BODY:	**CABINET**
DATE:	**10th July 2013**
SUBJECT:	**Medium Term Financial Strategy 2013-2017**
REPORT OF:	**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:

i) Approve the updated medium term financial strategy 2013-17 as summarised in **Appendix 2**.

ii) Agree the balance of assumptions made in the strategy and request that the strategy be brought back to Cabinet if there are material changes to the balance of assumptions prior to the 2014/15 budget setting.

iii) Request that the emerging budget proposals for 2014/15 be brought to Cabinet in December prior to detailed consultation.

iv) Agree the principal risks of the strategy in **Appendix1.**

1. Executive Summary

The strategy:

- takes into account further reductions in Government support of 12%
- assumes no real terms increase in Council Tax
- assumes a flat council tax base over the cycle
- assumes growth in retained business rates of 1% per annum
- targets recurring savings rising to £2.1m over the next three years
- models further benefits realisation from the DRIVE programme of £1.2m per annum
- assumes savings in procurement rising to £0.3m per annum
- follows a priority based budget system to preserve front line services
- targets further efficiency savings to be realised of £0.6m per annum from services and/or new income streams

- allows for £0.6m of annual growth in the Capital Programme
- preserves reserves above the minimum levels
- continues to zero base reward grants, to allow investment as and when received
- provides resources to honour nationally agreed pay awards
- makes allowances for increases in National Insurance contributions and increased costs due to pension auto-enrolment
- allows funding for unavoidable growth in service costs of £200k per annum
- maintains a strategic change fund (c£1m) to support DRIVE and invest to save
- maintains an economic development Reserve (c£0.5m) to recycle new homes bonus allocations into the local economy
- maintains a repairs and maintenance reserve to support asset management (c£1m)
- keeps a revenue contingency to meet unforeseen expenditure/loss of income at around 2% of the net budget (£300k)

2. Introduction

The 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 DRIVE transformation programme
- The Council's sustainable service delivery strategy
- The Council's corporate plan
- The major service strategies and plans

2.1 The MTFS was last approved in July 2012 and set the challenge to the 2013/14 budget setting process as well as a updating the three year financial strategy.

2.2 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.

2.3 Over the life of the current parliament the Coalition Government has effectively reduced the general support to the Council by some 40% in cash terms which equates to 50% in real terms.

2.4 Whilst the previous Government's 4% annual efficiency target has not been replaced with a specific target, in order to protect front line services this Council put in place a priority based budget system that yielded a cumulative 25%

efficiencies in its first three years of the Comprehensive Spending review period (£3.7m) This was in excess of the reduction in grant for 2011/14 (£3m) thereby creating some headroom to reinvest in services as well as preserving the overall reserves position.

2.5 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.

2.6 In setting the last four yearly 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 an 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.

2.7 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 revolving business plan has been adopted for the HRA and only the statutory interaction between the HRA and the general fund is acknowledged in the MTFS.

3. Sustainable finance

3.1 The basic legal definition of a balanced budget is that planned expenditure can be met from income and reserves.

3.2 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.

3.3 Therefore it is proposed that over the cycle of this MTFS ongoing expenditure must be financed from ongoing resources with only non recurring investments being met from any surplus reserves.

3.4 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 (approx 3% of net spend) if services are to be protected. This is on top of the austerity programme reductions outlined in 1.3.

3.5 Given the current reduction in grant and the inability to raise council tax in real terms, the Council has to look to longer term measures to maintain sustainable finances. These include measures under the Sustainable Service Delivery Strategy (SSDS) and the growth of income streams.

4. The National Financial Picture

4.1 The coalition Government has set out a plan to significantly reduce the nation's structural budget deficit by the end of the parliament and beyond.

4.2 This involves various measures that will reduce the amount of resources to local government including:

- A 40% reduction in central government support 2011-2016
- Combining various grants in a "single pot"
- A 10% cut in funding for the local council tax support scheme which replaced housing benefit subsidy in 2013/14.

The Government is currently carrying out its next CSR that will come into force in 2015.

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. Therefore the Council has adopted a stabilisation measure that takes interest received on balances, interest paid on debt, capital repayment of debt and revenue contributions to the capital programme as a single capital financing budget.

4.4 The Government continues to target an inflationary rate of 2% using its preferred method of Consumer Price Index (CPI) although the rate is currently 2.4% and has averaged over 3% in the last three years.

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. This support has already eroded by a third and will further erode to represent a real terms reduction of around half by the end of this strategy.

4.6 Against this backdrop service demands on Councils are ever increasing with demographic and downturn causal effects.

4.7 In his 2013 budget statement, the chancellor suggested that a cap on public sector pay rises would be 1% for at least two years.

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. Further changes are outlined in the current Pensions Bill which are likely to at least mitigate future funding pressures. The strategy assumes no increase in employer's contributions after the next triennial valuation is announced later in 2013. The Council will however have to find additional resources to fund "auto enrolment" due to start in November 2013.

5. 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 2010/13 outturns, whilst containing normal variances in year, resulted in a positive overall variance due mainly to increased performance in housing benefit overpayment recovery. Some underlying issues in the discretionary areas have been recognised in setting the 2013/14 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) although the rate is currently 2.4%. The strategy assumes 2% inflation from 2014/15.

The Council, in common with most, does not add inflation each year to all its supplies and services budgets as this would add some £400,000 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 £250,000 per annum (CPI). An allowance of £50,000 per annum for other unavoidable inflation (such as energy and business rate increases) is contained in the strategy.

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 current economic climate has 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
2013/14*	1%
2014/15	1%
2015/16	2%
2015/16	2%

* The 2013/14 situation is not currently resolved although there is an extant 1% offer from the employers.

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 2014.

The next triennial revaluation of the fund is currently taking place which will set rates effective from 2014/15. With the recent change from RPI to CPI as the annual index, and the potential changes arising from the Pensions Bill including a career average instead of final salary scheme, the strategy assumes no increase in employer contributions after the current revaluation.

The Council currently recoups its past service deficit a % of pay, however the fund actuary may require councils to amortise this deficit on a cash basis due to the risk of falling payroll numbers.

If a choice exists from 2014/15, then the decision as to whether to switch payment methods will be included in the budget setting process. In theory there is no material difference in the overall cost.

5.5 Fees and charges

The Council currently receives income from fees and charges for its services of around £13m.

The Council has been reducing its exposure to income targets in areas affected by the economic downturn in successive budgets. In setting the 2013/14 budget a targeted increase of £300,000 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 2014/15 an overall gain of £200,000 (1.5%) per annum will be realised in fees and charges (mainly inflation) but and this will increase in subsequent years (to 2%) as the economy recovers.

Individual service and financial plans will still strive to achieve some real terms increases where it is felt appropriate and achievable.

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 2013/16.

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 recycle these into capital financing as longer term interest rates used for borrowing purposes will increase too.

5.7 Council Tax

In closing the 2012/13 accounts, The Council has a declared a collection fund surplus of £24,000.

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.

The Council has taken advantage of the Government's tax freeze grant for the last three years. The grant for 2013/14 (£80,000) is not paid in future years despite the permanent loss of the revenue that would accrue from a rise.

The strategy assumes rises of 2% (based on CPI target) from 2014/15 i.e. no real terms increase in council tax across the life of the MTFS.

The strategy also assumes no increase in the overall council tax base, although some housing development is still in the pipeline. The Base will be reassessed annually.

5.8 Government Grants/Retained Business Rates

The Council currently receives £3.4m of revenue support grant.

In addition the Council now retains a proportion of business rates (£3.6m) collected based on 40% of the real increase in those collected using a base year of 2011/12. Increases in the retention from business rates are designed to promote local growth. The strategy assumes that business rate retention will rise by 1% per annum based on rate increases, although initiatives such as the Town Centre and Sovereign Harbour developments should contribute a further retention in future years.

In respect of reward grants the strategy continues to zero base these on the basis that if grants are received then spending plans can be brought forward to match the grants. The economic regeneration reserve was created in 2011/12 in order to facilitate this.

The new Homes Bonus is a reward grant that currently gives c£1800 for each new property brought into use/constructed and is paid for six years. The council's policy is to treat this grant as "one off" and use it for economic regeneration initiatives. In 2013/14 there is a small element (£130k) of the grant (£550k) that is used to support the budget, however the MTFS assumes that this will be eliminated by 2014/15.

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.

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 effect 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 growth.

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 growth.

One of the Council's main priorities is to increase the amount of available capital for development. The strategy provides for reinvestment of savings to the tune of £630k in capital financing. This would support over £10m of future capital spending at current long term interest rates.

5.10 Savings

Taking all known factors and assumptions as outlined above the Council needs make a minimum level of new savings of £700k 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	2013/14	2014/15	2015/16	2016/17
	£'000	**£'000**	**£'000**	**£'000**
SSDS	250	300	600	300
Service Based	170	200	200	200
Procurement	1100	100	100	100
Total	**1520**	**600**	**900**	**600**

This represents an average of £0.7m of new recurring savings each year.

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 now needs to be subject to an annual service and financial planning process in the same way as the general fund, this has begun and will feature in the 2013/14 budget setting process.

6. Reserves

6.1 The Council has the following main fund/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

Capital

- 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 2012/13 accounts show the balance available to the general fund to be £4.1m. This is the assumed starting point for the MTFS. There is a planned draw on reserves to meet non recurring expenditure in 2013/14 of up to £393,000. In subsequent years this is expected to average around £200k per annum during the MTFS.

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 2014/15, once the localised council tax support scheme is introduced as this is likely to increase financial risk at least in the short term.

6.4 The strategic change fund was established in 2009 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 fund had a balance of £0.6m at 31.3.13 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. Contributions are made each year from revenue.

6.6 The system of carry forwards finished 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.

6.7 The Council has had a conscious policy of keeping reserve levels above minimum levels in reaction to the recession and the continued squeeze on public sector spending. The MTFS summary (appendix) shows that the general reserve will be reduced over the life of the MTFS to an estimated £3.2m

6.8 In 2011, 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. This fund has already started to make a difference and the current policy is to use any unbudgeted new homes bonus to top it up over time.

7. The impact of the capital programme

7.1 The Capital Programme 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 over time.

7.2 The Council has recently repaid some £30m of borrowing in the Housing Revenue Account as it entered the "self financing" regime in 2012/13.

7.3 The General Fund policy is to use borrowing only on a business case basis (e.g. Solarbourne). 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. The capital repayment element of any borrowing is only required once the scheme is finished.

7.4 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.

7.5 Capital investment can be used as "invest to save" therefore borrowing is an important tool in the overall financial strategy where savings exceed the cost of capital.

8 Consultation

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 Staff are consulted via the Managers Forum and "Drop in Sessions" held periodically.

9. Conclusions

9.1 In order to maintain sustainable finances the Council will need to make new efficiency savings or income streams to the order of £0.7m per annum.

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
Chief Finance Officer

Background Papers:

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

Cabinet Reports: – Finance Matters (Standing Item)

- *Budget and Council Tax Setting February 2013.*
- *MTFS – July 2012.*
- *Statement of Accounts – July 2013.*

Audit Committee- Final Accounts- June 2012.

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