

REPORT TO:	FINANCE & MANAGEMENT COMMITTEE	AGENDA ITEM: 7
DATE OF MEETING:	16th OCTOBER 2014	CATEGORY: RECOMMENDED
REPORT FROM:	DIRECTOR OF FINANCE and CORPORATE SERVICES	OPEN
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SUBJECT:	UPDATE of the COUNCIL'S MEDIUM TERM FINANCIAL POSITION to 2020	REF:
WARD (S) AFFECTED:	ALL	TERMS OF REFERENCE: FM 08

1.0 Recommendations

- 1.1 That the updated financial projection on the General Fund to 2020 as detailed in **Appendix 1** is approved.
- 1.2 That the financial projection provides the basis for planning purposes and for setting the General Fund Budget for 2015/16.

2.0 Introduction and Purpose of the Report

- 2.1 In accordance with the Council's Financial Strategy, the report updates the Council's medium term financial position. This follows the reported out-turn for 2013/14, together with known and identified changes since the 2014/15 budget-round.

The Council's Financial Planning Framework

- 2.2 A key factor within the Council's overall Financial Strategy is medium term financial planning. This is considered good practice and is based on Audit Commission guidance which directs councils to achieve a resilient and sustainable financial position. The Council's arrangements for achieving this, together with its success, are subject to an External Audit each year
- 2.3 The main target within the Financial Strategy is to achieve a minimum level of general reserves (£1m) by the end of every financial planning period. This is based on a Medium Term Financial Plan which sets out a financial projection for 5-years on the General Fund.

- 2.4 The main focus of the projection is to estimate the Council's future financial position and provide an early warning sign of any financial challenges that may lie ahead in future years. This then provides an opportunity to take a planned approach to remedial action. In addition, it is used as the basis for building detailed budget plans each year.
- 2.5 It also helps the Council to focus on the resources that it will have available at the end of each period. In addition, it identifies where resources and spending are changing in the medium term to enable action to be taken at an early stage to prevent any loss of financial stability.
- 2.6 The financial model projects forward current base spending and income. This is adjusted for anticipated changes in factors such as interest rates, inflation, together with the economic situation, central government policy and local spending/financing plans, etc.
- 2.7 It is regularly updated to take account of previous spending changes and their effects into the medium term. The projection aims to show a prudent but realistic position over the 5-year period.

Aim of this Update

- 2.8 The Council's financial policy requires a mid-year review of the medium term financial position. This follows the budget out-turn for the previous year and before the forthcoming annual budget round. This provides a basis for planning purposes and identifies potential issues, risks and opportunities.
- 2.9 No significant changes are expected to the national funding position ahead of 2015/16. In addition, the main variables within the projection are not expected to vary from those currently used. Therefore, this update:
 - Factors in known and certain changes since the last update in February 2014.
 - Provides a commentary and assessment on the projected financial position as it currently stands.
 - Identifies key areas impacting upon the projection.

Housing Revenue Account (HRA)

- 2.10 *It should be noted that this update does not include a review of the HRA. This is currently subject to a full update as part of the HRA's Business Plan review and will report separately later in the year.*

3.0 The Detailed Projection

3.1 Following the budget round for 2014/15, the medium term financial position was projected as shown in the following table.

General Fund: Medium-Term Projection as at February 2014

Year	Budget Deficit / Surplus (-)	Sums Earmarked against Reserves	Balance of General Reserve
Base Budget 2014/15	-£170,310	£502,000	-£4,160,038
Projection 2015/16	£172,321	£295,000	-£3,692,717
Projection 2016/17	£190,127	£340,000	-£3,162,590
Projection 2017/18	£690,732	£20,000	-£2,451,857
Projection 2018/19	£889,393	£20,000	-£1,542,465

3.2 The table showed the projected level of reserves still above the minimum contingency level of £1m by 2019, with a budget surplus in the current financial year 2014/15.

Projected Budget Deficit

3.3 However, an on-going budget deficit was projected in future years, rising from £172,000 in 2015/16 to nearly £900,000 in 2018/19. The current level of general reserves was healthy and was effectively being used to finance the future budget deficits.

3.4 However, this was not considered to be a long term solution, especially given the longer-term deficit. Consequently, in order for a sustainable position to be achieved in the medium term, the Council set a target to meet the estimated deficit in 2015/16 by taking action in 2014/15. This required savings of £175,000 to be found within the current base budget.

Updated Projection as at October 2014

3.5 This is detailed in **Appendix 1** and summarised in the following table.

General Fund: Medium-Term Projection as at October 2014

Year	Budget Deficit / Surplus (-)	Sums Earmarked against Reserves	Balance of General Reserve
Base Budget 2014/15	-£220,580	£402,000	-£5,728,670
Projection 2015/16	£213,134	£295,000	-£5,220,536
Projection 2016/17	£290,933	£340,000	-£4,589,603
Projection 2017/18	£826,386	£20,000	-£3,743,218
Projection 2018/19	£1,048,099	£20,000	-£2,675,118
Projection 2019/20	£846,056	£20,000	-£1,809,062

- 3.6 Although some individual figures have changed following agreed actions, the overall medium term position has not changed significantly, i.e. an adequate level of general reserves, but with a projected and increasing budget deficit after 2015/16.
- 3.7 Following the addition of a further year (2019/20) to maintain a rolling 5-year period, the balance on the General Reserve is still projected to be above the minimum level of £1m, at approximately £1.8m in 2020. The balance in 2014/15 has increased from £4.1m to £5.7m due to the better out-turn position in 2013/14 as previously reported.
- 3.8 In addition, budget savings of £80,000 (£400,000 over 5-years) made to-date in 2014/15, towards the target of £175,000, have also been included.

Contingent Sums

- 3.9 The projection continues to make provision for growth of £100,000 to be added into the base budget. In addition, provision for inflation is included each year which is added into the base budget on a compound/cumulative basis.
- 3.10 A sum continues to be earmarked to support any recurring costs of the pay and grading review, subject to implementation.
- 3.11 In addition, certain sums are allocated against the General Reserve. These mainly relate to amounts earmarked to meet one-off costs associated with the pay and grading review, together with the future replacement of vehicles and plant.

3.12 The main estimates and assumptions included in the projection are considered in the following sections.

Pay Inflation

3.13 The projection provides for increases of 1% for the 2 years 2014/15 and 2015/16. This is in accordance with the Government's proposals for public sector pay increases. From 2016/17, the projection is based on an increase of 2% in accordance with economic forecasts for general inflation.

3.14 The Council's pay bill on the General Fund is currently around £6.7m per year; a 1% variation equates to approximately £67,000 per year. The pay award for 2014/15 is still under negotiation at a national level.

Inflation on Other Costs and Income

3.15 Inflation is not universally applied to all expenditure items and provision is only made where it is considered unavoidable. This mainly applies to items such as fuel, energy/utility costs, repairs/maintenance and contracted services.

3.16 Annual increases are also applied to concurrent expenses paid to parish councils, together with grants to voluntary bodies.

3.17 Many cost heads are cash limited and in particular those relating to supplies, office and other overhead expenses. Increases are also applied to fees and charges where the Council has discretion to do so.

3.18 General inflation has been applied to the relevant cost heads at 2% per year (2.5% for utility costs and maintenance) on an on-going basis, including fees and charges.

Fees and Charges

3.19 The level of increase for fees and charges does present a risk. Year on year, it may not be possible to generate the increase on each and every charge made.

3.20 In accordance with the Council's Charging Policy, the level of fees and charges is reviewed on an annual basis during the budget round, with an average increase across each service area being used as a target.

Total Inflation – Contingent Sum

3.21 A summary of the inflation provision included in the projection is shown in the following table. This effectively shows by how much the current base budget is forecasted to grow each year.

Analysis of Overall Inflation

	2014/15 £	2015/16 £	2016/17 £	2017/18 £	2018/19 £	2019/20 £
Pay	68,620	70,236	141,876	144,714	147,608	150,560
Maintenance and Utilities	26,834	52,178	53,483	54,820	56,190	57,595
Contracts and Services	115,926	119,558	126,535	128,565	130,637	135,475
Income	-88,479	-55,169	-56,273	-57,398	-58,546	-59,717
Total Inflation Provision	122,901	186,803	265,621	270,700	275,889	283,913

3.22 The total provision for inflation is held and controlled as a separate contingent sum. It is only allocated to budgets once an inflationary increase or allowance is either approved or known to have impacted upon a base budget.

3.23 Since this policy was introduced some years ago, there has only been a limited need to use the contingent sum, mainly to meet the costs of a national pay increase for employees.

3.24 Any unused balance is returned to the General Reserve at the year end. There are also on-going savings if the base budget is not actually increased from one year to the next in accordance with the inflation factors, because the base position is lower compared to that forecast.

Interest Receivable

3.25 Interest received from money held on short-term deposit is based on the interest rates and average deposit balances as shown in the following table.

	Rate	Deposit £m	Interest £'000
2014/15	0.65%	7.5	49
2015/16	0.65%	6.0	39
2016/17	1.15%	5.0	58
2017/18	1.65%	5.0	83
2018/19	2.15%	4.0	86
2019/20	2.15%	4.0	86

- 3.26 The current Bank of England Base rate of 0.5% is not expected to be increased until 2015/16. Latest predictions then show it rising steadily to a peak of between 2.5% to 3% by around 2018/19.
- 3.27 This is based on the current strategy of the Bank of England and the members of its Monetary Policy Committee, who favour maintaining interest rates as low as possible in the current economic climate.
- 3.28 Although many economic commentators are reporting that the economy is moving back towards its pre 2009/10 peak based on positive growth, together with employment and inflation statistics, many are also advising caution regarding its long term sustainability at this stage.

Service Income

- 3.29 The current Base Budget estimates certain levels of income from the main charging areas as shown in the following table.

	£	Annual Increase Applied
Planning Fees	-550,000	No - this is the base figure to 2019/20
Building Regulations	-250,000	No - this is the base figure to 2019/20
Trade Waste	-236,900	Annual inflation uplift on base budget
Licensing	-246,180	Annual inflation uplift on base budget
Land Charges	-100,000	No - this is the base figure to 2019/20
Property Rents	-685,677	Subject to phased rent reviews
Leisure Services	-171,758	Annual inflation uplift on base budget
TOTAL	<u>-2,240,515</u>	

- 3.30 The income effectively contributes to the cost of these services. In accordance with Regulations, income should not be to such an extent from year to year, that large surpluses are made.
- 3.31 This is particularly the case for Planning Fees, Building Regulations, Land Charges and Licensing. Any additional income should be reinvested back into the service, used as a contribution to non-chargeable work or future prices for the service reduced.
- 3.32 After charging overheads, none of these services currently show large surpluses. In addition, additional income from Planning Fees has been set-aside to meet one-off costs associated with appeals and the Local Plan.
- 3.33 Income from property is effectively investment income as it provides a rate of return on Council assets.

3.34 The total amount in the current base budget of approximately £2.2m is well below the level of 2009/10. However, actual income has exceeded budgeted levels over the last two years and is currently projected to do so again in 2014/15.

Core Funding

3.35 Besides Council Tax, the Council's core funding comprises:

- Revenue Support Grant (RSG)
- Retained Business Rates (RBR)
- New Homes Bonus (NHB)

3.36 No changes have been made to the assumptions or figures in this updated projection. RSG is still projected to reduce in accordance with national forecasts. Provisionally, the Council had already been notified of a reduction from £2.5m in 2014/15 to £1.7m in 2015/16.

3.37 Further reductions after that of up to 50% by 2019/20 are projected, although this will be subject to the next national spending review, which is expected in 2015/16. The new Business Rates Retention System is not due to be reviewed until 2020.

3.38 Reductions in RSG are being partly offset by projected growth in NHB and RBR. These could increase further on the back of local growth in new residential and commercial development.

Council Tax

3.39 A 2% increase in the rate of Council Tax continues to be included in the projection for planning purposes. This reflects the Government's limit above which a local referendum would be required to set a higher increase.

3.40 In addition, the projections for Council Tax income assume a continuation of growth in new properties of 1% per year. The average growth over the last 5 years has been approximately 1.5%.

3.41 A 1% variation in the rate of Council Tax equates to approximately £45,000 per year.

4.0 The Overall Financial Position

4.1 After several years of making budget savings, the updated projection continues to show the General Fund with a current budget surplus but an increasing deficit in future years.

- 4.2 The projection assumes that base costs are increasing year after year due to inflation and growth, whereas in reality this has not occurred.
- 4.3 This is clear in monitoring and budget out-turn reports. These highlight reductions in net expenditure compared to the Budget although a large proportion has been increased income.
- 4.4 The projection estimates current net service expenditure will grow by approximately £1.1m over the next 5-years (just over 10%). In contrast, core funding is only estimated to increase by £100k over the same period due to the anticipated reduction in RSG.
- 4.5 Although the projection assumes growth in some core funding (NHB, RBR and Council Tax) the increasing deficit is exacerbated by the projected reduction in RSG. This continues to be a major factor. Therefore, current financial planning needs to be based on this scenario and this risk managed accordingly.
- 4.6 It is clear that the current and short term financial position is sound. The Council's External Auditor continues to assess it as both resilient and sustainable. Their report to the Audit Sub-Committee in April 2014 benchmarked the Council's arrangements for securing financial resilience.
- 4.7 The Council was one of only 24 authorities who had all "green light" indicators against 22 assessment criteria for financial resilience. It was concluded that the Council's arrangements are adequate and although the financial position is challenging, the Council's arrangements mean that it is well placed to address this challenge.

Financial Strengths

- 4.8 The strengths of the Council's current financial position are as follows:
- Positive cash flow
 - No debt outstanding (on the General Fund)
 - Not reliant on interest rates rising to generate additional income
 - General Reserve projected to remain above contingency level by 2020
 - Contingent sums to guard against inflation and growth
 - Budget for a full establishment
 - Earmarked reserves for IT and vehicle replacement
 - Separate provision made for bad debts and unexpected costs that could arise such as pay and grading, the Local Plan and pensions
 - Earmarked reserves to sustain project and ad-hoc work
 - Steady growth in the Tax Base and service income
 - Capital expenditure not reliant on revenue funding or borrowing

Financial Risks

4.9 Within the financial projection, there are risks and the main ones are considered to be as follows:

- Further reductions in RSG and changes to the national distribution system
- Sustainability of the economy and its impact on core funding and income
- Limitations on Council Tax
- Underlying cost pressures yet to surface
- Ageing assets increasing the cost of repairs and maintenance
- Greater cost of Housing Benefits being met locally
- Pressure on local pay rates, pensions and from Auto Enrolment

Key Message

4.10 The General Fund has built up a good level of reserves, mainly due to budget underspends. Much of this has been due to one-off factors such as staffing vacancies and additional income. Whilst in recent years, this has been a familiar pattern, it cannot be guaranteed in future years.

4.11 Current spending is projected to be greater than income as costs are expected to increase and overall core funding reduces. Consequently, there is an underlying budget deficit and this is still a key factor for financial planning.

4.12 Uncertainty still exists regarding further reductions in RSG after 2015/16. Many commentators consider that it will reduce, but by how much and in what form, is not clearly known.

4.13 A spending review is expected early in the next Parliament during 2015/16. It is not expected that the provisional financial settlement published by the Treasury for 2015/16 will change in the meantime.

4.14 The critical year for the Council will be 2016/17. This is the year that the deficit starts to accelerate based on current projections. In the meantime, the new RBR scheme will have bedded in and the outcome for the Council will become more certain.

4.15 However, the outcome of the next spending review will be critical for the Council. In the meantime, it is considered prudent for the Council to continue to plan based on the current projections and to meet the projected deficit in 2015/16.

5.0 Background Papers

Published Medium Term Financial Plan and Financial Strategy

http://www.south-derbys.gov.uk/council_and_democracy/council_budgets_spending/budget_and_financial_strategy/default.asp