

BODY:	CABINET
DATE:	8th July 2015
SUBJECT:	Medium Term Financial Strategy 2016-2020
REPORT OF:	Deputy Chief Executive (Chief Finance Officer)
Ward(s):	All
Purpose:	To set out an overarching financial strategy to support the Council's strategic priorities and plans over a four year period.
Contact:	Alan Osborne, Chief Finance Officer, Tel 01323 415149 or internally on ext 5149
Recommendations:	Members are asked to: <ul style="list-style-type: none"> i) Approve the updated medium term financial strategy and associated plan 2016-20 as summarised in Appendix 2. ii) Agree the balance of assumptions made in the strategy iii) Request that the emerging budget proposals for 2016/17 be brought to Cabinet in December prior to detailed consultation. iv) Agree the principal risks of the strategy in Appendix1.

1.0 Introduction

The Council's Medium Term Financial Strategy is a Rolling 4 year Strategy that takes into account:

- The external financial environment
- The overall financial demands of services
- The Council's existing and projected financial resources
- The Council's political priorities and stated aims
- The Council's sustainable service delivery strategy
- The Council's corporate plan
- The major service strategies and plans

- 1.1 The MTFs was last approved in July 2014 and set the backdrop for the 2015/16 budget setting process as well as a informing a three year rolling service and financial planning cycle.
- 1.2 In common with all the public sector, the medium term outlook for the Council is extremely challenging and in order to protect and improve services an ambitious ongoing programme of savings is key to success. With more radical measures required, it is essential that the Council takes a longer term approach to savings as more radical savings initiatives will inevitably take longer to plan and deliver.

- 1.3 Over the life of the last parliament the Coalition Government has effectively reduced the general support to the Council by some 40% in cash terms which equates to over 50% in real terms. Government funding is expected to fall a further 30% over the next parliamentary cycle to 2020. Members will note that the date of Cabinet is the date set for an extraordinary national budget which will set the scene for the next comprehensive spending review in the Autumn. The next CSR is expected to cover the period to 2019/20.
- 1.4 In order to protect front line services the Council put in place a priority based budget system that has kept pace with the scale of cuts to funding and made provision for reinvestment in services. The Council has set out its stall to become less dependent on day to day revenues to run services, instead opting to use any spare financial capacity to enhance the capital programme.
- 1.5 The Council's DRIVE programme provides the programme to deliver efficiencies that support the Council's Corporate Plan. The MTFs and Capital Strategy identify and direct resources at a strategic level, which are then compounded via the service and financial planning and budget setting process.
- 1.6 In setting the last six annual budgets the Council has achieved its "Golden Rule" of meeting its ongoing budget requirement from ongoing resources in each year. Technically, the rule applies to the cycle of the MTFs, and it is reasonable to use reserves to smooth out the budget as savings accrue over the cycle. By not using reserves in this manner it has meant that reserves over the minimum level are available for one off investments in services decided via the service and financial planning process.
- 1.7 The Council, as a registered social landlord is obliged to run a Housing Revenue Account (HRA) that is statutorily ring-fenced from its general fund. A 30 year rolling business plan has been adopted for the HRA. The Council is working in partnership with Eastbourne Homes Ltd a wholly owned subsidiary to deliver efficiency savings in partnership using shared services. All savings accruing to the HRA are reinvested in housing services. During the last two years over £500,000 of ongoing efficiencies has been realised and built into the EHL budget.

2.0 Sustainable finance

- 2.1 The basic legal definition of a balanced budget is that planned expenditure can be met from income and reserves.
- 2.2 Whilst that definition is the legal minimum, it does not provide for sustainability if reserves are used in the long term to resource any differences between ongoing expenditure commitments and ongoing incoming resources.
- 2.3 Therefore it is a given that over the cycle of this MTFs ongoing expenditure must be financed from ongoing resources with only non recurring investments being met from reserves over and above the minimum.

- 2.4 As with all Councils, the effect of inflation is felt on gross expenditure, whilst any increase in council tax or grant is based on a net position. This "gearing effect" means that there is a natural gap of c£400k per annum that needs to be met from efficiencies (approximately 2.5% of net spend) if services are to be protected. This is on top of the Government reductions outlined in 1.3.
- 2.5 Given the current reduction in grant and the inability to raise council tax in real terms, due to capping criteria, the Council has to look to longer term measures to maintain sustainable finances. These include measures under the Sustainable Service Delivery Strategy (SSDS) including the Council's "Future Model" as well as shared services and the growth of income streams.

3.0 The impact of the capital programme

- 3.1 The Capital Programme also has an effect on the Councils revenue finances as any investments that cannot be met from grants, contributions, capital receipts or straight revenue funding need to be met from borrowing. This has to be repaid with interest from revenue or capital receipts over time.
- 3.2 The General Fund policy is to use borrowing only on a business case basis. Any such borrowing is fully financed by way of interest charges and the Minimum Revenue Provision (MRP) which is the capital repayment. As new schemes that require borrowing are approved, the Council has to make provision for repayment via the capital financing budget. In order to keep this sustainable a stability mechanism that pools the following budgets is maintained.
- Interest earned
 - Interest payable on debt
 - Minimum Revenue Provision
 - Revenue contributions to the capital programme (to balance)
- 3.3 It is up to Councils to set their own MRP and balances of Capital Receipts and Contributions can be offset to reduce this liability in the short term, although this only provides for short term relief against the cost of capital. The current policy of the Council is to pay 4% MRP on historic debt and MRP based on the useful life of assets created since 2011, however the Council's Treasury Management Strategy does allow some flexibility to adjust this in future if necessary.
- 3.4 Capital investment can be used as "invest to save" therefore borrowing is an important tool in the overall financial strategy where savings on schemes exceed the cost of capital.

4.0 The National Financial Picture

- 4.1 The Government has set an objective to eliminate the nations's budget deficit by the end of the parliament.
- 4.2 This will involve various measures that will reduce the amount of resources to local government including:
- A further reduction in general central government support 2016-2020
 - Reducing the amount of resource available to DCLG as it is not a "protected" Department which will impact on specific grants

- Increasing in the funding for New Homes Bonus (NHB) paid for by further reducing the revenue support grant (RSG)
- A further year on year reduction in Housing benefit administration grant (on top of the £200,000 reduction in the last 4 years)

Other measures may well be announced on the 8th July and Cabinet will be briefed accordingly.

- 4.3 The current extended period of low interest rates reduces the income to the council as it generates investment income due to positive cash flow and reserve balances. Any debt is at fixed rates and it is important to manage all capital financing as one budget as described in section 3.
- 4.4 The Government continues to target an inflationary rate of 2% using its preferred method of Consumer Price Index (CPI) and is currently below target, although the Bank of England that is responsible for achieving the target has indicated that the below target rate is due to short term effects principally oil prices.
- 4.5 The actual effect of the national deficit reduction programme to this Council has been the amount made available via the Revenue Support Grant (RSG). The Council received £8.9m in RSG in 2010/11. Whilst a scheme to retain an element of business rates was introduced in 2013, the Council is now receiving £2.8m of RSG in 2015/16.
- 4.6 Against this backdrop service demands on Councils are ever increasing with demographic and increased expectation causal effects.
- 4.7 In his last budget statement, the chancellor suggested that a cap on public sector pay rises would be maintained and they should not increase above inflation or 2% as a maximum.
- 4.8 The Government has already reduced the benefits paid to members of the local government pension scheme, by pegging future increases to the CPI instead of RPI. This has had the effect of increasing the overall funding of pensions schemes and therefore reduces the demand for future increases in employer contributions. A new career average revalued scheme (CARE) came into being on 1.4.14 with employee contributions lifted and benefits reduced. The Council will however have to find additional resources to fund "auto enrolment" due to start in November 2017.

5.0 The strategy commentary and main assumptions

5.1 Issues arising from previous years

The Foundation of any sound financial plan is a predictable budget to outturn position. The 2014/15 outturn, whilst containing normal variances in year, resulted in a positive overall variance due mainly to increased performance in housing benefit overpayment recovery. Some minor residual issues in the discretionary areas have been recognised in setting the 2015/16 budget.

5.2 Inflation on goods and services

The Government has a long term commitment to retain an inflation rate of 2% per annum (CPI) Therefore the strategy assumes 2% core inflation from 2016/17.

The Council, in common with most, does not add inflation each year to all its supplies and services budgets as this would add some £300,000 per annum.

Instead, it assumes a level of continuous improvement in procurement allowing for only contract inflation that cannot be negotiated downwards to be applied at a cost of some £200,000 per annum (CPI).

5.3 Pay inflation

One of the major costs in a District Council is the cost of its employees. This accounts for some £12m for this Council.

The recent economic climate and caps on public sector pay has led to some relief in this respect to the Council.

The strategy assumes the following increases based on the Government announcements and inflation targets:

Year	Pay inflation
2016/17	2%
2017/18	2%
2018/19	2%
2019/20	2%

5.4 Pension costs

The increase in the Council's increase to employer contributions to the East Sussex Pension scheme is currently capped at 1% over 3 years (0.33% per annum increase) This expires in March 2017.

The next triennial revaluation of the fund is due to take place in 2016 will set rates effective from 2017/18. With the recent change from RPI to CPI as the annual index, and the changes arising from the Pensions Bill including Career Averaged Revalued Earnings (CARE) instead of the previous final salary scheme, the strategy assumes no increase in employer contributions after the current revaluation.

The Council previously recouped its past service deficit as a % of pay, however the fund actuary has required councils to amortise this deficit on a cash basis since 2014/15 due to the risk of falling payroll numbers. Whilst this budget will increase in the short term it is not a material increase and will be paid for using the inflation allowances.

5.5 Fees and charges

The Council currently receives income from fees and charges for its services of around £14m.

The Council has been reducing its exposure to income targets in areas affected by the economic downturn in successive budgets. In setting the 2015/16 budget a targeted increase of c£200,000 was built into the budget. This was offset partially by reducing some unachievable income targets via the service and financial planning process.

It is assumed that for the year 2016/17 an overall gain of £200,000 (1.5%) per annum will be realised in fees and charges (mainly inflationary increases)

Individual service and financial plans will still strive to achieve some real terms increases where it is felt appropriate and achievable as well as new income streams to reduce the long term dependency on government grants.

5.6 Interest Rates

The current bank "base rate" is 0.5% and has been since March 2009.

There are differing forecasts in the future profile of interest rates which are largely dependent on a recovery and inflationary pressures in the economy. Most analysts now predict that there will be a very slow recovery and rates will only increase modestly in the period 2015/16.

The Council's treasury management advisor (Sector Ltd) is forecasting a small increase in the rate to 0.75% in 2014/15 rising to 1.75% by the end of 2015/16.

The strategy assumes no increase in overall yield from interest rate rises over the life of the MTFs. Any increases that do occur will have a short term effect of increasing the amount of resources available to the Council (around £100k per percentage point) however the strategy will need to recycle these into capital financing as longer term interest rates used for borrowing purposes will increase too. The stabiliser mechanism as outlined in 3.3 will be used to smooth the effects of changes in interest rates over the life of the MTFs.

5.7 Council Tax

It is inevitable that surpluses and deficits will arise due to the fact that the tax base has to be estimated 3 months before the start of the year and the actual position is subject to collection fund performance as well as changes in the tax base in year. However in recent years these have been well managed. A The collection rate for budget purposes of 98% is assumed from 2016/17 which is consistent with current performance.

The Council has taken advantage of the Government's tax freeze grant for the last five years. No announcements have been made about council tax increases beyond March 2016. Therefore the strategy assumes that no freeze grant scheme will be available from 2016/17.

The strategy assumes rises of 2% (based on CPI target) from 2016/17 (i.e. no real terms increase in council tax across the life of the MTFS)

The strategy also assumes increases (1%) each year in the overall council tax base. The Base will be reassessed annually as party of each budget setting process. Each 1% increase in the tax base yields approximately £80,000 per annum of additional tax.

5.8 Government Grants/Retained Business Rates

The Council currently receives £2.8m of revenue support grant. This is set to reduce by a third over the life of the next parliament.

In addition the Council now retains a proportion of business rates (£4m) collected based on 40% of the real increase in those collected using a base year of 2011/12. The Council has joined an East Sussex wide pool (administered by Wealden DC) that is designed lead to a further retention of approximately £200k per annum from 2015/16, this additional resource has been added to the amount available for capital.

From time to time the Government will make adjustments to business rates scheme, for which it compensates Councils for the loss of retained rates by way of a "section 31 grant".

There are still backdated appeals on rates that relate to the old national scheme (pre 2013) the Council has had to make immediate provision for these appeals in order to fall in line with the other councils in the East Sussex Pool. This will unwind during the life of the MTFS.

The strategy assumes that business rate retention will rise by 2% per annum based on CPI rate increases, although initiatives such as the Town Centre and Sovereign Harbour developments should contribute to further retention in future years.

The new Homes Bonus is a reward grant that currently gives c£10,000 for each new property brought into use/constructed and is paid over six years. The funding stream is set to increase to £1.4m per annum by 2016/17. No announcements have been made about the future beyond the current six year horizon, however it is assumed that the scheme will be withdrawn and it will wind down gradually (approximately £180k per annum in the first three years from 2017/18)

The third type of grant is specific grants for the purposes of running individual services e.g. housing benefit administration and NNDR collection grants. The service and financial planning process deals with fluctuations in such grants with a view to matching the cost of the service against the grant received.

The overall amount of the main general grants from Government is therefore as follows:

	2016/17 £'000	2017/18 £000	2018/19 £000	2019/20 £000
RSG	2600	2400	2200	2000
Rate Retention	3745	4204	4288	4374
New Homes Bonus	1400	1220	1040	960
TOTAL	7745	7824	7528	7234

5.9 Revenue headroom for new or enhanced services

The Cabinet has indicated that it would like to continue the migration of resources from non priority areas to priority areas over the life of the MTFS.

Clearly any headroom can only be achieved if savings achieved are greater than the reduction in resource due to funding changes and the effects of inflation.

The strategy assumes that an average minimum of £700k per annum of savings is required to make good the loss of grant and the effects of inflation as well as provide £200k per annum for unavoidable growth as well as up to £100k per annum increases in the capital financing budget.

The service and financial planning process and the detailed budget proposals will identify whether headroom can be created by making savings in excess of the minimum need and other agreed service growth.

5.10 Savings

Taking all known factors and assumptions as outlined above the Council needs make an average level of new additional savings of £600k per annum over the life of the MTFS.

The Council has set out a number of corporate initiatives in order to help facilitate savings under the auspices of DRIVE.

The principal programmes are now under the Sustainable Service Delivery Strategy (SSDS)

Whilst these programmes have stretch targets that have been agreed as part of each individual programme, this strategy assumes the following bankable savings accruing as set out below. This does not alter the targets set for each programme, but merely reflects what can reasonably be counted at this stage. Service and financial planning will provide more certainty as each year approaches.

Programme	2016/17	2017/18	2018/19	2019/20
	£'000	£'000	£'000	£'000
Future Model	300	0	100	100
Shared Services	250	150	250	250
Procurement	50	50	50	50
<i>*Service Based</i>	<i>200</i>	<i>200</i>	<i>200</i>	<i>200</i>
Total	800	400	600	600

*To match unavoidable growth

5.11 The Housing Revenue Account (HRA)

The HRA is ring fenced from the General Fund although should it fall into deficit then it would have to be subsidised by the general fund.

Transactions between the HRA and the general fund comprise three main elements:

- Interest on the HRA balances paid to the HRA
- Debt charges paid by the HRA to the General Fund
- Recharges from the General Fund to the HRA for support services

For the purposes of this strategy it is assumed that there is no change to the existing overall level of transactions between the accounts.

From 2012/13 the HRA became more like the general fund in that it needs to assess the cost of its capital programme against the resources available in the HRA, now that the subsidy system has been disbanded. Responsibility for setting rent levels is now localised however controls over rent levels and borrowing limits remain.

A 30 year business plan was adopted by the Council February 2012, and the HRA is subject to an annual refresh and five year overhaul from 2017.

6.0 Reserves

6.1 The Council has four main revenue reserves:

Revenue

- General fund reserve – As a contingency and support the corporate plan
- Strategic change fund – to support the DRIVE programme
- Repairs and maintenance fund – to support the asset management plan
- Economic regeneration fund – to support the local economy

In addition there is one principal capital reserve

- Usable Capital Receipts – earmarked for future capital schemes

In addition the Council holds funds on behalf of others e.g. section 106 contributions.

- 6.2 The 2014/15 accounts show the balance available to the general fund to be £4m. This is the assumed starting point for the MTFS. There is a planned draw on reserves to meet non- recurring expenditure in subsequent years at around £250k per annum. No assumption on underspends is made in the strategy despite the fact that over £1.6m has been returned to general reserves over the last 4 years.
- 6.3 The previous MTFS recommended a minimum general fund reserve of at least £2m. The budget paper in February itemised the risks and as they have not changed significantly in the interim, it is assumed that the minimum level of reserves is fixed at £2m for the MTFS, although this will require review during the budget setting process for 2015/16.
- 6.4 The strategic change fund was established in order to help facilitate the release of ongoing savings. This reserve is a key enabler for change and it will need replenishing in time. The reserve currently has a balance of £1m.
- 6.5 The repairs and maintenance reserve had a balance of £0.8m at 31.3.15 and has been used to support the asset management plan, high priority and corporate asset non capital items are financed from this fund where they cannot be met from the service budgets.
- 6.6 The system of carry forwards was abolished in 2010, with the exception of partnership and third party funds. The Council now follows a policy of pooling all general reserves which better facilitates corporate planning. It is not intended to reintroduce carry forward of unspent budgets during the life of the strategy.
- 6.7 The Council has had a conscious policy of keeping reserve levels above minimum levels in reaction to the challenging economic climate and the continued squeeze on public sector spending. The MTFS summary (appendix 2) shows that the general reserve will be reduced over the life of the MTFS to an estimated £3m excluding any windfalls or underspends.
- 6.8 The Council set aside £500,000 from general reserves in the economic regeneration reserve to pump prime initiatives aimed at promoting the local economy and creating new income streams for the Council to help offset the reductions in Government funding..

7.0 Risks

- 7.1 The main risks arising from this strategy and actions to manage are included at **appendix 1.**

8.0 Consultation

- 8.1 The MTFS starts the period of consultation and a separate paper on the agenda on the Councils improvement journey makes recommendations on the consultation processes from now until the budget setting in February 2016.
- 8.2 It is a requirement to consult with the business and voluntary sectors over the detailed budget proposals that will emerge from this strategy in the autumn.
- 8.3 The Joint Staff Committee is briefed regularly as the process emerges.
- 8.4 The Council's staff are consulted routinely via the Managers Forum as well as participating in the service and financial planning process annually.

9.0 Conclusions

- 9.1 In order to maintain sustainable finances and fund its ambitions, the Council will need to make new efficiency savings or income streams averaging £0.6m per annum for the next four years.
- 9.2 Due to the scale of the challenge the programme of change will require more radical measures for savings that often have a lead in period of 1 to 2 years, therefore the SSDS programme is a key enabler to meeting this challenge.
- 9.3 The MTFS both collects the financial effects of demand and supply changes and informs the corporate change agenda.

Alan Osborne
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Background Papers:

The Background Papers used in compiling this report were as follows:

Cabinet Reports:

- *Budget and Council Tax Setting February 2015.*
- *MTFS – July 2014.*
- *Statement of Accounts – June 2015.*
- *Performance Monitoring Reports - Quarterly*

Audit and Governance Committee - Final Accounts - June 2014.

To inspect or obtain copies of background papers please refer to the contact officer listed above.

Risk/Effect	Contained in MTFS	Appendix 1 Other Mitigating Measures
Income Reductions due to demand changes	<ul style="list-style-type: none"> • Statutory recession hit income budgets adjusted each year as part of service and financial planning • No real growth assumed in overall income targets in 2016/20 • The economic regeneration reserve set aside to aid regeneration and contribute new sources of income • Interest budget set at current low interest rate • Unachievable income budgets reviewed during service and financial planning • Programme savings targets being set higher than the assumed delivery in the MTFS • Reserves above the minimum level 	<ul style="list-style-type: none"> • Service and financial plans to test possible income generation activities and price sensitivity • New sources of income explored in service and financial Plans annually across three year horizon • Planning at 2 levels in service and financial planning process to challenge assumptions
Government Support Being Reduced even further than forecast	<ul style="list-style-type: none"> • Assumption follows the Governments announcements to date • Prudent estimates of future income flows • Zero basing of reward grants • Reserves above minimum level 	<ul style="list-style-type: none"> • Possibility of service alterations to a modified level • Change assumptions during budget setting • Update MTFS early in the event of material change • Priority based budget system has flexibility to adapt
Benefits Performance reducing due to scale of changes	<ul style="list-style-type: none"> • No overall surplus built into subsidy budget 	<ul style="list-style-type: none"> • Service review of delivery arrangements • Mobilise resources from other areas if performance hit by staffing shortages • Relieve service with one off resources to avoid performance drop
Savings not being delivered	<ul style="list-style-type: none"> • Matching growth choice with performance of savings delivery • Strategic Change Fund to support invest to save • Capital Invest to save available case by case • Reserves well above minimum level can be used to smooth out fluctuations • Level of Revenue contribution to capital can be varied in the short term 	<ul style="list-style-type: none"> • Use compensating savings in short term • Reduce discretionary spend in year • Review minimum revenue provision to slow down capital repayments