

LOCAL GOVERNMENT ACT 2003 – REPORT BY THE CHIEF FINANCIAL OFFICER**1. SUMMARY**

- 1.1 This report assesses the risks arising from the budget proposed for 2019/20, and the adequacy of the available mitigations, in the context of the proposed reserves and the outlook for 2020/21 and beyond.
- 1.2 It concludes that the estimates as proposed are sufficiently robust to allow the Council to set the budget, but raises some concerns about the longer term sustainability in view of the uncertainties regarding the local government finances beyond 2019/20.

2. INTRODUCTION

- 2.1 The Chief Financial Officer has a statutory duty under Section 25 of the 2003 Local Government Act to make a statement on the adequacy of reserves and the robustness of the budget.
- 2.2 In the context of its service and financial planning the Council's overall approach to risk management is to take appropriate action to mitigate risks, or ensure that sufficient contingency exists, so that service provision is not threatened by unforeseen financial problems during the financial year.
- 2.3 Making changes to service provision at short notice in order to resolve a budget problem can have a number of undesirable consequences. These can include:
- (a) damage to the Council's reputation and customer relationships if advertised services are unavailable or delayed;
 - (b) failure to meet agreed performance targets;
 - (c) inefficiencies in overall service provision;
 - (d) associated costs of reducing service provision, such as staff redundancies, when planning changes over a longer timescale would allow greater flexibility; and
 - (e) potential problems for partner organisations that are dependent upon Council financial support to achieve agreed goals.
- 2.4 To avoid such problems the Council manages its financial risks by ensuring that its annual budget represents a reasonable estimate of the costs of providing agreed service levels. It also holds appropriate balances and reserves so that resources are available to allow a managed and considered response should any significant variations or emergencies arise.
- 2.5 This report considers:
- The robustness of the budget and key budget areas;
 - Adequacy of General Fund balances;

- Review of Earmarked Reserves and risks to incentivised income; and
- Future Years beyond 2019/20.

3. ROBUSTNESS OF THE 2019/20 ESTIMATES AND TAX CALCULATIONS

- 3.1 The Council Tax calculations for 2019/20 are based upon forecasts of expenditure, income and council tax revenues up to 31st March 2020, with some significant assumptions made in order to prepare these forecasts. When setting its Council Tax for 2019/20 the Council needs to be satisfied that these assumptions are reasonable. In order to ensure the robustness of the budgeting, the Council's budget process commenced in September 2018 and progressed with Cabinet's consideration of the MTFs in February 2019.
- 3.2 All areas of budgets have been reviewed by Heads of Service. In addition a number of budgets are subject to overall cross-service review, including the Council's employee budgets.
- 3.3 Some comments on the areas of the budget having key financial impacts are set out below:

(a) Pay and Pensions

The budget includes provision for an increase of 2% per annum and continues to provide for annual progression through pay scales where this is part of the terms and conditions of employment. A 1% change in pay amounts to around £230k per annum.

From April 2014 the Local Government Pension Scheme has moved to a career average scheme that combines an increased accrual rate of 49ths with commensurate changes to employee contributions. The Employer's superannuation payment due to the Suffolk County Council Pension Fund has been determined at 22.8%, with £3 million for superannuation back funding for the past service element of pension costs. The next triennial actuarial valuation is due in 2019 and will determine the rate from April 2020.

The Council's establishment budget is based on a full establishment. To allow for in-year vacancy savings the budget includes an annual vacancy saving of £400k. This is based on previous years' out-turn.

(b) Price Increases

Provision has been made for known price increases including the effects of utilities and business rates. Unless specifically requested by services, the budget assumes any price inflation is absorbed by the service.

(c) Income from Fees and Charges

A significant part of the Council's costs continues to be met from fees and charges. Progress against income targets will need to be monitored throughout the year, particularly in the light of continuing economic volatility.

The budgeted increases in fees and charges are based on three key principles; cost recovery, market value and inflationary increases. The budget also includes those increases that are set and proposed by Government.

(d) Investment Income

Since March 2009 interest rates have continued to produce low returns from investments. On 6th February 2019 the Bank of England maintained the Bank of England rate at 0.75% (increased from 0.50% to 0.75% on 2 August 2018). The Bank of England is reluctant to increase the bank rate while uncertainty remains over Brexit.

Security of the Council's cash is the over-riding consideration in setting its Treasury Management Policy Statement. During the year the Council constantly receives advice from its Treasury Advisors with regard to the creditworthiness of financial institutions.

Following advice from the Council's external treasury advisors Arlingclose the Council has invested in the region of £5 million into a pooled Local Authorities Property Fund (LAPF) to increase return on investment and to also diversify the portfolio from just purely investing with banks and building societies. The Property fund's value is derived from a mixture of capital values and rental income. The current projected dividend yield is 4.27% (the projected capital return when the investment is redeemed). With any investment there is risk and fluctuations in market activity or a downturn in the property market could affect the capital return on investment.

The budget takes a cautious view on interest rates, making allowance in line with forecast inter-bank lending rates.

(e) Housing Benefit

At a forecast £42 million, Housing Benefit remains the Council's largest financial transactions and subject to increasing risk and change. Welfare and benefit changes, and localised council tax support, which all began in April 2013, together with the planned introduction of Universal Credit, serve to make the existing arrangements more complex.

Welfare changes will continue to be closely monitored in order to continue to protect the Council from any emerging risks and liabilities.

(f) Business Rate Retention

From April 2013, councils have been able to retain a proportion of the business rates generated within the district and benefit from business growth over the longer term.

As business rates is an increasingly important income source for the Council, measures for closer monitoring of the local economy and its performance, and the impact on business rates have been put in place.

From 2020/21 there will be significant reform in the local government finance system which will include resetting business rates baselines. Reset of the system and the establishment of new funding formulae could result in the Council losing its financial advantage under the current system – predecessor Council, Suffolk Coastal, benefited from actual business rates income being significantly above the baseline, which was set at a low level in 2013/14.

As a prudent budgeting approach, the Council's General Fund Revenue Budget only includes business rate income at the government baseline level; although in practice the Council receives significantly more than this as its proportionate share of income. The position on this incentivised income is referred to in more detail in section 6 of this report.

Under the present Business Rates Retention system, the General Fund's maximum exposure to an adverse variance in business rates income would be the difference between the baseline and the safety net level that would be guaranteed by the Government. For 2019/20 this amounts to around £500k for the Council.

(g) Government Grant

As part of continued public sector deficit reduction measures, and as part of moves to address social care expenditure pressures in local government, the Council has seen large reductions to Revenue Support Grant (RSG). The 2019/20 budget includes RSG of £323k, however, given the uncertainty of the local government finance environment beyond 2019/20, the MTF5 has assumed RSG will not be received in future years.

(h) Council Tax Income

Council Tax income is one of the most important and stable income streams to the Council, funding approximately 50% of the Council's Net Budget Requirement. The change from council tax benefit to council tax support in April 2013 saw a reduction in the tax base of some 9,700 band D equivalents, with one implication being that the Council needed to try and recover council tax from low income claimants. Collection rates have been carefully monitored, and in calculating the 2019/20 tax base, the Council was able to maintain the estimated collection rate at 99%.

(i) Council Tax Levels

In the 2019/20 Final Finance Settlement, Council Tax increase referendum limits for shire districts is a maximum of £5 or 3%, whichever is the greater. The 2019/20 Budget incorporates a council tax increase of 2.5%. This equates to an increase of £4.05 and generates an additional £350k of income to the Council in 2019/20.

(j) Capital Investment

The forecast costs of specific schemes included in the approved capital investment plans are based upon reasonable estimates of cost and capacity to deliver the programme. If additional works are proposed during the year, these will be subject to formal approval and the financial implications will need to be considered at that time.

The capital investment proposals rely upon an overall funding envelope made up of a number of sources, including internal borrowing, capital receipts, and capital grant and revenue contributions. In determining the overall affordability of its capital programme, the Council has taken a prudent approach of not including anticipated capital receipts as a source of funding in the programme until such a time when the income is received and realised.

The capital investment programme for the Council is partly funded by borrowing (internal and external). The Council is required to complete a range of calculations (Prudential Indicators) to evidence that borrowing for capital expenditure is affordable, prudent and sustainable over the medium term. This makes sure that the cost of paying for interest charges and repayment of principal by a minimum revenue contribution (MRP) each year is taken into account when drafting the Budget and Medium Term Financial Strategy.

The Council makes use of the Short Life Assets Reserve to purchase a number of short life assets, such as vehicles and ICT acquisition and replacement. Funding of new assets from

the Reserve is repaid over the life of the asset from the revenue budget recognising the use of the asset. This approach ensures that the Council's borrowing approvals are used for funding spend on assets with a longer life, such as land and buildings.

The Council also makes use of the Capital Reserve and the Business Rate Equalisation Reserve to fund revenue contributions to the capital programme.

(k) Transformation and Efficiency

The Council has an enviable record of delivering its efficiency targets and once again the budget includes a number of efficiencies and savings that will need to be achieved in the coming year. However, finance settlements continue to make increasing demands on the Council to balance its resource and spending plans. Over the coming months the Council must continue to develop more innovative and some radical solutions to service delivery in order to address the estimated cumulative shortfall in resources. The Council remains committed to fund initiatives and projects that will produce savings or deliver additional income in future years' revenue budgets and has sufficient earmarked reserves for this purpose.

- 3.4 The Council's integrated performance management process includes a requirement for Cabinet to review the overall financial position every quarter. This review monitors revenue and capital budgets, and Treasury Management. In addition, key high profile General Fund revenue budgets are subject to additional review by the Council's Corporate Management Team. This helps to ensure that the Council takes appropriate action to resolve any financial issues as they arise and reduces the possibility of significant unforeseen problems during the year.

4. CHIEF FINANCE OFFICER BUDGET ASSESSMENT

- 4.1 I hold the view that the assumptions made in preparing the Budget for 2019/20 are reasonable and that the resulting estimates and Council Tax calculations are robust.

5. ADEQUACY OF GENERAL FUND BALANCES

- 5.1 The Council holds a number of reserves and balances to enable it to plan and manage its finances soundly. The Council's General Fund is estimated to have a balance of £6 million as at 1st April 2019 with no further use anticipated for the future years (subject to on-going review). At that level the General Fund Balance is within the thresholds established as part of the MTFS and represents a strong component in the Council's overall financial wellbeing.

- 5.2 I consider that the General Fund Balance is adequate to:

- a) provide cover for a reasonable level of variation in spending or income in the case of reserves held to mitigate against possible future events;
- b) meet unforeseen variations in the assumptions underlying the budget;
- c) address the risks arising from the Government's transfer of business rates, council tax and welfare changes;
- d) meet expenditure in advance of income being received; and

e) allow emergencies to be dealt with quickly.

- 5.3 With the significant financial challenges and opportunities facing the Council over the medium term, the Council should continue to maintain a robust level of General Fund Balance of about 3% to 5% of budgeted gross expenditure. This equates to about £4 million to £6 million.
- 5.4 The main budget risks and sensitivity to the Council's key in-year income and expenditure variables are shown below. The Council has sufficient contingencies and balances to manage these key risks.

Review & Risk Assessment of General Fund Revenue Balances 2019/20

Risk Area	Identified Risk	Risk		
		2019/20 £'000	Likelihood / Sensitivity %	Risk Value £'000
Pay Costs	Additional 1% on pay award	230	5%	12
Investment Income	Reduction in investment rates by 0.5%	550	10%	55
Car Parking Income	Economic, environmental, and market risks to income budgets	3,864	10%	386
Planning Fee Income	Economic, environmental, and market risks to income budgets	2,421	15%	363
Building Control Income	Economic, environmental, and market risks to income budgets	862	15%	129
Land Charges Income	Economic, environmental, and market risks to income budgets	415	50%	208
Garden Waste Income	Economic, environmental, and market risks to income budgets	2,350	30%	705
Waste Recycling Income	Possible decline in dry recyclables market	2,400	30%	720
Housing Benefit Subsidy	Possible adverse variance on subsidy	41,008	0.5%	205
Housing Benefit Overpayments	Possible adverse variance on overpayments recovered	1,314	10%	131
Council Tax Support	Possible increase in caseload - Effect on tax base	1,587	10%	159
Homelessness Administration	Possible increased caseload resulting from economic factors and welfare changes	710	15%	107
Partnerships	Potential operational failures and need to implement transitional arrangements	1,500	20%	300
Savings and Efficiencies	Non-achievement of vacancy saving	400	20%	80
Business Rates	Reduction in income to Safety Net level	500	50%	250
Risk Value Sub Total				3,810
Add: Contingency for unforeseen factors				550
Total Risk Value				4,360

6. REVIEW OF EARMARKED RESERVES AND RISKS TO INCENTIVISED INCOME

- 6.1 In addition to the General Fund Balance, the Council holds a range of Earmarked Reserves as part of its overall financial management. Two of the most significant Earmarked Reserves that the Council currently holds have been built up from incentivised income under the current arrangements for financing local government. These reserves form an extremely important part of delivering a range of Council objectives and are subject to specific risks in the medium term. These are referred to in more detail below.

Business Rate Equalisation Reserve

- 6.2 As referred to previously, the Council operates an earmarked Business Rate Equalisation Reserve. This Reserve holds additional business rates income over and above the baseline level required for the General Fund Budget. Increased use of business rates income in support of the budget constitutes an increased risk to the council, as this income is subject to uncertainty and volatility, especially in respect of economic factors. This reserve is an important source of funding for the capital programme.

- 6.3 Due to reform of the Business Rates system and the reset of the business rates baselines from April 2020 the funding picture for 2020/21 onwards is one of significant uncertainty. The 2019 Spending Review will confirm overall local government resourcing from 2020/21. A consultation on ‘*A review of local authorities relative needs & resources*’ was launched by the Government in December 2018.

New Homes Bonus

- 6.4 The New Homes Bonus (NHB) is funding allocated to councils based on the building of new homes and bringing empty homes back into use. It has become an extremely important source of incentivised income for the Council.
- 6.5 The Council makes use of up to 70% of its in-year NHB allocation (average of £1.3 million across the MTFS period) to support community initiatives and projects, with the remaining 30% being made available to support budget pressures if required. Unused NHB funding is held in a reserve. This approach adopted by the Council provides continued support to community initiatives but balances it against the overriding need to retain financial sustainability.
- 6.6 In a consultation on the 2019/20 Local Government Finance Settlement, the Government stated that the threshold for baseline growth will be reviewed. However, after consideration of representations from the consultation and the housing stock numbers reported through the Council Tax base data, the Government decide not to change the baseline for 2019/20. The 2019/20 allocation is therefore based on the current methodology.
- 6.7 As 2019/20 represents the final year of funding agreed through the 2015 Spending Review, the Government’s intention is to consider how to effectively incentivise housing growth. It is therefore anticipated that changes will be made to the way in which NHB funding is distributed from 2020.
- 6.8 Although the forecasts included in the Budget and MTFS indicate the continuation of healthy balances on the incentivised income reserves, it is important in this Chief Financial Officer report that the Council’s attention is drawn to the risks associated with such significant areas of the Council’s overall financing.

7. FUTURE YEARS BEYOND 2019/20

- 7.1 The Council is faced with significant challenges over the coming years. The Council will have to monitor the impact on its financial position and service provision arising from:
- (a) managing and addressing the impact of welfare changes on residents and the delivery of services,
 - (b) the introduction of Universal Credit,
 - (c) its success or otherwise in being able to promote a sustainable local economy in order to maintain and or increase its income derived from Government’s business rate retention scheme,

- (d) ensuring that its planning policies continue to support a proportionate and sustainable growth in employment, the local economy, housing and infrastructure,
- (e) significant reform in the local government finance system from 2020/21, including an updated, more robust and transparent distribution methodology to set baseline funding levels and resetting business rates baselines. This reform places greater uncertainty and income risk on the Council; and
- (f) changes to the NHB funding system and the resulting sustainability of continuing to support community initiatives and projects that have benefited from this incentivised income.

7.2 With continued substantial change and further significant reductions in public sector funding, the Council will need to respond in increasingly innovative ways to support its communities and maintain the momentum of improvement over the medium and longer term. Overall, the Council's budget is robust, and it has sufficient earmarked and general balances to manage key risks and deliver on a range of objectives. However, it is important that the Council recognises the risks to incentivised income areas outside of the budget itself, and does not become over reliant on these sources to both balance the budget and finance its longer-term ambitions.

8. FINANCIAL GOVERNANCE

8.1 Given the forecast financial position of the Council in the medium term, and in particular the reductions in Government funding and the risks and uncertainties concerning incentivised income, it is imperative that the Council's commitment to strong financial governance is maintained and strengthened.

Simon Taylor (CPFA)

Chief Finance Officer (S151 Officer)