Committee:	**Scrutiny**	**Agenda Item**
Date:	**7 February 2013**	**11**
Title:	**Medium Term Financial Strategy**	
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Summary

1 As part of the annual budget setting process, the Medium Term Financial Strategy (MTFS) is due to be considered by Cabinet on 19 February and Full Council on 28 February.

2 The MTFS shows the following:

- The Council is in a stable financial position with reasonable confidence that this situation will prevail until at least 2015.
- Extreme difficulty in making reliable forecasts about Government funding from 2015.
- Progressive replacement of core Formula Funding with New Homes Bonus, a more variable funding stream.
- Forecasts suggest some limited budgetary flexibility in the next few years, rather than being in a position of having to make cuts to balance the budget.
- Reserves levels are adequate.
- A more challenging position is expected to arise before the end of this decade.
- Financial discipline and work to identify more efficiency savings must continue.

3 There is an opportunity for the Scrutiny Committee to review the report and provide comments in support of the recommendations, or to propose alternatives. Examples of the questions Scrutiny may wish to consider are:

- Are the assumptions used to build the forecasts reasonable?
- What would happen if actual events differed from the assumptions?
- Does the Council have a robust plan for addressing any deficits forecasted?
- Are plans for the use of any surpluses prudent, sustainable and good value for money?

Recommendations

4 The Scrutiny Committee is requested to endorse the following recommendations to Cabinet, or suggest alternatives.

5 The Cabinet is requested to approve, for recommendation to Full Council, the Medium Term Financial Strategy as set out in this report.

Financial Implications

6 Detailed in the report.

Background Papers

None.

Impact

Communication/Consultation	The forecasts in this report have been discussed with CMT, the Leader and Finance Portfolio Holder.
Community Safety	None
Equalities	None
Health & Safety	None
Legal implications	It is a legal requirement to set a balanced budget
Sustainability	The MTFS is designed to ensure the financial stability and sustainability of the Council over the medium term
Ward-specific impacts	None
Workforce/Workplace	Efficiency savings will have workforce implications

Medium Term Financial Strategy (MTFS)

7 The MTFS complements the Corporate Plan by setting out the anticipated resources available to enable the delivery of corporate priorities. It predicts the costs that will be incurred and estimates available income, and thus quantifies the level of flexibility within the budget, or savings necessary to balance the budget, as the case may be.

8 The MTFS covers the Corporate Plan period on a rolling five-year basis and thus this updated MTFS is for the period 2013/14 to 2017/18.

9 The MTFS focuses on the General Fund – budgets for all services except council housing, which is addressed by the separate HRA Business Plan. Capital expenditure is also excluded as this is covered by the 5 year Capital Programme. The interactions between the HRA, Capital Programme and General Fund have been built into the MTFS projections.

10 In a formal sense the MTFS is approved by the Council annually as part of the budget setting process, and undergoes a formal mid-year review by the Cabinet. In between these half-yearly updates, officers monitor the financial situation and will bring issues to Members' attention as required.

Key assumptions used

11 Necessarily the 5 year forecast is based on assumptions about the future. Below are the key assumptions used. Members should be comfortable that the assumptions are reasonable, neither unduly optimistic or pessimistic.

Government Funding

12 Government funding has always had a degree of unpredictability about it, with Formula Grant levels not confirmed until the shortly before budgets have to be finalised, and some funding often not confirmed until just prior to the start of the year, after budgets are set. However, uncertainty about Government funding continues to be at an unprecedented high level, especially from 2015 onwards.

13 The Government has issued a provisional financial settlement for 2013/14 (confirmation expected in early February) and a provisional settlement for 2014/15 (confirmation expected early 2014). The Government is carrying out a new Spending Review in 2013 which will undoubtedly have implications for local government finance, but an accurate prediction of the effects on UDC is not possible. From 2015 onwards there is huge conjecture because of the unforeseeable outcomes from the 2015 General Election and the ongoing implications of economic under-performance and Government deficit reduction plans. Finally 2013/14 sees the implementation game-changing reforms of local government finance, the effects of which are difficult to predict. Producing a five year forecast in these circumstances is not straightforward.

14 Core funding currently comes by way of **Formula Funding**, which is approx £2.8 million in 2013/14 (provisional). The provisional figure for 2014/15 is just under £2.4 million. There is no information about Formula Grant from 2015/16 onwards however it is expected that the trend established in the 4-year Comprehensive Spending Review period of 2010/11 to 2014/15 will continue. During this period, the Council has sustained a 42% cut in its level of annual core funding, around £1.7m per year. The average cut is therefore 10.5% and the MTFS assumes that this will be the annual cut in each year from 2015/16 onwards.

15 The Formula Funding figure for 2013/14 includes £1.35m as the Government's estimate of UDC's share of business rates under the new **localised business rates** system. This figure is based upon complex formulae and an array of tariff adjustments, top ups, levies, and safety net adjustments. There are many variables e.g. collection performance, rateable value appeals, business growth, insolvencies, reliefs, bad debts. The actual figure won't be confirmed until the end of the financial year. The downside risk is mitigated by the safety net mechanism which guarantees that UDC will receive £1.25m. The upside risk is considerable if actual performance exceeds assumed levels. The MTFS prudently assumes that the share will continue at the 2013/14 level and be subject to Formula Funding reductions.

16 **Council Tax Freeze Grant** has been paid to councils who have frozen (or reduced) their Band D figures in 2011/12, 2012/13 and 2013/14. The 2011/12 grant was for four years but has been rolled into Formula Funding. The 2012/13 grant was one-off. The 2013/14 grant is to be paid for 2 years. It is possible that the 2013/14 grant will rolled into Formula Funding from 2015/16, but the Government has not said this, so the MTFS prudently assumes that the grant ends in 2014/15.

17 **New Homes Bonus** rewards local authorities for housing growth. It is a rolling six year scheme, with 2013/14 being year three. In summary, councils receive a sum equivalent to the average English Council Tax bill, around £1,500, for each new dwelling (Band D equivalents). For example, if there are 333 new dwellings arising in the year, the council concerned would receive £500,000 in New Homes Bonus per year until the end of the scheme. This is compounded as illustrated in the table below.

UDC New Homes Bonus payments £000	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8
	2011/12	**2012/13**	**2013/14**	**2014/15**	**2015/16**	**2016/17**	**2017/18**	**2018/19**
	Actual	Actual	Provisional	Estimate	Estimate	Estimate	Estimate	Estimate
Housing growth year ending Oct 2010	714	714	714	714	714	714		
Housing growth year ending Oct 2011		534	534	534	534	534	534	
Housing growth year ending Oct 2012			794	794	794	794	794	794
Housing growth year ending Oct 2013				438	438	438	438	438
Housing growth year ending Oct 2014					451	451	451	451
Housing growth year ending Oct 2015						572	572	572
Housing growth year ending Oct 2016							703	703
Housing growth year ending Oct 2017								535
Total New Homes Bonus received	**714**	**1,248**	**2,042**	**2,480**	**2,931**	**3,503**	**3,492**	**3,493**
			MTFS PERIOD					

18 The estimates in the table above are based upon new housing completions predicted as reported to the LDF Working Group, with a 10% moderation for prudence.

19 The table shows that NHB should continue to increase until the sixth year, then plateau off as the first year funding drops out to be replaced by the seventh so that in any one year, only six years' worth of NHB is paid.

20 The ongoing rate of NHB will depend upon the amount of housing growth and occupancy. If growth slows, then the amount of NHB will reduce. Therefore NHB is a volatile funding stream.

21 During 2010/11 – 2014/15, the cumulative loss of Formula Funding is around £3.35m, which compares with NHB awards of £4m. Thus the Council has been a net beneficiary of this shift in funding approach. As the trends of core funding cuts continues, and with NHB funding being volatile, the Council faces serious financial risks in the medium to longer term.

22 There is a risk that at some point the Government will reform the NHB system, for example by giving a greater share to upper tier councils, which will affect the amount receivable by the district council.

23 As NHB is effectively supplanting core funding, the MTFS does not make any commitment to treat it is a stand alone item that can be made available for community projects, and therefore the one-off Jubilee Fund comes out of the budget after 2012/13. (The £88,000 budget for Ward Members - £2,000 each – remains in the budget as an annual sum). As part of considering each annual budget round, the amount of budgetary flexibility will be assessed based upon latest available information, and consideration given to funding one off projects in a sustainable way.

Council Tax

24 In recent years the Government's policy has been to strongly encourage councils to minimise Council Tax increases.

25 Decisions about each annual increase will be taken in the February of each year according to the needs and circumstances arising at that time. Having taken informal guidance from the Finance Portfolio Holder, the MTFS includes a planning assumption that the district council tax will be cut by 1% in 2013/14, and frozen in each of the following four years.

26 The MTFS also assumes an annual taxbase growth of 1%. This is a prudent assumption which is slightly below recent experience.

27 The Council has adopted a new system of **Local Council Tax Support** (LCTS), which becomes operative from 1 April 2013. LCTS will give Council Tax discounts to low-incomed households, replacing Council Tax Benefit which is abolished. The Council's scheme is the only one in Essex that meets DCLG Transition principles, the key one being that a person currently on full Council Tax Benefit will not have to pay more than 8.5% of the Council Tax bill. The Council is subsidising the scheme by £212,000 in the first year.

28 The Council has decided that it will carry out a review of the scheme during 2013, with a view to making changes from 2014/15 to ensure ongoing financial sustainability. This will include a review of second homes and empty homes discounts, with a view to possibly reducing these discounts, thus generating more Council Tax income, possibly to cross-subsidise LCTS. For MTFS purposes it is assumed that the £212,000 subsidy, which is built into the 2013/14 budget, is a one off item.

29 The Government has provided funding for LCTS an element of which is to be passed onto town & parish councils, to avoid LCTS discounts skewing the Band D calculations. The MTFS assumes that the Government funding and the 2013/14 parish funding level of £194,000 will continue.

30 The table below shows projected Council Tax income over the MTFS period. A 5% LCTS demand growth per annum is built into to the forecast.

	2013/14	2014/15	2015/16	2016/17	2017/18
Council Tax Base (Band D equivalents)	34,389	34,733	35,080	35,431	35,785
LCTS Tax Base reduction	-2,550	-2,677	-2,811	-2,951	-3,099
Net Tax Base for Council Tax setting purposes	31,839	32,056	32,269	32,480	32,686
District Council Tax (Band D)	£145.95	£145.95	£145.95	£145.95	£145.95
Change on prior year	**-£1.47**	**£0.00**	**£0.00**	**£0.00**	**£0.00**
Council Tax Income (£000)	**4,647**	**4,679**	**4,710**	**4,740**	**4,771**

Inflation assumptions

31 At time of writing, inflation (December 2012 figures) is at 3.1% (RPI) and 2.7% (CPI). Analysts predict short term volatility but a medium term decrease towards the Government's 2% CPI target. The cost of fuel and utilities remain volatile, however, and subject to larger cost increases than general price inflation.

32 The Government's pay policy for public sector employees is to cap increases at 1% per annum. For local government, national pay bargaining arrangements apply and there is no guarantee that Government pay policy will be applied. This is something that the Council has no control over. A freeze has been in place since 2009. This seems unsustainable so the MTFS prudently assumes a 1% annual pay award, together with the following inflation assumptions:

MTFS assumptions	**Approx value of each 1% change**	**2014/15**	**2015/16**	**2016/17**	**2017/18**
Pay award	£85,000	1%	1%	2%	2%
Supplies & services inflation (contractual indexation)	£28,000	3%	3%	3%	3%
Supplies & services inflation (other)	£32,000	2%	2%	2%	2%
Utilities & fuel	£6,000	5%	5%	5%	5%
Fees & charges income (except car parks)	£40,000	2%	2%	2%	2%
Car parks income	£8,500	0%	0%	0%	0%
Pension Fund Deficit contribution	£5,000	4%	4%	4%	4%
Housing Benefits	£170,000	MTFS assumes that inflationary impact will be outweighed by benefits reductions with no net increase in spend. No adjustments made for Universal Credit however expenditure will migrate from UDC to DWP during the MTFS period. There is not a significant bottom line impact because of expenditure being met by DWP subsidy (estimated recovery 98%).			

Other assumptions

33 Because of housing and population growth there will be additional demands on district council services, estimated at £100,000 per year, slightly above 1% of net service expenditure.

34 Capital financing costs to stay fairly constant at £1.5m as one off revenue contributions in 2013/14 are replaced by the financing costs of new schemes in future years.

35 Recharge of costs to the HRA will be subject to an inflationary increase.

36 Investment income will remain constant at £50,000 per annum.

37 The Collection Fund balance will be zero from 2014/15 onwards (currently £6,000 surplus).

38 The Working Balance will be maintained at a level equivalent to the sum of 2% of expenditure and 2% of income.

5 year financial model

39 Based upon the draft 2013/14 budget being presented for approval and the assumptions detailed above, a five-year forecast has been prepared and is summarised below.

£000	**2013/14**	**2014/15**	**2015/16**	**2016/17**	**2017/18**
Service Expenditure	32,123	32,145	32,365	32,634	32,909
Service Income	-23,575	-23,661	-23,782	-23,856	-23,981
Net Service Expenditure	8,548	8,484	8,583	8,778	8,929
Demand growth	0	100	200	300	400
Corporate Items					
Pension Fund	488	508	528	548	568
Capital Financing Costs	1,525	1,500	1,500	1,500	1,500
Collection Fund Balance	-6	0	0	0	0
Community Budgets	50	0	0	0	0
Recharge to HRA	-1,204	-1,228	-1,252	-1,277	-1,302
Investment Income	-50	-50	-50	-50	-50
LCTS subsidy	212	0	0	0	0
LCTS parishes grant	194	194	194	194	194
Net General Fund expenditure	9,757	9,508	9,703	9,993	10,239
Formula Funding (excl. Homeless)	-2,797	-2,373	-2,124	-1,901	-1,701
Council Tax Freeze	-50	-50	0	0	0
New Homes Bonus	-2,042	-2,480	-2,931	-3,503	-3,492
LCTS funding	-513	-513	-513	-513	-513
LCTS transition	-13	0	0	0	0
Net Operating Expenditure	4,342	4,092	4,135	4,076	4,532
Net transfers to/from(-) reserves	305	90	90	90	90
Council Tax Requirement	**4,647**	**4,182**	**4,225**	**4,166**	**4,622**
Council Tax	-4,647	-4,679	-4,710	-4,740	-4,771
Flexibility(-)	**0**	**-497**	**-485**	**-575**	**-148**

40 The summary shows that limited flexibility of around £0.5m per year exists in 2014/15, 2015/16 and 2016/17, with a smaller level of flexibility in 2017/18 as New Homes Bonus plateaus out and inflationary pressures and core funding reductions continue.

41 Extrapolating this further into the future suggestion that in 2018/19 the Council is not likely to have any flexibility and will be required to make savings, or draw upon reserves, to balance the budget in that year, and certainly by 2020.

42 The Council maintains a Budget Equalization Reserve to smooth out the effect of any funding reductions and cuts. Opportunities to bolster this reserve should be considered during the next few years in order to ensure maximum stability in the leaner years ahead.

43 **It is emphasised again that major uncertainty underpins these forecasts, in particular relating to Government funding from 2015 as discussed above.**

Reserves

44 The Council is required to establish reserves to meet expected future financial commitments and to ensure a safe level of contingency in the event of unforeseen events. This is discussed in the report later on the agenda, “Robustness of Estimates and Adequacy of Reserves”.

45 The Council’s policy, established in previous iterations of the MTFS, is to ensure that a Working Balance is maintained at a minimum safe contingency level equivalent to the sum of 2% of expenditure and 2% of income; around £1.2 million. This is subject to annual advice provided by the Section 151 Officer under Section 25 of the Local Government Act 2003.

46 Based upon the projected use of reserves included within the five year budget model, the following table sets out the forecasted reserve balances during the period covered by the MTFS.

£000	**31 March 2013**	**31 March 2014**	**31 March 2015**	**31 March 2016**	**31 March 2017**	**31 March 2018**
Working Balance	1,214	1,214	1,214	1,214	1,214	1,214
Budget Equalization Reserve	1,251	1,463	1,463	1,463	1,463	1,463
Other reserves	3,154	3,257	3,347	3,437	3,527	3,617
Total	**5,619**	**5,934**	**6,024**	**6,114**	**6,204**	**6,294**

47 Any unused flexibility would be added to the reserves, for example if the forecasted £497,000 of flexibility in 2014/15 was not used, it would increase the total reserves as at 31 March 2014 to £6,431,000, and so on.

48 The table shows that total reserves stay reasonably constant during the MTFS period. This should ensure that the Council continues to enjoy reasonable stability, allowing time to plan for difficulties expected in the longer term and to take the necessary steps to ensure continued stability after 2018.

Strategic Solutions Workstreams

49 In 2009 the five workstreams were established and from 2010 a small corporate team was set up to secure the savings needed by the MTFS. The Workstreams are:

- Shared Services
- Devolution
- Income Generation
- Service Reduction
- Efficiency Savings

50 The workstreams have been successful to date, with cumulative annual savings of over £2 million delivered by 2013/14.

51 There is more to do however. Because of the inherent volatility and conjecture in the MTFS projections, and the demanding position forecasted for 2018-2020 onwards, the Council must continue efforts to ensure it is well placed to meet future challenges.

52 The priorities for the workstreams in 2013/14 are as follows:

- Asset management
- Museum
- Postage
- Pest Control
- Fuel
- Trade Waste
- HR
- Finance.

53 The Council maintains a Change Management reserve to meet the one off costs of delivering the projects.

Decision making

54 Inevitably during the period of the MTFS, resource allocation decisions will be required based upon changing circumstances and priorities. Some budgets will need to be increased, and some reduced.

55 The Council will seek to safeguard those services that it considers to be highest priority as stated in the Corporate Plan.

56 The Council may make savings in priority areas only if there is no significant adverse impact to quality and level of service provision. For example, the Council may find a more efficient means of delivering the service, or partnership funding may be secured. Otherwise, the Council will not make savings that result in diminution in service quality in these areas unless there is absolutely no alternative e.g. inability to balance the budget.

57 The Council acknowledges the need to provide statutory services, and in many cases these will be consistent with Corporate Plan priorities. Where the link between the need to provide a statutory service and Corporate Plan priorities is not as strong, the Council will provide a level of service consistent with affordability. Efficiency gains and partnership working will be explored as means of providing statutory services to an acceptable level at a lower cost. In some circumstances, the Council will consider reducing the level of service in order to make savings and redirect resources to the Council's highest priorities.

58 Subject to the above, unavoidable and essential growth items will be funded by the making of savings from elsewhere within the Council budget, or the generation of additional income. The Council will manage its budget as a corporate whole, if necessary transferring money from one activity to another if this is what is necessary to match limited resources to the highest priorities.

59 In ordinary circumstances the Council will not use reserves to fund any ongoing expenditure. In exceptional circumstances, the Council may use reserves for one-off items or to alleviate budget pressures within the context of an overall plan to achieve a balanced budget but will seek opportunities to replenish reserves consumed in this way.

Risk Analysis

Risk	Likelihood	Impact	Mitigating actions
Actual experience differs from the assumptions in the budget and business plan	3 some variation is inevitable	3 sums involved are potentially significant	Ensure MTFS has element of flexibility Robust monitoring Half yearly review by Cabinet

1 = Little or no risk or impact
2 = Some risk or impact – action may be necessary.
3 = Significant risk or impact – action required
4 = Near certainty of risk occurring, catastrophic effect or failure of project.