Report to Cabinet

24 November 2016

By Brian Donnelly (Cabinet Member for Finance and Assets)

DECISION REQUIRED

Not Exempt

Horsham District Council

Medium Term Financial Strategy 2017/18 to 2019/20

Executive Summary

The review of the Financial Strategy, as part of the budget setting process, enables a balanced budget target to be established with a focus on an affordable level of Council Tax, delivery of the corporate priorities and policies of the Council and the continued enhancement of value for money and satisfaction with services for the residents of the District.

The 2016/17 budget was set in February 2016 and future deficits were projected for 2017/18 through to 2019/20. Since then there has been a period of planning on a range of income generation ideas, continuing the business transformation journey to the next stage and other efficiency measures. This report sets out the proposed Strategy for the period 2017/18 to 2019/20 to establish the context for the Council's budget and medium term financial planning scenarios and assumptions.

Recommendations

That the Cabinet recommends Council:

i) note the projected budget gap detailed in paragraph 3.6

ii) approve the Medium Term Financial Strategy 2017/18 to 2019/20.

Background papers

Report to Cabinet

Wards affected: all

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Background Information

1 Introduction and background

1.1 The Medium Term Financial Strategy was last fully reviewed by Council on 24 February 2016 as part of the annual budget setting cycle. At that meeting a balanced budget for 2016/17 was set. Cabinet and Members have received a number of presentations since then to keep them informed of progress with the development of the new strategy.

1.2 The local government finance system is becoming increasingly complex. The difficultly of predicting what factors such as interest rates, Grant funding and energy costs will be in two to five years' time is further complicated by uncertainty regarding the financial impact of the government's welfare reform programme and future income from retained Business Rates. It is however certain that the amount of money available to district councils will continue to reduce over the next five years.

1.3 During 2016, officers have been working up plans to address the budget deficits that were projected for 2017/18 through to 2019/20. This has been done through a combination of a range of measures including income generation, continuing the business transformation journey to meet the demands and expectations of our customers, and other efficiency measures. Each year as the budget is set, unavoidable growth becomes apparent in the services. This is because of increased responsibilities from legislation, contractual obligations and inflationary pressures.

1.4 This review ensures that the 2017/18 budget and resultant Council Tax level will be set within the context of the Council's Corporate Plan priorities and the financial strategy in order to deliver a balanced budget, updated for the latest information and knowledge available to the Council.

2 Relevant Council policy

2.1 To deliver a balanced budget over the medium term.

3 Details

Strategic political, economic and regulatory outlook

3.1 The offer made by Government last year offer of a four-year settlement through to 2019/20 has been agreed. This provides a relative degree of certainty in that the Revenue Support Grant and the baseline Business Rates funding level won't get any worse during this period. However this does mean a £800,000 reduction in our government funding, which is 29% of the total.

3.2 The Local Government Association (LGA) has calculated that the total Core Spending Power of all Local Authorities (defined as baseline funding from government in paragraph 3.1 and income from Council Tax and Business Rates retention) will reduce by £6.75bn over the review period (2015/16-2019/20). More details of how this will filter through are likely to emerge in the Autumn Statement Spending Review scheduled on 23 November 2016. The Council's detailed financial settlement for 2017/18 will probably be communicated to us immediately prior to Christmas.

3.3 On 23rd June 2016, the EU referendum took place and the people of the United Kingdom voted to leave the European Union. Until exit negotiations are concluded, the UK remains a full member of the European Union and all the rights and obligations of EU membership remain in force. During this period the government will continue to negotiate, implement and apply EU legislation. It will be for the government to begin negotiations to exit the EU and the outcome of these negotiations will determine what arrangements apply in relation to EU legislation and funding in future, once the UK has left the EU.

3.4 The UK economic outlook has been affected by the vote to leave the EU in the short term. Whilst the long term future impact remains uncertain it should be noted that interest rate forecasts have been updated based upon outcomes to date, including the reduction of the Bank of England base rate, the widening of the quantitative easing programme which saw additional bond releases and the reduction in the credit rating of UK banks by investment firms. Interest rates are at historically low levels with significant increases now not predicted within the period of this MTFS. The value of the pound has also decreased significantly; by 20% against the U.S. Dollar and by 15% against the Euro. Conversely, the FTSE 100 share index has risen by around 10% since the referendum to approach 7,000. Inflation has started to increase in recent months putting pressure on expenditure, measured in September 2016 at 1% under the Consumer Price Index (CPI) and 2% under the Retail Price Index (RPI). The impact from the cost of fuel is also slowly rising.

3.5 Both the demand for the Council's services and its income streams are affected by the general economic health of the District, and the prevailing interest rate has a direct impact on interest receipts. Therefore the uncertainty of the economic and regulatory outlook adds risk to the setting of a precise financial strategy. With this in mind, the assumptions within the MTFS have been revisited in the sections below.

Budget assumptions prior to remedial action

3.6 Future budget projections are based on a number of assumptions. Table 1 sets out the budget assumptions at November 2016 and Table 2 the forecast revenue budgets in 2017/18 through to 2019/20. Details of the budget assumptions and the reasons for the change in assumptions are explained in the following paragraphs.

Table 1: Budget assumptions

	November 2016		
Budget Assumptions	**2017/18**	**2018/19**	**2019/20**
Pay award annual 1%	£175k	£175k	£175k
Inflationary pressures approx. 1.75% to 2.5%	£250k	£300k	£300k
Pensions revaluation approx. 1%	£125k	£125k	£150k
Minimum level of reserves	£6m	£6m	£6m
Reduction in RSG	£680k	£280k	£700k
Increase in dwellings	1,000	1,000	1,000
Increase in Council Tax*	0%	0%	0%

*Central government's assumption of a Council Tax increase by a district council is £5.

Table 2: Revenue budget prior to remedial action

November 2016	2017/18 £000	2018/19 £000	2019/20 £000
Net expenditure	13,378	13,884	14,777
Funded by: New Homes Bonus	800	500	200
Council Tax	8,376	8,504	8,631
Government grant - RSG	149	0	0
Government grant - transitional	134	0	0
Government grant - negative RSG	0	0	(695)
Government grant - Business Rates	1,915	1,972	2,034
Additional Business Rates retained	400	400	400
Payment to parishes	(10)	(0)	(0)
Total funding	11,764	11,376	10,570
Net deficit	**1,614**	**2,508**	**4,207**

Inflation cost pressures and interest rates

3.7 Local Government pay is negotiated nationally and the Council has no direct influence on the settlement. The local government pay award of 1% in May 2016 covered both 2016/17 and 2017/18. Given the potential prospect that inflationary pressures may drive further salary demands, a further 1% pay increase in 2018/19 and 2019/20 has been budgeted as well. In expenditure terms, this equates to approximately £175k of additional expenditure per annum.

3.8 Economic forecasters are predicting a diverse range on inflation over the next three years, reflecting the uncertainty of the post-Brexit era. The MTFS currently budgets for a 1.75% increase in inflation on the expectation that CPI will remain above the current 1% as a minimum, up to 2.5% by 2019/20. The Bank of England suggested in its November inflationary forecast this could be as much as 2.7% in 2017 and 2018. Whilst income is also affected by inflation, inflation also increases our expenditure that offsets the increases in Council Tax and charges. The impact of inflation on the MTFS will be revisited on a monthly basis as the monthly statistics are released by the Office of National Statistics. Likewise, the pension contributions of 1% will be revisited as information about the 2016 triennial revaluation of the Council's Pension Fund funding statement is finalised by the actuary.

3.9 The Bank of England base rate has recently fallen to a historic low of 0.25%, affecting the Council's income streams from investments. The Council has taken action over the past year to diversify the investment strategy into non-bank deposit holdings which should help to mitigate the effect, but nevertheless, this will impact on the Council's ability to generate income from investments during the period. Economic forecasters are again divided on when an upturn in interest rates may occur. The MTFS includes only a small increase over the three year period.

Council Tax

3.10 The government's 2015 Settlement funding assumptions assumed that all district councils would increase their Council Tax by £5 each year over the 4 year settlement period. The Council increased Council Tax by an inflationary 1.2% in

2016/17 which was the first increase since 2010/11. This raised an extra £100,000. It remains the lowest Council Tax in West Sussex and in the bottom quartile of all district councils.

3.11 For all other councils, central government assumed that Council Tax would rise by an inflationary forecast of 1.75% each year over the period. Using this inflationary measure as a proxy, a 1.75% p.a. increase in Council Tax raises approximately an additional £150,000 each year.

Localisation of Business Rates

3.12 From 1 April 2013 the structure of local government finance changed, with local authorities retaining a share of Business Rates collected in their area. The calculations are based on target rates of collection set by government and are somewhat complex, but resulted in the Council retaining around 5% of the £41m total collected, equating to around £2m. Local authorities can increase their business rate income by growing the business rate take in their area; conversely, if collections fall then local authorities bear an element of risk.

3.13 Historical data suggests a 'flat' picture with limited material Business Rates growth envisaged over the period of the MTFS, which is why the retained £400k additional business rate income remains static across the period. This area is a 'momentum indicator' where growth is more likely to continue where it is already taking place. At the moment, on average, every successful new business opening is offset by a conversion of a business premise to residential flats or a closure. In the first seven months of 2016/17, the rateable value declined by £620k. In the longer term, initiatives such as the development of North Horsham and the redevelopment of the old Novartis site may offer some upside but at the moment our economic growth as an area is way below the desirable level for affluence of its population.

3.14 In comparison with other authorities the Council is comparatively less at risk as it has relatively few single significant sites in respect of business rate valuations. For example, it is not the site of a power station, airport, major retail park or regional distribution centre. Some risk does exist however, principally around outstanding rates appeals for which the Council would have to bear its share of lost revenue should those appeals prove successful. The Council had a provision of £2m for business rate appeals at 31 March 2016. The slow rate at which the Valuation Office is tackling the backlog of appeals makes the Council sceptical that the provision for appeals will fall, especially as a very high level of appeals against the 2017 revaluation listing is expected.

3.15 Whilst the 2017 Valuation Office revaluation listing has increased the rateable value, the multiplier has fallen to compensate, with a planned neutral net effect across the country. A period of transition with a damping effect to limit some of the increases and decreases to businesses will come into effect from 2017/18. Based on early analysis, a relatively small increase in cost to the Council is expected as a result of these changes over the period of the MTFS.

3.16 The government has been consulting on the future of Business Rates with the intention of allowing local government to retain 100% of locally collected rates by the end of this parliament as announced in 2013. This does not mean that the Council will get to keep the £41m that it currently collects from Business Rates.

Business rate income will continue to be distributed around the country as before. The Council expects that any additional revenue will only replace reductions in RSG and New Homes Bonus which are known to and are expected to fall significantly, but this is also likely to come with additional responsibilities that will give rise to additional costs.

3.17 Furthermore, in the longer term, the March 2016 budget announced that the increase in the Business Rates multiplier will be switched from RPI to CPI from 2020. The multiplier is the annual increase in Business Rates determined by the government. CPI tends to go up more slowly than RPI so this change is likely to reduce the buoyancy in the Business Rates yield. Over time this will have a significant impact on the resources that are available to local government as a sector.

3.18 At this point therefore, it is difficult to calculate the effect of all these potential changes as not enough details are known but conclude that there is a high degree of uncertainty, especially beyond 2020. The Council will revisit the impact of this as it learns more of how the scheme will work and will feed this into a future MTFS.

New Homes Bonus (NHB)

3.19 The New Homes Bonus provides an incentive payment for local authorities to stimulate housing growth in their area. The calculation is based on Council Tax statistics submitted each October and, up to 2016/17, a ‘bonus’ was payable for the following six financial years based on each (net) additional property using a standardised Council Tax Band D amount (£1,455). In two-tier local government areas this payment is split in the ratio 20% to county councils, 80% to district councils. NHB is currently not ring-fenced and can be spent at the Council’s discretion.

3.20 From 2017/18, the mechanism under which NHB funding levels are determined is due to change. A consultation has been undertaken by government. However the outcome of this has not yet been announced. What is known is that the number of years for which the bonus is payable is likely to reduce to less than 4 years and the amounts the Council will receive in future are likely to significantly reduce. We anticipate that the announcement on NHB will come through in the 2016 Autumn Statement.

3.21 In anticipation of this reduction in funding, the Council is planning to taper its revenue reliance on NHB over the three year period so that by 2020/21 it does not include any NHB in revenue funding. This contrasts to the £1.17m that was included in the 2015/16 revenue budget.

3.22 The NHB reserve stood at £3.7m at 31 March 2016. Once the future of New Homes Bonus becomes clearer, the Council could chose to develop a policy for spending part or fully the NHB for projects other than funding the existing capital programme. However, the resulting increase in financing costs will then need to be considered.

Capital programme

3.23 Planned capital expenditure of approximately £23m is expected in 2017/18, which reflects the building of the new Broadbridge Heath leisure centre, the redevelopment of the Hop Oast depot and the replacement of the current waste

collection vehicles which are reaching the end of their useful economic life. The impact of this large capital programme and the more modest future capital expenditure in 2018/19 and 2019/20 is that the Council's minimum revenue provision (a prudent mechanism to pay back the capital) increases significantly, as do the interest payments on the borrowing. By the end of the three year period, this equates to around an additional £1m of expenditure each year.

3.24 The provisional £23m 2017/18 programme includes around 20 capital programme bids for 2017/18 that have been put forward for consideration and the business cases are currently being reviewed. Around £3.8m of the £5.1m has identified funding sources, with the remaining £1.3m currently unfunded. The schemes include improvements to parks and countryside, parking and property. The two-stage challenge process will refine this list before the capital programme is presented and finalised in January 2017.

Reserves and reserve strategy

3.25 The Council holds two types of reserves, earmarked reserves and general revenue reserves. Earmarked reserves are funds received for a specific purpose. For example, grant funding that can only be expended on particular purposes. Details of the earmarked reserves held by the Council at 31st March 2016 are shown in table 4 below.

Table 4: Earmarked reserves

Earmarked Reserves at 31 March 2016	£'000
Neighbourhood Planning Grant	318
S106 reserves	1,393
NNDR reserve	1,435
Council Tax localisation	278
Health and Wellbeing	198
Weekly Waste Collection	254
Community reserves	250
Other	515

3.26 General reserves are reserves held to ensure that the Council has sufficient funds to deal with any emergency or uncertainty. The Council also uses its general fund reserves to fund capital expenditure and redundancy payments. General reserves at 31st March 2016 were £9.1m. Of this, £0.5m of the 2015/16 revenue budget surplus has subsequently been transferred into an earmarked transformation reserve to fund one-off up-front costs of business transformation.

3.27 The Council agreed in October 2012 on a minimum level of general reserves of £6m. From 2020 onwards income from central government is uncertain due to the consultation around business rate retention. The Council's current strategy on reserves gives sufficient flexibility and headroom to deal with any issues that arise. Implementing Future Horsham efficiencies and planned income schemes, together with the potential actions set out later below, would result in balanced budgets through to 31 March 2020. Apart from funding this transformation, the Council would not need to dip into reserves. Therefore the general fund balance is anticipated to be around the £7m mark at the end of 2019/20.

3.28 The intention is to further review the strategy in the light of any new information on business rate retention and political and regulatory announcements in the Autumn

Statement as and when these become available to ensure that the budgets will be balanced on an ongoing basis into the 2020s as well.

Future Horsham

3.29 For several months, under the banner of "Future Horsham", the Council has been working on ideas to ensure that it can continue its business transformation journey to meet the demands and expectations of its customers in the face of financial and demographic pressures. Future Horsham will deliver a stronger Council which will be more productive and better equipped to serve customers. It will also help to protect front-line services whilst ensuring that the Council has a strong and responsive support services.

3.30 The key elements of the changes that are planned are:

- ***Shared Services****:* Following Cabinet approval in July 2016 to further investigate shared services, full business cases are being undertaken on Legal, HR and Internal Audit shared services with Chichester and Arun District Councils. Initial high level reviews indicated savings in the region of £250k p.a. could be made if these were fully implemented. In addition the Council are also looking at other areas of shared service, including for example expansion of the Building Control partnership to include Arun and Chichester District Councils.
- ***Change of technology:*** The Council is working on a new ICT strategy which will help to define how it invests in technology to support the Future Horsham programme. For example, enhanced mobile working and a greater ability for customers to self–serve online. In addition the Council is in the process of procuring a new Financial Management System which will enable savings to be delivered.
- ***Self-service:*** The future model for internal support services (e.g. Finance and HR) will mean that managers are trained, equipped and empowered to deal with routine matters directly so that costs are reduced in the back office.
- **Service efficiency:** A systematic approach to redesigning business processes will be implemented to ensure they are as streamlined as possible and that the technology the Council employs works to maximum benefit.
- **Contract reviews:** The Council will re-negotiate existing contracts with service suppliers to reduce costs. It has already done so to a substantial scale on the Leisure Centre Management contract.
- **New businesses:** The Council aims to become more commercial. It needs to generate more income and have more ideas such as the recent bulky bag collection service.
- ***Benefits review:*** Longer term, the Council is looking at how it can operate the Council Tax Benefits support scheme more efficiently and this has the potential to save money. Consultants have been appointed by Census to give initial option appraisals.

3.31 In total, Future Horsham business transformational efficiencies are expected to contribute around £1.4m towards the £4.2m budget gap by 2019/20. In addition, the Council has identified around £1.8m of new income sources and additional income expected from a growth in the number of users.

Potential actions

3.32 The Council has a number of potential actions it could take to mitigate the deficit. It could choose to increase Council Tax, fees and charges. It could also consider ceasing the delivery of some services and further rationalising its property estates.

3.33 When the budget report is presented to Cabinet at the end of January 2016, it will include the anticipated savings from the business transformation programme, commissioning opportunities and other service efficiencies.

3.34 Potential actions are summarised in table 5 below. The waste collection, rural car-parking options and increasing garden waste charges are included on the Cabinet agenda. The decisions on those items will have a significant bearing on the overall strategy and if approved there will be less pressure on discretionary front line services. In addition Cabinet is recommended to support the proposed increases in Council Tax and to recommend to Council that the MTFS is approved on that basis.

Table 5: Potential options

Potential Options	2017/18 £000s	2018/19 £000s	2019/20 £000s
Procurement of rear-loading waste collection vehicle fleet in 2018/19	0	270	270
Alternate weekly collection of waste in 2018/19	0	730	730
Increase in Garden waste charge £2 in 2017/18 and 2018/19.	105	210	210
Introduce Rural car-parking disk charges in 2017/18	0	315	315
Increase Council Tax by central government assumption of 1.75% inflation	150	300	450
Total of potential options	**255**	**1,825**	**1,975**

4 Next steps

4.1 On 26 January 2017, the 2017/18 budget will be taken to Cabinet to recommend approval at the 15 February 2017 full Council meeting where the Council Tax for 2017/18 will be set. The MTFS will also be updated at this time to take account of the Autumn Statement and our settlement plus the final details of the 2017/18 budget.

5 Views of the Policy Development Advisory Group and outcome of consultations

5.1 The proposed MTFS, assumptions and potential actions were considered by the Finance and Assets Policy Development and Advisory Group at its meeting on 25 October 2016 and the Group was supportive of the proposed strategy.

5.2 A seminar for all Members was held on 10 November 2016 to allow all Members the opportunity to discuss and review the MTFS proposals in advance of the 2017/18 budget setting process.

5.3 The Chief Executive, Directors and the Head of Finance have been extensively involved in preparing the medium term financial strategy and are fully supportive of its contents. The Monitoring Officer has also been consulted during the preparation of the document and is supportive of its contents.

6 Other courses of action considered but rejected

6.1 Not taking actions set out in this report would put at risk the ability of the Council to reduce the budget deficits that are projected for 2017/18 through to 2019/20. Therefore, not taking any action has been rejected.

7 Resource consequences

7.1 The Future Horsham changes will lead to a reduction in the size of the workforce over the next three years. In September 2016, Horsham District Council employed 483 staff in total. This constituted 413 full time equivalent (FTE) posts. The precise figure of reductions, currently estimated at 30 posts, will be firmed up as detailed plans for the individual elements are finalised.

7.2 In accordance with the Organisational Change Policy the Council will take steps to avoid compulsory redundancies as far as possible through a combination of vacancy control, redeployment and, in appropriate cases, voluntary redundancy. A small number of posts have already been deleted (these were agreed at the last Personnel Committee).

8 Legal consequences

8.1 There are no legal consequences as a result of this report.

9 Risk assessment

9.1 The Council's reliance on central government funding and balancing the medium term financial plan is captured on the Corporate risk register at CRR01. This is regularly reviewed and updated and is monitored at Accounts, Audit & Governance Committee on a quarterly basis.

10 Other Considerations

10.1 There are no consequences of any action proposed in respect of Crime & Disorder; Human Rights; Equality & Diversity and Sustainability.