance arrangements.

2.11 However, the Council continues to face significant external challenges that it will need to manage over the medium term. There are still a number of actions and mitigations that are in the process of being implemented, potential pressures on the renewal of the waste collection contract and new risks to manage (e.g. the impact of County Council budget proposals, particularly relating to waste, on the Council). 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) 2015/16 to 2018/19

3.1 The MTFS is a key part of ensuring the Council's future. The approach during the 2015/16 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 2014 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 and a Member Budget Workshop held during January 2015.

3.2 Key assumptions, risks and mitigations

Section 5 of the Budget Report presented to the Policy and Resources Committee on 16 February 2015 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 2015/16; from 2016/17 reductions are estimated at 10% per annum as Government will not publish allocations for local government or individual councils until after the election.

  The risk is mitigated by using the latest intelligence to inform our forecasts. This includes announcements by the HM Treasury in the Budget 2014 and Autumn Statement 2014, the Office for Budget Responsibility's independent forecasts and Institute of Fiscal Studies analysis.

- **Business Rates Retention**. The current assumption is for the level of business rates in 2015/16 to grow to £22.1m, from a baseline of £21.5.m. The Council is likely to retain around £0.5m with a further £0.3m generated by "pooling" with other councils in Northamptonshire. The actual level of business rates for 2015/16 will not be known until after the end of the financial year. Beyond 2015/16 there are assumptions included in the MTFS for further growth in Business Rates. The majority of this relates to the Rushden Lakes development. However, it should be noted there is a high level of uncertainty over the level and timing of this growth

  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. The Council has developed an innovative approach to forecasting its level of Business Rates over the medium term with the establishment of the Business Rates Forecasting Group consisting of officers from planning, revenues and finance. The Council also has a good relationship with the Valuation Office Agency.

- **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 2015/16 will be met from council tax discounts/exemptions and a 12.5% council tax liability for those entitled to CTS. This is no change from 2014/15 and is expected to be cost neutral with regards to the impact on the wider council tax payer given on-going reductions in government grant to finance the gap.

  The risk is that the actual position is different from the budget at the start of the year as the final position won't be known until the end of the financial year. Extensive modelling has been undertaken to provide the Council with assurance of the financial impact. The primary reason for maintaining the liability at 12.5% for a second year is that previous estimates have been overly prudent with regards to non payment. Beyond 2015/16 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. It has been confirmed that the Council is in tranche 3 of the roll out for new single claimants from 1st October 2015. However, the implications for the Council's finances still remain unclear. Indications from the pilot councils show there could be an impact on the Council's Council Tax Support Scheme.

  The Council will mitigate this risk by using its intelligence networks to estimate the financial impact as information emerges during the financial year, and undertaking a fundamental review of its Council Tax Support Scheme during 2015/16 to ensure it is financially sustainable

- **Council tax.** The Council's strategy with regards to the level of council tax for 2015/16 is unclear as a firm position will not be known until council in February 2015 and this does not help medium term financial planning with any certainty or my ability to provide sufficient assurance on the strategy adopted. The MTFS assumes no increase in 2015/16 with increase at 1.99% in future financial years which is the maximum increase without triggering the need to have a referendum for a tax rise which is considered to be excessive. If the Council does not increase council tax in 2015/16 it will receive a Council Tax Freeze grant of around £39k from Government equivalent to a 1% rise. The Government has also stated that this grant will be incorporated into the baseline funding position in future years. However, no announcements have been made with regards to the future of incentives from Government to freeze council tax beyond 2015/16, any such announcements will not come until after the Election in May 2015.

- **Employee Costs and Vacancy Factors.** There has been a national pay agreement of a 2.2% increase over the period from January 2015 to March 2016. This has been incorporated into the budget for 2015/16. Pay inflation has been assumed to be 1% from 2016/17 onwards. This is in line with government announcements on public sector pay. Over the past 3 years the Council has budgeted for a full establishment; however, due to vacancies arising from staff turnover, the budget has been consistently underspent. The Council has experienced an average staff cost variance of 4.6% during this period. Vacancy factors have been trialled during 2014/15 and monitored via Finance Sub-Committee and CMT. These have now been incorporated into the 2015/16 budget and MTFS. Based on previous years and following a prudent approach, a level of 3.5% (£200k) has been assumed.

3.3 Across the period of the MTFS there are expected to be annual surpluses which lead to contributions to reserves each year. This is a much improved position than 12 months ago when the Council was facing a significant and increasing predicted gap each year in its MTFS. The reasons for this improvement are set out in paragraph 2.10

3.4 However, despite this surplus, there are a number of risks the Council faces over the period of the MTFS, in addition to the risks set out in 3.2, there are also the following:

- The renewal of the waste contract in 2018.
- The affordability of the capital programme from 2017.
- The impact of budget proposals from the County Council.
- Government funding reductions over and above those assumed in the MTFS.
- Timing of monies arising from forecast business rates, e.g. delays in new developments becoming operational.

3.5 If these risks are not mitigated or don't change positively, the current surplus position could return to a deficit position with further savings required. As such the Council needs to continue to search for opportunities to identify and deliver further efficiencies.

3.6 <u>Delivering the MTFS</u>
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, reviewing contracts, delivering business transformation projects 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 officers at the Council are 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.
- projects have clearly defined deliverables to transform services which balance service improvement with reducing costs and being more efficient.
- monies need to be set aside to support these programmes on an invest to save basis, with clear criteria and expectations of return.

Members are advised to ensure that:
- 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.

4.0 Revenue Budget 2015/16

4.1 The revenue budget 2015/16 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 2015/16 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. 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 2015.

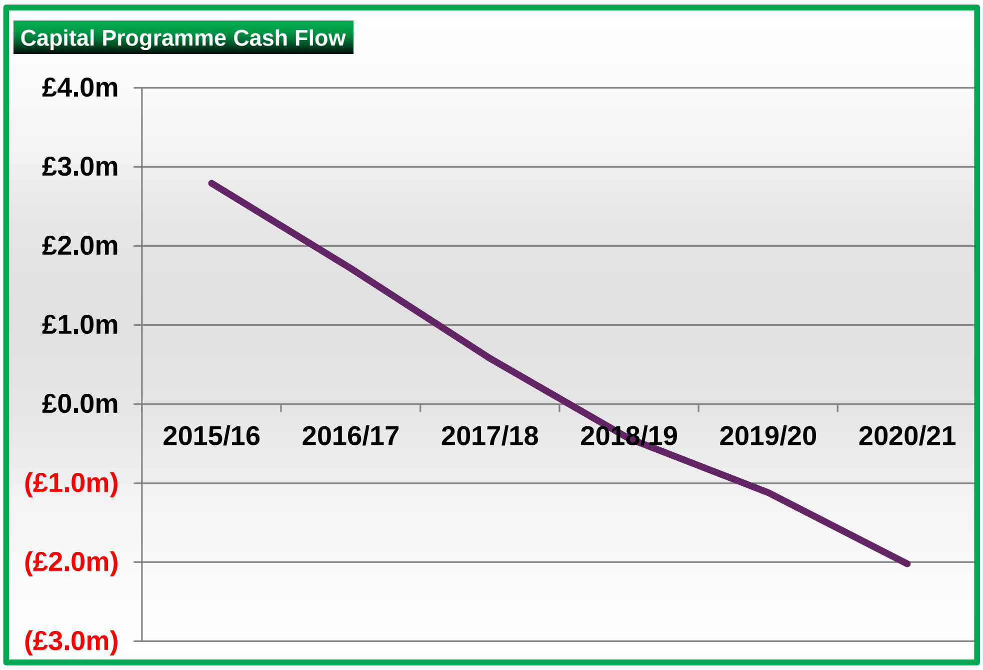
4.3 Budget Proposals
The budget includes £1.1m of savings, many of which have already been delivered as part of the in-year savings programme for 2014/15. The remaining savings proposals are considered to be low risk in terms of delivery.

5.0 Draft Capital Programme 2015/16 to 2024/25

5.1 Historically the Council’s Capital Programme has been funded from capital reserves, which accrued from the sale of housing stock in 2001. Three 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 original 6 sites, 5 have been sold realising £4.4m.

5.3 The realisation of these monies has provided certainty with regards to funding the capital programme over the past 12 month. During the past year the Council has also successfully released £2.4m of monies on its balance sheet to provide further funding for the capital programme. If the Council were to continue with all its capital spending plans as included in the Approved Capital Programme and Development Pool, it would have sufficient funding until 2018/19. This is shown in the graph below:



5.4 As can be seen from the graph above, the Council would use up its capital reserves over the next 3 years. In line with current capital programme governance it would be imprudent to release any further schemes from the Development Pool which do not have a clear funding source. Each scheme needs to be considered on its own merit prior to in moving into the Approved Capital Programme. Although it should be noted that some schemes in the programme are statutory in nature, Disabled Facilities Grant for example, where the Council has little or no discretion about spending the money.

5.5 As the Council has made its intention clear that it does not want to enter into long term borrowing to finance capital investment then the Council needs to determine its strategy for financing its capital programme at some point over the period of the MTFS. There are a number of options to do this, including:

- Managing the release of schemes from the Development Pool which would extend the period of using capital reserves. However there would still be an issue about how the programme would be funded over the longer term.
- Generate more capital receipts by selling assets. However there are few assets the Council owns and there would still be an issue about how the programme would be funded over the longer term.
- Finance the capital expenditure each year directly from revenue. Given the annual capital spend is forecast to be around £1m this would require significant savings to be made from other area of the revenue funded services.

5.6 To seek to mitigate these impacts a review of all capital schemes in the Development Pool will be undertaken early in 2015/16. This will be done through CMT and Finance Sub Committee.

5.7 There is a real danger that the Council is not willing, or in some cases unable, to invest sufficient resources in its capital programme. This could negatively impact on service provision, meeting statutory obligations, business continuity 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, for example Disabled Facilities Grants from the Better Care Fund.
- Sharing the costs of investment with partners.
- Using the 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.

6.0 Annual Treasury Management Strategy 2015/16

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 and medium term investment returns 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 has been concluded during 2014/15.

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 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 Use of Reserves to Finance Spending

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. In each year of the MTFS there is a planned contribution to reserves. This recognises the hard work the Council has undertaken in the last 12 months as set out in paragraphs 2.10 and 3.3 of this report. However, as explained in paragraphs 3.4 and 3.5, there are still a number of risks which need to be mitigated.
- Capital - the capital reserve is expected to be fully utilised in 2017/18. The Council needs to identify further funding sources to finance its capital expenditure commitment and plans beyond that date.

7.3 Minimum reserves

The minimum level of reserves, as assessed after considering the risks facing the Council over the medium term, is proposed to be £1.5m. This is a reduction from £2m in 2013/14 and £1.75m in 2014/15 to reflect reduced risks. The £1.5m 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 £0.5m 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 potential waste pressures arising from new legislation and decisions being made by the County Council which are likely to affect East Northamptonshire

The additional £0.5m 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 the Council Improvement Reserve is being continued, having been established in 2014/15. 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 These are set out in Section 1 of 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.)

14.2 That Council recognises the work undertaken over the last three years to ensure we have a balanced budget.

(Reason: To ensure the Council has a stable and sustainable Medium Term Financial Strategy and Plan)

<table>
<tr><td rowspan="2">Legal</td><td colspan="5">Power: Local Government Finance Act 1992, Local Government Acts 1972, 2000 & 2003, Localism Act 2011</td></tr>
<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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