

EAST HERTS COUNCIL

CORPORATE BUSINESS SCRUTINY – 30 AUGUST 2016

REPORT BY THE EXECUTIVE MEMBER FOR FINANCE & SUPPORT SERVICES

FINANCIAL STRATEGY AND MEDIUM TERM FINANCIAL PLAN FROM 2016/17 TO 2020/21

WARD(S) AFFECTED: All

Purpose/Summary of Report

- To consider revisions to the Financial Strategy for the years 2016/17 to 2020/21. 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.

RECOMMENDATIONS FOR CORPORATE BUSINESS SCRUTINY:

That:

(A)	Scrutiny consider the Medium Term Financial Plan from 2016/17 to 2020/21 and make recommendations to Executive on any revisions that should be considered in terms of the planning assumptions used.

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 1 March 2017 for their approval.

2 Report

- 2.1 This report considers and outlines the underlying assumptions within the Medium Term Financial Plan (MTFP). The report was rescheduled from the July round of meetings following the referendum vote to leave the European Union on 23 June 2016 to allow any immediate impact to be considered.
- 2.2 There will be significant financial implications for the Public Sector as a whole however until the Government formally triggers Article 50 to start the 2 year period of negotiation with the EU the status quo is maintained. During this period the UK still retains the full rights and obligations as a full EU member state.
- 2.3 There is uncertainty with regard to the future of projects and initiatives funded by the EU. In the short term the award of funding from the European Rural Development Programme for England (RDPE) administered by East Herts Council on behalf of the Local Action Group has been suspended.
- 2.4 The impact on Local Government upon leaving the EU may have significant impacts on funding from Government, regulatory changes (e.g. procurement rules) and the impacts of changes to wider society and the economic environment.
- 2.5 There will be a continued assessment of the impact to the council as a result of the referendum vote to leave the EU and this will continue to feature in future updates to the MTFP.

2.6 This report addresses key areas in the following sections:

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 17 February 2016. 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 2016/17 Local Government finance settlement the allocation of Revenue Support Grant was £1.145m, a reduction of £0.912m (44%) compared to the 2015/16 allocation.

3.2..2 This funding source is forecast to reduce to £0.351m in 2017/18 reducing to zero from 2018/19 onwards. The Council will need to consider how to mitigate this by growing business rates and other income sources.

3.3 Non Domestic Rate income (NDR):

3.3..1 The 2016/17 NDR income estimate is £1.956m.

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 2016/17. RPI inflation from Sept 2014 to Sept 2015 was 0.8% 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. The Government announced in the Budget in March 2016 that consultation will

begin in summer 2016 on the implementation of 100% business rates retention in 2019/20. A number of working groups have been set up by the LGA to facilitate this consultation work.

- 3.3..4 It is anticipated that the implementation of 100% business rates retention will be accompanied by additional responsibilities and therefore an increase in the costs borne by Local Government. The details of these responsibilities are to be confirmed.
- 3.3..5 In the light of the extreme uncertainty surrounding the implementation of 100% business rates retention the MTFP has included a forecast NDR income in 2020/21 based on current assumptions. Following the consultation period and the publication of the mechanisms within which the scheme will operate this forecast will be updated with the implications on NDR income levels and any increased costs passed to Local Government.
- 3.3..6 In the meantime a number of changes will be implemented from April 2017. Small Business Relief will be doubled to 100% for properties with rateable values of £12k and under and be tapered for properties between £12k and £15k. The threshold for the Business Rates Multiplier will also increase to a rateable value of £51k reducing the number of businesses liable to pay the higher rate.
- 3.4 **Section 31 Grant:** The estimated income for 2016/17 of £0.712m 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 2016/17 is £0.917m. 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:**
 - 3.6..1 The MTFP assumes that the Council Tax demand made by East Herts Council will increased in 2017/18 by 2.0% followed by 2.0% rises in each subsequent year until the end of the MTFP period in 2020/21.
 - 3.6..2 The additional revenue generated by increasing Council Tax demands from 1.0% to 2.0% will be ring-fenced to contribute to the Collection Fund Reserve to smooth out anticipated future fluctuations in NDR income in the transition to 100% business rates retention.

3.6..3 District Councils may increase Council Tax by up to £5 on a Band D property (approx. 3.2% for East Herts Council).

3.7 New Homes Bonus:

3.7..1 The 2016/17 allocation of New Homes Bonus from the Department for Communities and Local Government (DCLG) is £3.6m. This is made up of incremental allocations from 2011/12. This is illustrated in Chart 1 below.

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. Several options for reforming the New Homes Bonus have been consulted upon by DCLG in spring 2016.

3.7..3 DCLG outlined their preferred options and the New Homes Bonus allocations in future years have been modelled on that basis.

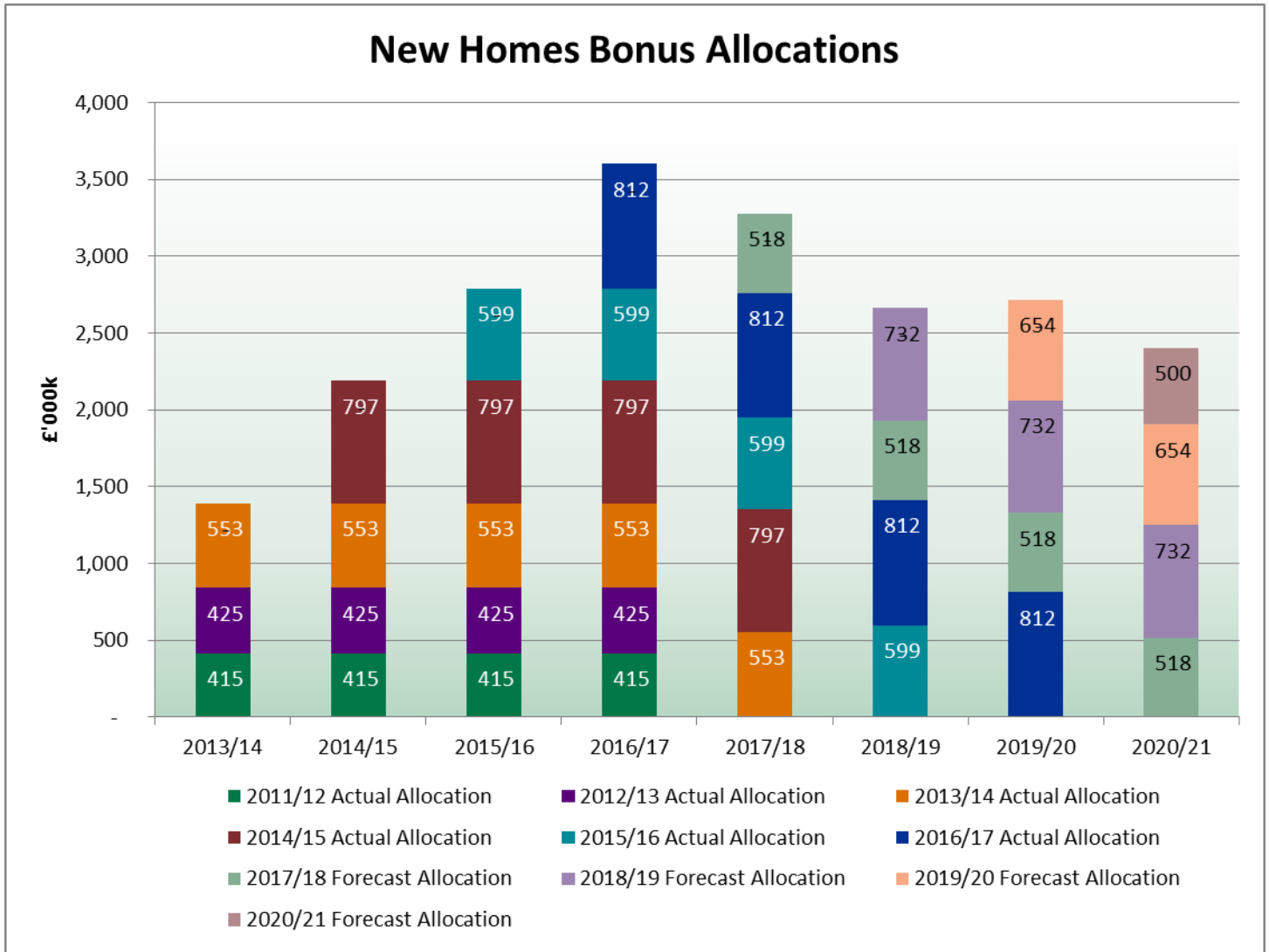
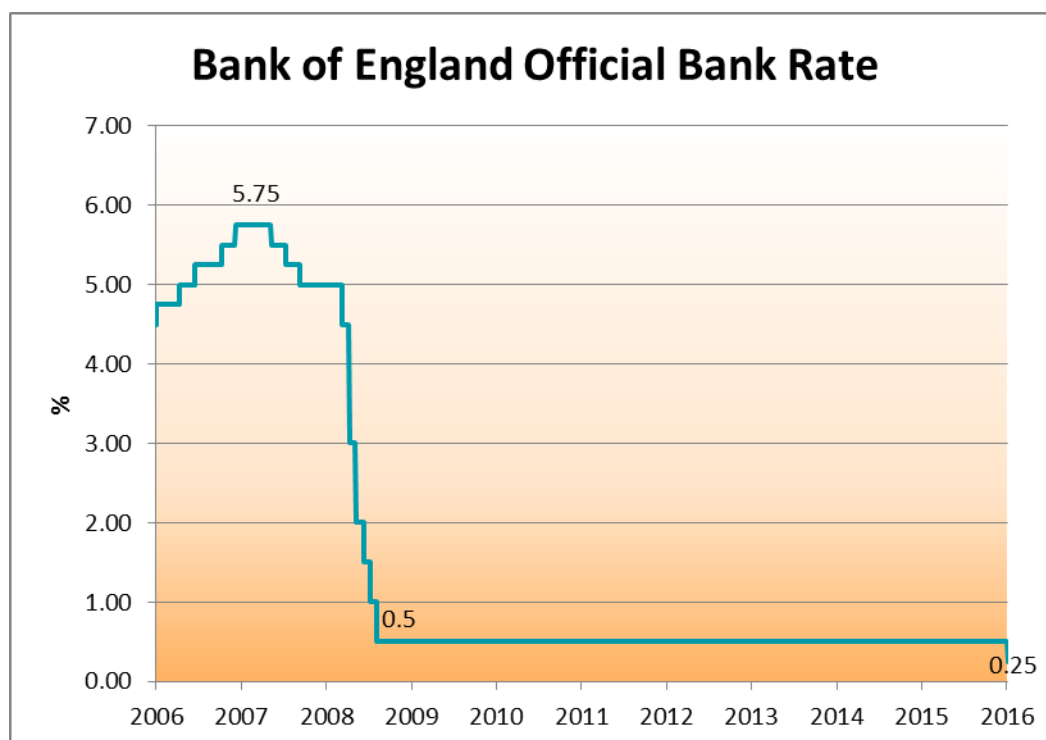


Chart 1: New Homes Bonus Allocations and Forecast

3.8 Investment interest:

3.8..1 The forecast income generated from investments placed on behalf of the council in 2016/17 is £843k. This figure has been reduced by £24k since the last version of the MTFP. The Bank of England Monetary Policy Committee (MPC) voted to reduce the base rate by 0.25% to 0.25% on 4 Aug 2016. The recent history of the base rate is shown in Chart 2 below.

Chart 2: Bank of England Official Bank Rate



- 3.8..2 The impact of this reduction is that income generated from short term investments is likely to fall. This shortfall can be funded from the Interest Equalisation Reserve should it be required.
- 3.8..3 The long term investments in Property Funds continue to perform well following the referendum vote to leave the EU. There are two elements to these investments; the capital unit value and the revenue rental return. The capital unit value fell by an average of 1.2% in July 2016 although the performance year to date is flat. The revenue rental returns do not appear to be adversely affected and are performing well. The continued performance of the Property Fund investments will continue to be closely monitored.

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 Following the referendum to leave the EU there is a new Prime Minister, Chancellor of the Exchequer and a new ministerial team at

the DCLG. The effect of a new Government being formed on the future funding allocation to Local Government is unclear. There has been no emergency Budget and the next budget will follow the usual cycle in the autumn.

- 4.4 The DCLG are continuing with their work on 100% NDR retention with a target implementation date of 1 April 2019 with no indication that this will be affected by the referendum vote.
- 4.5 The continuation of the New Homes Bonus scheme in its current form is also uncertain. This source of funding will be revised following a consultation process the results of which are not yet known. The implementation of a revised scheme is expected from 1 April 2017.
- 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 development of devolution within Local Government. The impact on East Herts is not yet quantifiable 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 March 2016 and balances based on the draft final accounts are summarised in **Essential Reference Paper E**.
- 5.3 At 31 March 2016 general reserves totalled £5.043m, a reduction of £0.124m during 2015/16. The general reserve balances are within the maximum level of reserves set out in **Essential Reference Paper E**.
- 5.4 At 31 March 2016 earmarked reserves totalled £11.601m. Net transfers out of earmarked reserves during 2015/16 totalled £2.218m including transfers from general reserves. This included the following appropriations:
 - £1,068k Collection Fund deficit transferred from the Collection Fund Reserve to fund NDR appeals provisions.

This will smooth the effect of income volatility in NDR funding in future years.

- £1,000k utilised to from the Pension Fund Additional Contribution Fund.
- £380k utilised from the Transformation Fund to fund one-off investments in service improvement.
- £265k utilised from the New Homes Bonus Priority Spend reserve including funding the Stamp Duty Land Tax costs associated with the purchase of the site on Old River Lane.
- £771k transferred into the Commercial Property Fund to support the development of commercial investment opportunities.

5.5 These reserve movements are summarised in the table below:

	Balance at 31 March 2015 £m	Balance at 31 March 2016 £m
General Reserves	5.167	5.043
Earmarked Reserves	13.819	11.601
Total Reserves	18.986	16.644

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 currently underway 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 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 2017/18. 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 1 March 2017 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 2017/18. These are outlined in the table below:

Risk
Agreed savings for 2017/18 are not achieved resulting in overspends and budget shortfalls in future years.
Fees and Charges do not generate the expected income in 2017/18 with knock-on effects in future years.
The level of Council Tax for 2017/18 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 following DCLG consultation.
The assumed increases in Fees and Charges for 2017/18 onwards are not 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.

Risk

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

Budget Report to Executive; 17 February 2016.

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