

EAST HERTS COUNCIL

CORPORATE BUSINESS SCRUTINY – 14 JULY 2015

EXECUTIVE – 4 AUGUST 2015

REPORT BY THE EXECUTIVE MEMBER FOR FINANCE & SUPPORT SERVICES

FINANCIAL STRATEGY AND MEDIUM TERM FINANCIAL PLAN FROM 2015/16 TO 2019/20

WARD(S) AFFECTED: All

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**Purpose/Summary of Report**

- To consider revisions to the Financial Strategy for the years 2015/16 to 2019/20. This includes the policy on reserves and the proposed planning assumptions to be used to update the Medium Term Financial Plan in preparation for annual budget setting.

<b><u>RECOMMENDATIONS FOR CORPORATE BUSINESS SCRUTINY:</u> that:</b>	
<b>(A)</b>	<b>Scrutiny consider The Medium Term Financial Plan from 2015/16 to 2019/20 and make recommendations to Executive on any revisions that should be considered in terms of the planning assumptions used.</b>
<b><u>RECOMMENDATIONS FOR EXECUTIVE:</u> that:</b>	
<b>(A)</b>	<b>Any revisions to the Medium Term Financial Plan from 2015/16 to 2019/20 arising from Corporate Business Scrutiny be considered and the adoption of the strategy be recommended to Council.</b>
<b><u>RECOMMENDATIONS FOR COUNCIL:</u> that:</b>	
<b>(A)</b>	<b>The proposed Financial Strategy be adopted;</b>
<b>(B)</b>	<b>The planning assumptions set out in this report be adopted by the Council as the basis for framing the 2016/17 budget and Medium Term Financial Plan to 2019/20.</b>

## 1 Background

- 1.1 This report sets the context for the future financial position for East Herts Council. The Financial Strategy is a statement on the Council's approach to the management of its financial resources to meet its Corporate Priorities. The strategy also considers the appropriate level of reserves that the Council holds to mitigate current and longer term risks.
- 1.2 Medium term financial planning must make assumptions about the future demand profile and cost pressures on expenditure and on factors that affect income sources. The Medium Term Financial Plan (MTFP) represents a summary of these assumptions and their impact on the funding of the council.
- 1.3 The MTFP outlines the anticipated funding and expenditure each year and where there is a shortfall the MTFP highlights the amount of savings required that have not yet been identified.
- 1.4 The MTFP sets the financial envelope within which the council must fund its activities in order to set a balanced budget in each of the next 4 years. In order to begin the budget setting process for 2016/17 and beyond it is therefore prudent to revise the MTFP at the beginning of the Finance and Business Planning process. Throughout the summer and autumn services plans and budgets will be produced to deliver a balanced budget for 2016/17. In addition this process will allow the council to identify where savings may be achieved in future years and begin planning their delivery.
- 1.5 One of the outcomes of the Finance and Business planning process will be the budget report presented to Council on 17<sup>th</sup> Feb 2016 for their approval.

## 2 Report

- 2.1 This report considers and outlines the underlying assumptions within the Medium Term Financial Plan (MTFP) and addresses the following key areas in the following sections of this report:

Report Section	
3	Funding Changes
4	Financial Strategy
5	Review of Reserves

6	Underlying Assumptions
7	MTFP Development
8	Budget Setting Risk Management

### 3 Funding Changes

3.1 The last version of the MTFP was reported to Council on 18<sup>th</sup> February 2015. In revising the assumptions within the model a number of adjustments have been made to the sources of funding received by the Council. Where changes have been made these are outlined in the paragraphs that follow.

#### 3.2 Revenue Support Grant:

3.2..1 In the 2015/16 Local Government finance settlement the allocation of Revenue Support Grant was £2.057m, a reduction of £0.759m (27%) compared to the 2014/15 allocation. This funding source is likely to continue to reduce in future years and the Council will need to consider how to mitigate this by growing business rates and other income sources.

3.2..2 The forecast income from the Revenue Support Grant from 2016/17 onwards has been revised since the February 2015 report due to a revised model being published by a consultant to the Council.

#### 3.3 Non Domestic Rate income (NDR):

3.3..1 The income modelling has separated the income received from NDR and Section 31 reliefs provided by Central Government over the MTFP period. The 2015/16 NDR income estimate is £1.717m.

3.3..2 The government has continued to apply a 2% cap on the increase to NDR bill demands (a.k.a. Business Rates Multiplier) in 2015/16. RPI inflation from Sept 2013 to Sept 2014 was 2.3% although the loss in business rate income will be offset by a corresponding increase in Section 31 grants.

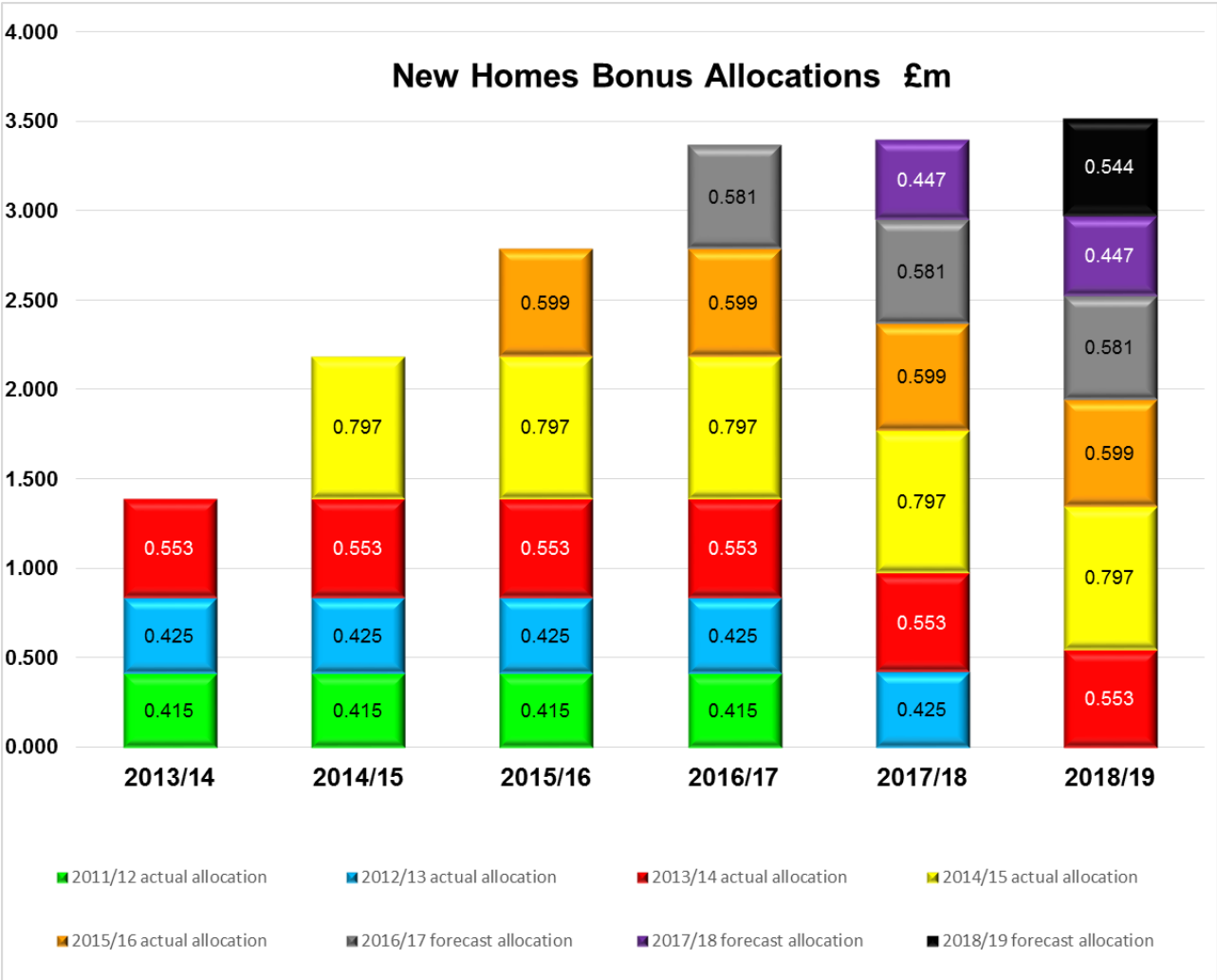
3.3..3 There continues to be a high degree of risk in modelling the future income received under the NDR scheme. This is due to the scheme being revised on a frequent basis. There is also a significant risk that the NDR scheme will be fundamentally changed in future years.

- 3.4 **Section 31 Grant:** The estimated income for 2015/16 of £1.06m is the amount of grant owed to the Council arising from government policy decisions on rate reliefs.
- 3.5 **Collection Fund:** The forecast deficit on the Collection Fund for 2015/16 is £1.244m. This is due to the Council's decision to fund NDR appeals. This forecast deficit will be funded from the Collection Fund Reserve which is earmarked to smooth the effect of NDR income volatility.
- 3.6 **Council Tax:** The MTFP assumes that the Council Tax demand made by East Herts Council will be frozen in 2016/17 followed by 1.0% rises in each subsequent year until the end of the MTFP period in 2019/20. A 1.0% rise from 2016/17 will raise an additional £90k in funding.

3.7 **New Homes Bonus:**

3.7..1 The 2015/16 allocation of New Homes Bonus from the Department for Communities and Local Government (DCLG) is £2.79m. This is made up of incremental allocations from 2011/12. This is illustrated in Chart 1 below.

**Chart 1: New Homes Bonus Allocations and Forecast**



- 3.7..2 This source of funding represents a large proportion of East Herts Council income. Any change to the New Homes Bonus scheme is likely to have a significant impact on the funding of council services. Our assumption remains that the scheme will continue in its current form.
- 3.7..3 The forecast income from New Homes Bonus has been revised since the February 2015 report due to a revised allocation of funds for 2015/16 increasing from £525k by £74k to £599k. The forecast amounts for allocations for future years have not been adjusted as these remain prudent.
- 3.8 **Investment interest:** The forecast income generated from investments placed on behalf of the council in 2015/16 £843k. This figure has been reduced by £24k since the last version of the MTFP due to interest rate forecasts continuing to extend the period that the Bank of England Monetary Policy Committee (MPC) hold the base rate at 0.5%. This shortfall can be funded from the Interest Equalisation Reserve should it be required.

## 4 **Financial Strategy**

- 4.1 The current financial strategy is included in **Essential Reference Paper D**.
- 4.2 The financial strategy and the MTFP have a 5 year focus and for the purposes of the strategy this remains sound. Strategic Finance officers will continue to model the impact of financial decisions and other scenarios that have an impact upon Council funding.
- 4.3 The Chancellor of the Exchequer has announced that he will present a revised Budget to Parliament on 8<sup>th</sup> July 2015. The Government announced as a manifesto commitment that they would seek to reduce welfare funding by a total of £12billion. The impact of these funding reductions on East Herts Council is unclear at the time of writing this report.
- 4.4 The Government has also announced that DCLG funding will be reduced by a further £230m in 2015/16. As the majority of local government funding comes from the DCLG it is possible that this reduction will be passed on to local authorities although the DCLG have stated that this will not be the case.

- 4.5 The continuation of the New Homes Bonus scheme in its current form is also uncertain. It is possible that this source of funding will be revised in the Budget on 8<sup>th</sup> July 2015.
- 4.6 As the impact of these funding changes becomes clear these will be fed into the MTFP.
- 4.7 There are other emerging issues that may have an impact on the MTFP including the sovereign debt crisis in Europe, the ongoing uncertainty around Greece's ability to service its debts and the potential impact of the UK referendum on leaving the EU in 2017. The impact on East Herts is unclear but as these issues continue to develop and their impact can be measured they will be incorporated into the MTFP.

## **5 Review of Reserves**

- 5.1 Reserves are either usable or unusable. Unusable reserves arise from statutory accounting transactions and cannot be used to fund revenue or capital expenditure. This report only considers the Council's usable reserves. The Council's Reserves Policy is included in **Essential Reference Paper E**.
- 5.2 A review of reserves has been carried out as at 31<sup>st</sup> March 2015 and balances based on the draft final accounts are summarised in **Essential Reference Paper E**.
- 5.3 At 31<sup>st</sup> March 2015 general reserves totalled £5.167m, a reduction of £2.928m during 2014/15. These transfers have brought the general reserves balance within the maximum level of reserves set out in **Essential Reference Paper E**.
- 5.4 At 31<sup>st</sup> March 2015 earmarked reserves totalled £13.819m. Net transfers to earmarked reserves during 2014/15 totalled £5.445m including transfers from general reserves. This included the following appropriations:
- £307k Collection Fund surplus transferred into the Collection Fund Reserve to smooth the effect of income volatility in NDR funding in future years.
  - £2,767k transferred to the New Homes Bonus Priority Fund to support future priority spending plans.
  - £1,000k to create the Insurance Fund to allow the Council to self-insure in future years.
  - £1,000k to create the Pension Fund Additional Contribution Fund.

- £500k to create the Commercial Property Fund to support the development of commercial investment opportunities.

5.5 These reserves movements are summarised in the table below:

	Balance at 31 March 2014 £m	Balance at 31 March 2015 £m
General Reserves	8.095	5.167
Earmarked Reserves	8.374	13.819
<b>Total Reserves</b>	<b>16.469</b>	<b>18.986</b>

## 6 Underlying Assumptions

6.1 **Essential Reference Paper C** refers to the assumptions that have been made in terms of inflation and other price increases during the medium term which have been incorporated within the MTFP.

6.2 The MTFP model highlights that there are unidentified savings that will need to be delivered from 2017/18. The Finance and Business Planning process that is about to begin will ensure that these are fully met and a balanced budget is set.

## 7 MTFP Development

7.1 The MTFP model and assumptions will continue to be assessed and revised throughout the year with particular attention being paid to the announcements made in the Budget on 8<sup>th</sup> July 2015 and the Local Government Settlement expected in December.

7.2 The Council Tax base will continue to be monitored throughout the year. Any emerging increases or decreases in the tax base will be modelled and impact included in the MTFP.

7.3 The Finance and Business Planning process will identify future funding requirements and future savings required to deliver a balanced budget from 2016/17. This will include an assessment of historic trend patterns in order to reduce future underspends and ensure that resources are directed to reflect the priorities of the Council. Any growth or savings proposals that result from this process must be contained within the resources available to the Council as set out in the MTFP.

7.4 The Investment Strategy will be revised to ensure that the return on investment achieved is optimised based on market expectations and

performance. The MTFP will be updated to reflect the impact on the interest income received.

7.5 Reserve balances will be monitored throughout the year to ensure that the general reserves remain within the limit set out in the Council's Reserves Policy and that earmarked reserves are utilised appropriately.

7.6 The next MTFP will be presented to members to adopt at Council on 17<sup>th</sup> February 2016 including recommendations from Executive and Corporate Business Scrutiny.

## 8 Budget Setting Risk Management

8.1 There are a number of risks that should be considered in setting the budget for 2016/17. These are outlined in the table below:

Risk
Agreed savings for 2015/16 are not achieved resulting in overspends and budget shortfalls in future years.
Fees and Charges do not generate the expected income in 2015/16 with knock-on effects in future years.
The level of Council Tax for 2016/17 is reduced resulting in a funding shortfall.
Government funding is reduced at a faster rate than expected and/or the New Homes Bonus Scheme is revised or ended
The assumed increases in Fees and Charges for 2016/17 onwards are not agreed.
A pay award above 1.5% from April 2016 is agreed.
Interest rates rise above 0.5% earlier than expected.
Inflation rises faster than expected resulting in increasing costs.
Investments do not generate the forecast return on investment.
An unforeseen event occurs which requires significant financial resources.

## 9 Implications/Conclusion

9.1 Information on any corporate issues and consultation associated with this report can be found within **Essential Reference Paper A**.



## Background Papers

None

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