Chichester District Council

CORPORATE GOVERNANCE & AUDIT COMMITTEE 23 November 2017

Financial Strategy and Plan 2018-19

1. Contacts

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2. Executive Summary

The purpose of this report is to assist Cabinet in updating the Council's financial strategy and action plan to help guide the management of the Council's finances during a period of diminishing resources, and to build upon the work already achieved in this area in previous years.

The Council currently anticipates further government funding reductions over the course of the remainder of this parliament which, without intervention, would create a deficit in our revenue position that must be addressed if we are to comply with the legal requirement of setting a balanced budget each year. This report sets out the key financial principles and actions that will assist in this process.

The challenge facing the Council remains being able to provide services that meet community needs with a significantly reduced overall level of government resource.

The key recommendations from this report will help to formulate the 2018-19 budget, and level of Council Tax.

3. Recommendation

That the committee consider and recommend to Cabinet:

3.1. **In the short to medium term the Council maintains a minimum level of reserves of £5m for general purposes.**

3.2. **To maintain the current provision of £1.3m of revenue support due to a number of uncertainties and risks within the financial strategy model.**

3.3. **The Council should continue to aim to set balanced budgets without the use of reserves, although some use of reserves in the short term may be necessary.**

3.4. **That in order to achieve a balanced budget over the medium term, officers should monitor delivery of the agreed deficit reduction plan.**

4. Background

4.1. The Council's 5 year Financial Strategy and the principles contained within it underpin the forthcoming budget cycle. The Council has an approved deficit reduction plan and took up the government's four year funding offer in the 2017-18 budget cycle to help provide some degree of certainty. However, the outcome after the snap general election in 2017 and Parliament working towards the country's exit from the European Union in 2019 are events that are having a broad impact on the economic climate both nationally and locally. In addition with the recent Bank of England Base Rate rise to 0.50% in November and continued inflationary pressures in the economy this could affect consumer spending, which is a significant driver in the UK economy.

4.2. Since much of the Council's income is related to the state of the economy in the form of retained business rates, fees and charges, this raises some challenges when forward planning. The Council, therefore, has to maintain a prudent and robust approach to its medium term financial plan, in order to manage service delivery with increasing costs, whilst also addressing continuing reductions in available government resource.

4.3. **The 2018-19 Settlement**

The 2017 spending review is not expected until 22 November, after this report will have been published, and so officers will therefore provide any relevant update at the meeting. Due to the Council's acceptance of the multi-year settlement offer, the 2018-19 settlement in relation to those specific funding sources included in that arrangement are already known. Any changes in responsibilities or the government's need to take account of future events will be announced in the provisional settlement in late December.

4.4. One event of interest will be in relation to the announcement of the successful pilot scheme bidders for the 100% localisation of business rates for 2018-19. The Council were part of the West Sussex bid submitted to the Department of Communities and Local Government (DCLG) to participate in the pilot scheme, following the authority granted to officers by Cabinet at its October meeting. The outcome of the bidding process will be announced as part of the draft funding allocations in late December.

4.5. The Government have yet to confirm the referenda principles for excessive council tax increases for shire authorities, but have consulted on the option of either a 2% increase or £5 whichever is greater. This helps low taxing authorities such as Chichester, as a small percentage uplift would benefit us much less than some other authorities that have higher council tax levels. If confirmed, this means that this authority will be able to increase council tax in 2018-19 by either 2% (which will generate additional income of approximately £156,000), or take up the option of a implementing a £5 increase (which will generate a further £104,000 of income). The higher increase of £5 has been assumed in the 5 year model for 2018-19, but the final decision will be made by the Council once the settlement has been confirmed. Also since the Government set these referenda thresholds annually, the five year model assumes a 2% per annum increase for 2019-20 and beyond.

4.6. **Beyond 2018-19**

The Government's fiscal policy after the 2017 general election has perhaps become less clear recently. However, it is still anticipated that the past significant funding reductions for local government is a trend that will continue for the foreseeable future, as the Government tries to address particular pressures in other demand led services in both local government and the National Health Service. It should be noted that 2018-19 is the third year of the multi-year settlement arrangement.

4.7. Whist it is still anticipated that the Government will implement full localisation of business rates (Non-Domestic rates or NDR), there are some early indications that this might be later than the widely anticipated date of 2020, when the current funding settlements are due to end. Even with the full localisation of business rates, the scheme will still have tariff and top-up payments. This will redistribute NDR income away from authorities such as Chichester where the income would be in excess of our perceived need for funding, to other areas where need exceeds NDR income.

4.8. The 100% Business Rate Pilot for 2018-19 is only for one year, and it is unclear from the Government whether the new pilots agreed would continue after the pilot year, even if the full implementation of the localisation of business rates is delayed. However, it should be noted that if the West Sussex pilot bid is successful then the assumed additional income of £23m will be pooled, so there is no impact on the 5 year model.

4.9. If the bid is unsuccessful, the Council has indicated that its preference is that the existing pooling arrangement with the other councils; Arun, Adur, Worthing and West Sussex County Council should continue to be operated in 2018-19. This enables the authorities to divert some business rate growth that would otherwise have been paid to the government into the local pool. The operation of the pool in 2017-18 is forecast to retain £3m. This is then available to fund growth related projects that benefit the whole county area. It is therefore recommended we continue to participate on the West Sussex business rates pool.

4.10. The Government continues to consult and refine the operation of the New Homes Bonus scheme (NHB). As part of the 2017-18 settlement announcement the Government decided to reduce the number of years for previous housing gains from 6 to 5 years in 2017-18, and then to 4 years from 2018-19, and set a national minimum baseline for housing growth at 0.4% as an incentive for councils to deliver more homes. Below this level no NHB is paid, and the Government also retained the option to making adjustments in 2018-19 and future years if necessary. It would appear that the Government is considering the allocation mechanism and how to ensure that authorities are planning effectively for new homes from 2018-19. At present the Council, in line with one of its key financial principles does not use NHB funding to balance its revenue budget.

4.11. The 5 year financial model (Appendix 2) has been updated to reflect the officers' best estimates of what may occur in 2018-19 and beyond. The model assumes the deficit reduction plan will be delivered on schedule, together with further savings and investment returns managed by the Commercial and

Business Improvement Programme Boards. This model will be kept under review so that the Council has time to respond should the situation, and government funding, deteriorate faster than currently predicted.

4.12. The four year funding offer that the Government announced alongside the 2016-17 settlement has been built into the 5 year model, and covers the period 2016-17 to 2019-20. Officers have therefore had to make assumptions beyond that period.

4.13. The Council has completed a number of investment and asset realisation opportunities in 2017-18 using the specific reserve available and will continue to add to this reserve any expected surplus from budget forecasts, so new opportunities can be pursued by the Estates Service in the future. This helps reduce the Council's dependency on central government funding, benefits the economy and brings community benefits.

4.14. As part of the treasury management and investment strategies the council has invested £10m in the Local Authority Property fund and a further £8m in mixed asset bonds during 2017-18. These pooled investments in property and mixed asset bonds offer greater diversity and are backed by assets providing security over the longer term. Whilst they offer slightly lower income returns than our own in house property investments (circa 5% versus 8 – 9%) they do offer an alternative source of relatively good returns for long term balances, with only modest capital risk, as compared to traditional Treasury Management cash deposits which currently generate less than 1%. The income received from these investments is reflected in the revenue budget to assist with the deficit reduction plan and are expected to realise over £660,000 per annum.

4.15. Appendix 3 sets out our current level of reserves, the commitments against those reserves, and therefore the potential funds available for the Council to invest in new schemes.

4.16. **In addition to government funding, other uncertainties and risks still remain which will impact on the Council's financial position, and make forecasting budgets more difficult**. These include:

- **Income from Fees and Charges.** The Council currently relies on £16.4m pa of income from its fees and charges to balance its budget. Much of this is discretionary spending, or linked to the economy.

- **The effects of inflation**. Inflationary pressures are growing in the economy, as the current rate is above 3% such that the Bank of England raised the Base Rate by 0.25% in November 2017, the first rise for 10 years. The overall effect of inflation on the Council's budgets is fairly neutral as expenditure inflation is largely offset by income inflation. However, some services have struggled in recent years to pass on the effects of inflation in setting their fees as customers are unable or unwilling to bear the increased cost. Fee levels have not kept pace with inflation in all services.

- **Pay settlements.** Following repeated pay freezes, local government has returned to limited increases of 1% in the past few years. While the current Government has allowed for certain areas of the public sector to

have slightly higher pay settlements, this is not across all sectors. So there is a risk over the longer term of increased pressure on national pay negotiations, especially if private sector pay increases outstrip the public sector. The current 5 year model assumes a 2% increase per annum. Some services have already struggled to recruit staff, especially where we are competing with the private sector, and some limited use of market supplements has had to be offered to fill vacancies. A pay review project is currently underway to address the pay structure at the Council, with £300,000 built into the 5 year model.

- **The localisation of Business Rates.** This brought both opportunity and risk, as a change in the business rate base locally will directly impact our funding. Localisation brings with it volatility as losses on collection which will largely fall on local councils in future rather than on the national pool. Also in April 2017 a new valuation list came into effect, and so the extent of potential appeals and any provision required is an unquantifiable risk. Whilst the localisation of NDR may present an opportunity to retain more growth all of the other associated risks are likely to remain.

- **The localisation of Council Tax Reduction (CTR)**. Currently, expenditure on this continues to fall since the original budget was set in 2016-17. However, localisation means that any increase in demand for support will have to be met locally in full in future.

- **Council Tax increase**. Last year Council took advantage to secure recurring income by option to take up the new freedom to low taxing authorities to increase their council tax by £5 rather than 2%. The Government set the increase "limits" annually i.e. the limits above which a referendum must be held. The criteria to apply for 2018-19 have yet to be confirmed, paragraph 4.5 sets out the assumptions applied in the 5 year model.

- **Welfare reform**, including changes to Housing Benefit cap and the phased introduction of Universal Credit, which will impact on certain services such as Benefits and Housing. The Council's updated discretionary housing payments policy for 2018-19 was approved by Cabinet in October 2017, to enable officers in the Benefits and Housing services to work together to ensure council's resources are used to best effect and to assist those most affected by the changes.

- **The New Homes Bonus** where funding is linked to growth in domestic properties, but is funded nationally by reducing the amount of government grant. This effectively, is a distribution of local government funding via a different mechanism, and is not new funding. The future of this source of funding is very uncertain, and is subject to a government review. In the current 5 year model officers have assumed reductions beyond 2018-19, but due to this funding source not supporting the revenue budget its impact is more on the future resources available for investment in one off expenditure rather than ongoing costs. The situation may become clearer after the Chancellor's autumn statement on 22 November.

- **Amended Waste Regulations and increased recycling targets.** New and tougher recycling targets and the need to separate out types of recyclate may drive substantially increased waste costs. An indicative estimate of £0.8m per year has been included in the 5 year model based on officer's current projections.

- **Cultural grants to the Chichester Festival Theatre and Pallant House Gallery.** These grants are to be fully funded from council tax as the earmarked reserves were exhausted in 2017-18.

- **Political environment.** The ongoing negotiations about the country's exit from the EU and the impact on the Council remain unclear. It is therefore too early to determine exactly how the withdrawal from the EU will impact on the Council. This will have to be continually reviewed and any impacts reflected in the financial model as and when they are known.

4.17. The Council took early action as the 2008 financial crisis started to emerge and has, from 2010-11 to 2015-16, achieved in excess of £8.6m of savings and increased income. In May 2013, members approved a £2.4m deficit reduction programme. This was exceeded and delivered £3.6m. In September 2016 the Council approved a further savings plan which sets out targets to deliver further savings / additional income of £3.8m. As savings are realised these are built in the Council's base budget and the 5 year financial model reflects the targets yet to be achieved as part of its plans. It has been via this medium term modelling that the Council has been able to plan ahead, and implement sensible and considered efficiencies in a timely fashion. This planning has helped to avoid making severe service cuts, yet thus far enabled us to balance our budgets, and invest in new priorities. Additionally it has enabled us to preserve the NHB funding for community benefit. A further benefit of careful planning has been that we have been able to implement a localised CTR in a way that has protected claimants.

4.18. The 5 year financial model (Appendix 2) has been updated to reflect current assumptions including government funding reductions and council tax projections, as well as projected costs and planned efficiencies. This includes provision for new cost pressures and bids for growth linked to the Council's corporate plan objectives; including housing, planning and the environment, amounting to £360k in 2018-19. These bids will be firmed up during the budget process and reported as part of the budget report to Cabinet in February 2018. It was also considered prudent to build in a contingency of £250k against the planned savings.

4.19. The model demonstrates a balanced budget over the next 5 years subject to delivery of the deficit reduction plan agreed in September 2016 and all of the other uncertainties set out above.

5. Outcomes to be achieved

5.1 The purpose of this report is to set out the key financial principles that should be applied over the short to medium term to help maintain a robust and balanced financial position for the Council, and which will be used to underpin the annual spending report in February 2018 to set the 2018-19 budget and Council Tax requirement.

5.2 This will help the Council to deliver its Corporate Plan objectives by having a sound financial position that is balanced over the medium term and enable investment in priority services.

6 Key Financial Principles

6.1 The financial principles that are used to underpin the Council's financial strategy and ensure a robust budget process are set out in Appendix 1. These are well established now, and have served us well in ensuring a sustainable balanced financial position over the medium term, and are recommended for continued use.

6.2 Treasury Management

6.2.1 The Council is required to agree its treasury management policy annually, and performance reports are also received during the year. The key objectives are security of the principal sums invested, and liquidity. Maximisation of investment return is a secondary objective. As such, removing revenue reliance on investment income not only strengthens the Council's financial position, but also reinforces the primary objective of the treasury management policy. However the use of the property fund and the mixed asset bonds enables the council to invest balances in long term funds which provide a predictable return that is being used to assist in closing the projected budget deficit.

6.2.2 The Treasury Management Policy, together with the Minimum Revenue Provision policy and Prudential Indicators are an integral part of the Financial Planning process, but they will be reported separately to Cabinet early in the New Year.

7 Alternatives that have been considered

7.1 The Financial Strategy is a vital tool for ensuring the Council continues to set a balanced budget even with all of the uncertainty and pressure faced by the Council in the current economic climate.

7.2 Various alternatives exist within the strategy and the 5 year plan. The NHB could for example be used to support revenue budgets, but this would be contrary to the financial principle of not using non-recurring income to fund recurring expenditure.

7.3 Although the financial model assumes certain levels of Council Tax increases, it will be for the Council to determine the appropriate level annually. For 2018-19 the Council Tax levels will be recommended by Cabinet at their February 2018 meeting for Council to consider at the March 2018 meeting.

8 Resource and legal implications

8.1 The financial principles will help to guide the management of the Council's finances over the short to medium term, and will underpin the budget process that will be reported to Cabinet in February.

9 Consultation

9.1 Corporate Governance and Audit Committee are asked to consider this report and make any recommendations as appropriate to Cabinet.

10 Community impact and corporate risks

10.1 The Council has taken action over the last five years to achieve a relatively strong financial position. However, there remains a great deal of uncertainty over the future with many different factors that may impact on the Council and change the financial forecast. The financial principles contained within this report will help the Council maintain its financial standing and protect valuable services to the community, whilst giving flexibility to respond to changes in the future.

11 Other Implications

Crime & Disorder:		None
Climate Change:		None
Human Rights and Equality Impact:		None
Safeguarding:		None

12 Appendices

12.1 Appendix 1 – Financial Principles

12.2 Appendix 2 - Five Year Financial Model.

12.3 Appendix 3 – Statement of Resources.

13 Background Papers

13.1 None