ESSENTIAL REFERENCE PAPER L

STRESS TEST: FINANCIAL RISKS FACING THE COUNCIL

Risk criteria used in assessing adequacy of reserves	**Commentary on East Herts position**	**RISK RATING**
The treatment of pay and price inflation in the budget	Estimated pay and price inflation is fully provided in service budgets so low risk of services overspending due to inflationary pressures. A 1% increase in pay or price inflation equates to £110k.	LOW
Estimates of the level and timing of capital receipts to fund the capital programme	Capital receipts not yet received are taken into account when financing the capital programme. The anticipated use in 2014/15 is some £2m which could be funded internally if the capital receipts are not generated.	MEDIUM
The level of demand led pressures and volatile/risky budgets	Localisation of Council Tax Benefit: The number of claimants seems to be relatively stable at present. Medium term demand will depend a lot on the national/local economy and as the population ages the cost of the scheme will rise. Each 1% increase in CTB equates to £8k. CT Collection rate remains stable but dependent on state of local economy.	LOW AT THE MOMENT LOW to MEDIUM

	NNDR income remains volatile as the amount we collect is dependent on the number of appeals made.	HIGH
	Housing Benefits: we get pound for pound subsidy from government to cover the benefits we pay out. The financial risk is in making overpayments (by mistake or through fraud) and the Council not collecting this back from the claimant. Predicting demand for housing benefits is also very difficult and future demands will partially depend on the type of new housing built in the area.	MEDIUM
	Fees and charges: income budgets are reviewed annually as part of the budget setting and are based on the most up-to-date information available at the time. A 5% shortfall on car park income = £160k and in other income = £85k.	LOW / MEDIUM
	The Land Charges income budget of £273k is at risk of being lost to the Council as the work associated with the fee is likely to move to the national Land Registry.	HIGH

The robustness and level of planned efficiency savings / productivity gains	The amount of savings built into the MTFP is relatively low compared to the overall total budget.	LOW
The financial risks inherent in any significant funding partnerships, outsourcing contracts, or major capital developments	East Herts has an increasingly more complicated model of service delivery than was previously the case. More services are procured through contract or through partnership delivery models. This means that the Council could face short term financial risks if a partner/contractor pulls out of the arrangement (even though there would be an exist strategy written into the agreement). In addition, the increasing amount of budget contractually committed means that it has less flexibility in the short term to divert resources towards any short term budget pressure.	MEDIUM
The overall financial standing of the Council (level of borrowing, debt outstanding, cash balances, exposure to volatility in the financial markets, etc.)	Level of borrowing: The Council has loans totalling £7.7m of which £6m falls due in 2020. The likelihood of the Council not having sufficient investments to repay this debt is very low. The Council's cash and investment holdings as at end of 2014: were some £52m.	LOW

	The Council's Treasury Management Strategy currently favours a risk adverse policy to its investments with a requirement that 50% or so of investments are in short term UK treasury bills or other short dated bank deposits in order for the Council to have ready access to cash. The biggest risk is a change to the UK bank base rate which is unlikely to go lower than it currently is. The move to property investment endorsed in the 2014/15 Treasury Management Strategy will increase the Council's risk exposure. There is a longer term risk that the Council may no longer be able to fund its capital programme from cash reserves/investments in the future. This would depend on whether the amount invested in capital expenditure remains at its current, relatively low, level and other demands needed from reserves.	
The long term solvency of the Pension Fund	The last triennial valuation of the Pension Fund was undertaken in 2013 and	LOW

	resulted in the Council making a lump sum payment from General Reserves to the Pension Fund of £1.008m in order to stabilise the annual Pension Deficit Contribution and employer contribution rate over a 3/4 year period. The next valuation will be in 2016 and the probability is high that the Council may need to consider making a similar payment to the Pension Fund depending on the level of deficit.	up to 2016/17 HIGH from 2016/17
The Council's track record in budget and financial management.	The Council has a long history of under spending its revenue budget by some £1m to £2m annually. The risk of unplanned overspends occurring that require emergency funding is very low.	LOW
The availability of reserves and contingencies to deal with any emergencies or overspending	As this report sets out, the Council is in a healthy position with regards to the amount of general and earmarked reserves it holds. In addition, the MTFP currently shows some £0.5m contingency in the revenue budget for this financial year and next although this reduces to £333k in 2016/17.	LOW

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<tr><td>The adequacy of the Council’s insurance arrangements to cover major unforeseen risks.</td><td>The Council is fully insured and currently does not self-insure any of its potential risks.</td><td>LOW</td></tr>
<tr><td colspan="2">External factors particularly the external financial climate which the Council is subject to and future funding levels expected from government.</td><td>HIGH</td></tr>
<tr><td colspan="3">The UK economy grew by 0.7% in the third quarter of 2014 compared to the previous quarter, and was up by around 3% on a year earlier. The recovery has now been sustained for nearly two years since early 2013 after a couple of sluggish years in 2011 and 2012.

Most economic commentators expect growth to continue for the rest of the year and next but international risks have increased over the past six months. The Eurozone has lost momentum and emerging market performance has faltered, with Chinese and Indian growth slowing and more marked downturns in economies such as Brazil, South Africa and Turkey. There is more uncertainty currently about the national economic outlook than there was six months ago.

The Office for Budget Responsibility (OBR) published their latest Economic and Fiscal Outlook on the 3 December 2014. Public sector net borrowing is expected to fall by 0.6 per cent of GDP this year, reaching 5.0% – half the peak it reached in 2009-10. Looking further ahead, OBR expect the deficit to fall each year and to reach a small surplus by 2018-19. On the Government’s latest plans and medium-term assumptions, OBR state that we are now in the fifth year of what is projected to be a 10-year fiscal consolidation. Relative to GDP, the budget deficit has been halved to date, thanks primarily to lower departmental spending (both current and capital) and lower welfare spending. The tax-to-GDP ratio his risen little since 2009-10. Looking forward, the Government’s policy assumption for total spending implies that the burden of the remaining consolidation would fall overwhelmingly on the day-to-day running costs of the public services – and more so after this Autumn Statement. Between 2009-10 and 2019-20, spending on public services, administration and grants by central Government is projected to fall from 21.2 per cent to 12.6 per cent of GDP and from £5,650 to £3,880 per head in 2014-15 prices. Around 40 per cent of these cuts would have been delivered during this Parliament, with around 60 per cent to come during the next.</td></tr>
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As an illustration of the potential risk to East Herts:
If it were decided that New Homes Bonus would no longer be funded then this would represent a loss for the Council (2016/17 MTFP estimates) of £1.4m annually (10% of the Net Cost of Services) plus a further £0.8m annually that is not used to fund the base budget but the NHB Priority Spend Budget. This potential loss would not occur at once as it is unlikely the government would withdraw funding already guaranteed from previous years.

Other potential financial risks arising from changes to the local government finance system include the following:

- An independent Commission on Local Government Financing was set up in 2014 to bring forward practical options for reform in the next Parliament and to suggest a range of measures to make local government financially self-sufficient. Most stakeholders agree that the local government finance system needs fundamental reform.
- The Business Rate Retention Scheme will be reset in 2020 which means that the benefits accrued by the fastest growing areas, like East Herts, will end at that point and may be redistributed under a new funding calculation: and everyone has to start again. Reset gives areas with the lowest economic growth a chance to catch up but could take away resources from us.

There are potential risks to the Council with the introduction of Universal Credit. However this is difficult to quantify as the detail of the changes is not yet known nor is it known when this will be implemented.