ARUN DISTRICT COUNCIL

REPORT TO AND DECISION OF CABINET on 16 NOVEMBER 2015

PART A : REPORT

SUBJECT: Financial Prospects 2015/16 to 2020/21	
REPORT AUTHOR: Head of Finance and Property EXTN: 37558	DATE: October 2015

EXECUTIVE SUMMARY:

The Council's Medium Term Financial Strategy (MTFS) covering the period up to 2020/21 rolls forward the data in the existing approved MTFS. The strategy amends certain assumptions contained in it to reflect changes in the Council's circumstances and other issues that have a strategic bearing on the Council's financial prospects.

RECOMMENDATIONS:

1. Agree the core assumptions set out in the Medium Term Financial Strategy and the current financial position
2. Allocate £8M of Capital Receipts to part finance the proposed new Leisure Centre plus further receipts if they become available
3. Note and agree the significant risks to local government finance that have been clearly outlined in the report
4. Agree the principle that the Council delivers future budgets within the recommended scenario contained in section 2.6 of the report
5. Note the increasing projected budgetary deficit and agree proposed financial targets for services to meet when formulating plans, within the Vision work, to move the Council towards a balanced budget as set out in the report
6. That the Medium Term Financial Strategy be used to set the Budgetary framework in preparing the 2016/17 budget

1. BACKGROUND:

1.1 A number of presentations have been made to groups of Members explaining the evolving financial situation, culminating in a brief presentation to a Vision workshop on 23rd July when the Chancellor's announcements (21st July 2015) of possible cuts to funding, to unprotected departments, of 25% and 40% were explored. It was explained that this would be hard to quantify under the current grant system, which is based on growth in housing numbers and Business Rates, but will, inevitably, lead to a significant decline in funding for the Council. The current assumptions based on growth have been input into the financial model which uses a wide range of strategically important financial assumptions and variables to obtain an informed view on year end balances, and to quantify the potential of any capital programme resources whilst maintaining a minimum level of balances of £4million. The assessment of the various assumptions is always considered carefully taking a prudent view. An important point to appreciate with a financial strategy is that it consists of a series of assumptions using the best available information to inform a financial forecast. In the current period of public sector funding austerity as announced by the Chancellor, the MTFS needs to strongly influence current and future policy decisions to ensure the Council is capable of living within the reducing financial sources it will have over the term of this parliament. The announcement by the Chancellor on 5th October regarding Councils retaining business rates has added further uncertainty but it is assumed that the basic tenet of 25% to 40% cuts will apply. It is highly unlikely that the recent announcements will stave off cuts that we have been expecting for local government and the only change is likely to be the mechanism how the Government extracts those savings from local government.

1.2 It has been considered necessary to make changes to some of the previous assumptions to address the recent announcements by government which have, on the whole, been detrimental to the Council's financial position. The principal assumptions made are:

- Council Tax increases by 2% per annum, in the recommended option, which is broadly in line with the previous strategy, and will start to address the reduction, in real terms, of the Council Tax Income Base which has been frozen for 5 years.
- Salary costs increase by 1% for 4 years until 2020/21 to reflect the Chancellor's announcements on public sector pay but this may have to be revisited if recruitment and retention difficulties are experienced.
- A prudent assumption has been made that the local scheme of Council Tax Support will not be amended for 2016/17 only and the Council will meet the deficit created by the reduction in Central Government funding but a conscious decision by Cabinet is required to reduce the cost of it by no later than 2017/18. Whilst the 'no change' in 2016/17 is difficult to quantify it will have a detrimental effect upon the MTFS.
- The current two-tiered system of basic and additional state pension will be replaced by a single tier pension in April 2016 which will result in the loss of the current 3.4% NIC contracting out rebate available to the Council which equates to growth of approx. £200k p.a.
- There is currently no precise information available from the pension fund's actuaries surrounding the impact of the triennial revaluation but an assumption has been made that employer pension contributions will continue to rise at 1% per annum under the current stability agreement. The Council currently also pay approx. £1m p.a. to address pension back funding issues and this is currently financed by a specific reserve, although this is currently forecast to be exhausted by 2019/20. If we are unable to replenish this reserve there will be a

commensurate increase (£1M p.a.) in the revenue budget thereafter.

- The details of the first major contract tendering processes are emerging and this has been reflected in the financial model. The financial implications of the current proposals for a new long term cleansing contract are included within both scenarios. Officers are currently reviewing alternative options for this large contract that will be bought back to Cabinet in 2016. This work may enable the impact shown within the two tables later in this report to be modified beneficially.

1.3 It is apparent that the points, outlined above, have had a negative effect on the MTFS and that significant savings will be required in the near future, as illustrated by Appendix A. The strategy is also heavily influenced by the decision to proceed with the new Leisure Centre at Littlehampton. The strategy proposes to earmark £8M of Capital Receipts towards the project and it is anticipated that the remainder of the projects estimated cost will be financed through a combination of grants, borrowing and possibly a revenue contribution. It is important to note that any savings from a new leisure contract are heavily dependent upon a new leisure facility being open in Littlehampton by no later than April 2019.

1.4 The enhancements to the capital programme which are recommended later on this agenda have also been included in the appropriate year along with the expenditure required for the Leisure Centre. The inclusion of future capital schemes, for financial modelling purposes, does not necessarily dictate that these schemes will be included in future budgets. The MTFS has assumed that we will continue with the previously agreed phased projects (e.g. Beach Huts and Public Toilets etc) in 2016/17 and an additional income generating scheme (Marine Park Gardens Café) has been included following the success of Hotham Park Café. From 2017/18 a figure of approx.£1M p.a. has been included to provide for a basic capital programme and to carry on with the essential investment in our infrastructure/assets. There will also, inevitably, be a requirement for additional investment in our IT systems and infrastructure as systems fall out of maintenance/support and become life expired.

1.5 It was explained in the report, to last September's (2014) Cabinet, that the most volatile and significant variables were New Homes Bonus (NHB) and Retention of Business Rates and that these are driven by the Government's growth agenda. This remains the case and the situation has been further confused by the recent announcements from Central Government outlined in para 1.1 above so whilst the direction of central government funding is known the detail at an individual local authority level remains uncertain. What is certain is there will be progressively less Government financial support available to councils.

1.6 The short term favourable effects of both NHB and the retention of Business Rates are more than offset by an assumption in the model that the level of Revenue Support Grant (RSG) will reduce to zero by 2018/19 i.e. a reduction of around £1M per annum. This assumption has been based upon figures provided by a firm of Local Government economists who are retained by the West Sussex district councils. This will, obviously, be closely monitored and the financial model will be adjusted as details emerge.

1.7 The following section outlines a number of risks that are associated with the MTFS and how these may be mitigated.

2. **PROPOSAL(S):**

2.1 Risks

Whilst the preceding section refers to the short term net benefits that the Council will gain from the funding based upon local growth it is important that the associated risks are also examined and fully understood.

- It is considered probable that the Government will announce a fundamental change to the current funding system based upon growth as it is considered inequitable across the country and there could be a switch to a more needs based system of support. However, it is not currently possible to model any future distribution mechanism. As referred to above this is further complicated by the recent central government announcements on potential public sector cuts and Business Rates redistribution and how this will be incorporated into the local government funding system.
- Whilst we have used the best available information there is a risk that the level of business rate appeals will be more than has been anticipated and this risk lies with local government. In partnership with other West Sussex districts and the County Council a software package has been purchased which uses an algorithm to calculate the level of appeals which should provide the best possible estimate. To mitigate the risk of appeals Cabinet has approved the setting up of a Business Rate Equalisation Reserve which currently stands at £1.4M.
- The levels of NHB have been relatively buoyant to date but this could easily change if the level of house building tailed off in the District and this is being closely monitored on a monthly basis. The risk of this occurring is not helped by the delay in being able to adopt a Local Plan.

2.2 The most serious financial risk that the Council is facing is the fundamental change in Local Government funding as outlined in the first bullet point above. Whilst the extent of cuts on Arun remains unknown it is vitally important to mitigate against such significant risks. The most effective mitigation against this risk is firstly to hold sufficient balances to ensure that the Council has enough time to plan and implement any reductions in expenditure and are not obliged to make ill informed decisions which, again, is illustrated by Appendix A and secondly to set a corporate target for reducing the forecast budget deficit and deliver agreed savings as soon as possible.

2.3 It is clear, however, using the information currently available in the financial model, that the Council is consistently operating with an increasing deficit budget and there are a number of very serious risks, as outlined above, which could easily exacerbate the situation. The Council is determined to formulate plans to eliminate this deficit through reductions in expenditure and increases in income.

Following the Council's Peer Review in March 2014, the Council has held three informal Member Workshops (10 February 2015, 23 July and 22 October 2015) to discuss the Council's Vision for 2020 and beyond.

The programme of work has been established to help provide the strategic direction the Council needs to become more effective and sustainable, whilst meeting the demands placed on the Council. The Member Workshops to date have highlighted that the Council needs to work towards:

- Offering a better customer experience
- Strengthening external relationships
- Providing more digital and online services
- Becoming smaller and more effective

Once firm proposals emerge they can be input into the financial model and it should be stressed that early savings will have the most positive impact on the bottom line so this should be a key consideration of the Vision discussions.

2.4 To ensure Members understanding of the financial risks that the Council needs to address, two examples have been modelled and summarised below.

2.5 <u>Base Model</u>

2.5.1 Includes the currently approved Council expenditure and controllable and uncontrollable income. This baseline model includes the Cabinet proposal in July concerning the scope of the tender specification for the minimum ten year cleansing contract. It also includes an assumption of not increasing Council tax over the period of the MTFS and only increasing controllable fees and charges by inflation. It is worth noting that 2016/17 is skewed by the receipt of a one off S.106 payment which will result in a decrease in the net expenditure

2.5.2 The effect of the above assumptions are summarised in the table below:-

	2015/16 £'000s	**2016/17 £'000s**	**2017/18 £'000s**	**2018/19 £'000s**	**2019/20 £'000s**	**2020/21 £'000s**
Net Expenditure	24,598	22,866	24,991	24,967	26,884	27,462
Deficit	1,462	+537	1,782	2,259	4,501	4,880
Balances	10,573	11,110	9,328	7,069	2,568	-2,312

Note: It is forecast that we will go below the minimum level of balances (£4M) in 2019/20

2.5.3 This modelling clearly highlights that this is not a sustainable financial position as by 2017/18 there will be a deficit budget of almost £2M and forecast to grow to almost £5million and balances are below the minimum level of £4million by 2019/20 requiring the Council to make significant revenue savings from a greatly reduced revenue budget base (which excludes the cost of major contracts as decisions will have already been taken committing the Council to long term contracts that cannot deliver further savings). This means the remaining revenue budget that the Council can influence would have to be reduced by an unrealistic percentage. It would therefore not be possible for the remaining services to find all of this unless the Council is proposing to stop delivering a large number of its existing services.

2.6 Recommended Scenario

2.6.1 Includes assumptions that all sources of controllable income will increase across the life of the MTFS i.e. Council Tax increases by 2% (or higher if referendum legislation allows) per annum and all other controllable fees and charges (this would mainly be car park income) increase by at least 10% in year one and are maintained at that level thereafter by further annual increases of not less than inflation. The Council's external auditors highlighted in 2015 that "*…the value of income from fees and charges although increasing remains below average*" so this would seem to support this approach.

2.6.2 The effect of the above income assumptions are summarised in the table below:-

	2015/16 £'000s	**2016/17 £'000s**	**2017/18 £'000s**	**2018/19 £'000s**	**2019/20 £'000s**	**2020/21 £'000s**
Net Expenditure	24,598	22,736	24,837	24,781	26,646	27,166
Deficit	1,462	+851	1,253	1,502	3,490	3,602
Balances	10,573	11,424	10,171	8,670	5,180	1,574

2.6.3 This demonstrates the tangible improvement if the opportunity is taken to increase Council Tax and other controllable sources of income. .This scenario however also highlights the strategic importance of all parts of the Council's services, be they internal or delivered by contracts, contributing to the significant savings required by 2017/18 to help contain the growth in the deficit budget and have any prospect of ever achieving a balanced budget. This approach, if agreed, will need to be further developed as significant further savings are still required and it is extremely unlikely that such savings can be achieved by just a realignment of services through efficiency, outsourcing or sharing services from within the remaining budgetary base. Furthermore, as outlined above, the funding available from Central Government will, in all probability, assuming the Chancellor delivers on his deficit reduction plans potentially, be significantly less than is assumed in the forecast.

2.7 The financial resilience of the Council was raised by the Council's external auditors Ernst & Young in their Annual Audit results report in September

2015. In the report the auditors identified a risk *"…financial pressures on the Council are increasing and its financial resilience is continuing to reduce…".*

2.8 The Auditors also highlighted that the *" given its current relatively high level of net expenditure and low levels of income there is a growing imperative for the Council to change. This is recognised as part of the Council Vision 2020 strategy and programme".* However it goes on to state that *" the Council is still considering what it might look like in the future and as yet no firm decisions have been made. The impact of the changes on services and finances is therefore not yet known, and the Council is not yet at the stage where a medium term savings plan has been established".*

2.9 The Vision work, therefore, has to explicitly agree clear plans to address the budgetary deficit which rises steeply as government funding is projected to reduce and the pensions reserve is, potentially, exhausted. This strategy will certainly have to be revisited later in the year once more detailed public sector funding deficit reduction plans emerge from Central Government but in all probability the position is extremely unlikely to provide any improvement in the Council's medium term financial position. It should be stressed that the examples illustrated above, and in the graph, make no allowance for savings emanating from the Vision work and, in practice, measures will be taken to ensure that balances do not become exhausted. Also the Council has faced similar situations in the past and has formulated deficit reduction plans although the situation, inevitably, becomes increasingly difficult.

2.10 The Council is working with other local authority partners and through the Local Government Association to seek a variety of freedoms and flexibilities from Central Government around devolving certain matters to the local area and to permit authorities to determine locally matters to do with uncontrolled fees and charges. If such current negotiations are eventually successful this may provide some improvement to the current assumptions contained in the MTFS but at this very early stage cannot be estimated or relied upon for financial planning purposes.

3. OPTIONS:

To accept the option outlined in the strategy

To not accept the assumptions outlined in the strategy

4. CONSULTATION:

Has consultation been undertaken with:	YES	NO
Relevant Town/Parish Council		X
Relevant District Ward Councillors		X
Other groups/persons (please specify)		X

5. ARE THERE ANY IMPLICATIONS IN RELATION TO THE FOLLOWING COUNCIL POLICIES: (Explain in more detail at 6 below)	YES	NO

Financial	X	
Legal		X
Human Rights/Equality Impact Assessment		X
Community Safety including Section 17 of Crime & Disorder Act		X
Sustainability	X	
Asset Management/Property/Land	X	
Technology		X
Other (please explain)		X

6. IMPLICATIONS:

To formulate the Council's Financial Strategy and to inform any consequent decisions on capital investment and revenue savings plans to be taken by Full Council and Cabinet.

7. REASON FOR THE DECISION:

To formulate the Council's Medium Term Financial Strategy and set the financial context and framework for decisions to be taken by the Council

8. BACKGROUND PAPERS:

https://www.gov.uk/government/news/spending-review-launched-by-chancellor