

ESSENTIAL REFERENCE PAPER C

Stress testing the MTFP: The Council's ability to withstand significant external shocks

Given that the MTFP is based on less than full knowledge of the future, there will be "events" which cannot be predicted or the impact of which cannot be quantified. It is important to consider the Council's ability to withstand any such events.

Below is set out an internal assessment of the Council's financial position. The Council's external auditors reviewed the financial resilience of the Council in 2013 as part of its overall assessment of our financial accounts. (see Audit Committee 18 September 2013) and gave a positive report.

External shocks can be divided between scenarios which trigger unavoidable spending from demand or price pressures and those arising from unforeseen shortfalls in income and might include any of the following:

- Continuation of public sector funding reductions
- A loss on investments arising from failure of one or more banks
- Changes in the arrangements for Local Government financing directly impacting on funding levels, including level of localised business rates being much lower than expected
- Failure of a major supplier
- A natural disaster
- Unforeseen additional take up of council tax support
- Prolonged pay and/or price inflation above expectation
- Investment returns running below forecast
- Costs arising from litigation

The Council seeks to mitigate the risk of some of the above – for example by insurances, its prudent approach to treasury management and the integration of service and financial planning over the medium term. However, none of the mitigation measures can offer a 100% guarantee the Council will not be subject to a significant financial shock.

The comments here are therefore not about likelihood but only about the ability to cope should any of the scenarios materialise.

The Council's budget requirement for 2014/15 is £14m. For the purpose of stress testing the impact of the event(s) is set at "major"- level 1 = 10% of the requirement and "severe" - level 2= 20% of the requirement i.e. circa £1.4m and £2.8m

The tools to cope with such an event are:

- Spendable reserves
- Borrowing and capitalisation including immediate access to cash
- The Bellwin formula
- Emergency increases in fees and charges
- Emergency reduction in spending
- Council tax

Spendable Reserves

The use of reserves is a potential response to meet non-recurrent shocks and potentially to buy time to make adjustment to spending if the shock is of a continuing nature.

The current approved Reserves Policy sets a minimum balance of £3m and a ceiling of £7.1m. The projected balance at March 2014 currently exceeds the ceiling but is subject to a number of risks as highlighted in the consolidated budget report. Earmarked reserves might be redirected in the short term providing another further coverage over the period of the MTFP if required.

Reserves are adequate to meet more than one level 2 events or a combination of Level 1 and 2 events.

A one off call on reserves would reduce cash balances and return on investments, but there is currently an earmarked reserve that could be brought into play that is specifically for interest being below the level set in the budget.

However, prior to a continuing call on reserves other options as set out below would be applied.

If the event was of a continuing nature the implications would be much more challenging and as noted above. The current MTFP includes a range of savings and to reduce spending by another £2.8m per year (Level 2 “shock”) would be extremely difficult being equivalent to over 25% of payroll costs. In such a scenario the council would have to look to a combination of:

- Targeted reductions in staffing
- Renegotiations of terms and conditions
- Significant increases in fees and charges
- Renegotiation of major contracts
- An exceptional increase in council tax

At this stage the benefits of more detailed financial contingency planning in applying the above tools to meet such a challenge is not considered cost effective as no contingency plan can anticipate all circumstances which might be in place. The circumstances are likely to trigger a business continuity event or emergency planning event and contingency planning is focused in these areas of service delivery.

Borrowing and Capitalisation

The council has a negative Capital Finance Requirement estimated at £40m at March 2014 which within the constraints of the Prudential Code permits borrowing to meet capital expenditure in response to shocks. In extremis the Council might seek approval from the Secretary of State to charge revenue cost to capital to spread the cost.

Bellwin Scheme

This refers to the scheme by which DCLG will meet the uninsurable costs of immediate response to an emergency such as caused by bad weather.

The threshold above which grant becomes payable is 0.2% of net revenue expenditure (£30k for East Herts) after which 85% of costs are recoverable. This “insurance policy” is limited to costs of immediate response and not to recovery i.e. costs incurred (within two months of an incident)

- *by a local authority in England on, or in connection with, the taking of immediate action to safeguard life or property or to prevent suffering or severe inconvenience, in its area or among its inhabitants;*
- *as a result of the incident(s) specified in the scheme which involved the destruction of or danger to life or property.*

Emergency Increases in Fees and Charges

Fees and charges which are subject to the Council's discretion raise income of about £4m per year. A 10% across the board increase would generate an extra £400k per year although consideration would need to be given that some of these fees and charges are only able to be set at "cost recovery" levels so may increase the need to increase discretionary fees and charges at more than 10%. It is more likely that this scenario would be considered as part of a package of measures rather than on an individual basis.

Emergency reductions in spending

The Council cannot instantly reduce much of its spending.

Payroll is a significant cost and it takes time to implement staffing reduction if legal challenges to dismissal are to be avoided and changes to terms and conditions by negotiation or imposition are protracted. Not filling vacancies has limited impact when turnover is low, as it currently is.

Contractual payments for outsourced services, rents, business rates, utility costs, licences, postal costs make up a further tranche of spending not able to be turned off at short notice.

A lead in time of 6 to 9 months is indicative of the minimum time to implement significant reductions in spending efficiently and mitigate impact on services.

Exceptional council tax increase

A 1% increase in council tax generates about £94k per year DCLG has indicated that an increase in Council Tax in excess of 2% for 13/14 would trigger a referendum and although the level for

14/15 has yet to be announced, it is likely to be similar. It would therefore be unlikely that the raising of exceptional Council Tax would be a tool that could be used to mitigate any financial shocks.

Liquidity and Access to Financial Markets

The Treasury Management Strategy ensures the Council always has ready access to cash, with 50% or so of investments currently in realisable short term UK treasury bills and other investments in short dated bank deposits. Although the latest Treasury Management strategy is looking to change the nature of our investment levels, it will still ensure that we maintain “safe” levels of ready access to cash.

The Council’s major debtors are council tax payers and businesses for business rates and adequate provision is made for bad debts. These sources of income are subject to ongoing monitoring and rates of collection remain high.

The Council has no requirement to refinance outstanding debt and capital expenditure will be financed by reduction in investments rather than external borrowing.

The Council is therefore well placed to withstand short term lack of liquidity in financial markets.