NORTH HERTFORDSHIRE DISTRICT COUNCIL

MEDIUM TERM FINANCIAL STRATEGY

2019-2024

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1.0 Introduction

1.1 The Medium Term Financial Strategy (MTFS), the Council's key financial planning document, is an integral part of the Council's Corporate Business Planning process. The Council operates a system of priority led budgeting, with those district priorities set out in the "Corporate Plan" policy document. The MTFS then sets out how the financial management process will contribute to delivering those priorities and sets out a clear framework for our financial decision making. The strategy is updated annually. We fully expect that it will change over time to reflect new opportunities and policy decisions.

1.2 The MTFS includes a forward look over the next five years to assess the spending pressures the Council is likely to face and the level of cost reductions or income generation that will need to be made to allow us to achieve our legal duty to set a balanced budget each year. The Council has intentionally increased the level of its general fund reserves. The intention is that they can be used to soften the impact of expected (although currently unknown) future funding reductions. There will still be a need for the Council to review what services it delivers and how, but this approach does give more time to plan the impact of these changes.

1.3 The Council is required to retain a certain level of reserves. This is to provide protection against both known and unknown risks. This includes being able to react to changes in demand and any emergencies that may arise. The higher balance also reflects that the risks faced by the Council are higher, as it becomes more reliant on delivering efficiencies, generating income and undertaking more commercial activities.

1.4 The current national political climate means that there is significant uncertainty within the MTFS and therefore it will be kept under review until the budget for 2019/20 is agreed at Council in February. Even once the MTFS is agreed by Council, it is still just a plan, and therefore it will be monitored throughout the year and amended to reflect updated information. The budget monitoring reports (revenue and capital) that are provided to Finance, Audit and Risk Committee and Cabinet are a key component of this.

2.0 The current picture

2.1 The 2018-23 MTFS set the following budgets for four years:

£000	**2018/19**	**2019/20**	**2020/21**	**2021/22**
Net revenue expenditure	15,513	15,534	15,127	14,896
Estimated Funding	15,235	14,873	14,108	14,641
Use of reserves	754	1,525	595	(56)
General Fund brought forward	6,407	5,653	4,128	3,534
General Fund carried forward	5,653	4,128	3,534	3,590
Assumed savings and income efficiencies to be delivered (cumulative)	**250**	**750**	**1,500**	**2,250**

2.2 Whilst the MTFS is for a five year period, detailed forecasts were only provided for a four year period. This reflected the substantial uncertainty over future funding levels and that the Council should aim to balance its funding within the four year period.

2.3 The final position at the end of 2017/18 was a General Fund Balance that was higher (£7.403 million) than estimated above. This was due to underspends against budget and higher than forecast income from Business Rates. Some of the underspends have been requested to be carried forward, which increases the forecast spend in 2018/19.

2.4 To refresh the MTFS for the period 2019-24 it is necessary to consider any changes that need to be made to funding expectations and expenditure forecasts. Annex 1 provides further details of some of these assumptions. The following paragraphs detail the relevant changes.

2.5 Last year's MTFS included an allowance for pay inflation of 3% in 2018/19 and 2019/20, followed by a 2% increase in each year thereafter. A pay award for Officers and Chief Officers has now been agreed covering 2018/19 and 2019/20. This will provide a general increase of 2%, with higher increases for those at the bottom end of the pay scales to reflect the increases in the National Living Wage. The amounts budgeted for 2018/19 and 2019/20 (including the ongoing impact) will therefore be adjusted to reflect the pay award. The assumption for 2020/21 onwards will be based on a 2% average increase. However this is likely to have a very limited impact on the previously identified pay differentials, and have no impact when compared with other Local Authorities. A more fundamental review of our pay scales could be carried out, but is likely to be a significant cost pressure. This will need to be kept under review in the context of our ability to recruit to vacant posts.

2.6 The Council submitted a 4-year sustainability (also known as efficiency) plan in September 2016. This provided certainty over the level of Revenue Support Grant (RSG) that the Council will receive up to 2019/20. This includes an additional Business Rate tariff (known as Negative RSG) from 2019/20 of over £1 million. Whilst there was a commitment in December 2017 that the Ministry for Housing, Communities and Local Government (MHCLG) would look at "fair and affordable" options for dealing with negative RSG. There was supposed to be a consultation in spring 2018 which has not happened and there have been no other subsequent announcements. Therefore the Council continues to work on the assumption that it will have to pay a negative RSG (or an equivalent reduction in funding) from 2019/20 onwards.

2.7 In December it was also announced that a fair funding formula and 100% business rates retention would be implemented from 2020/21. A new funding formula would allow a different targeting of resources, such as more money for social care. Business rates retention relates to retention within Local Government overall and not to the area where it is collected. Although there may be the opportunity for Authorities to retain a greater share of any growth in Business Rates. The intention was that 100% retention would be accompanied by a transfer of responsibilities to Local Authorities so that the impact was cost neutral (i.e. it would not provide any additional money for Local Government). There has been lobbying to make the case that at least some of the funding should provide additional resources, without accompanying additional responsibilities. There has also been rejection of some of the proposed additional responsibilities on the basis that future spending obligations would not be matched by increases in Business Rates. It is therefore looking like 100% retention will be replaced with 75% retention. Overall there is very little information to base future funding estimates on. There is likely to be some damping to reduce the initial shock of any change, but the intention is that this will be unwound quite quickly. Whilst funding estimates are provided over a 4 year period, there is increasing uncertainty for 2020/21 and beyond. The aim of the MTFS should therefore be to: balance funding and expenditure within 3 years based on current assumptions, maintain General Fund balances to provide more time to react to changes and generate ideas for efficiencies, income generation and service reductions that can be implemented as required.

2.8 Current estimates of Business Rates are based on what Central Government determine to be the Council's baseline need, which is a prudent assumption. The Council does get to retain some growth in Business Rates and the estimates could be changed to reflect this. However any growth is quite uncertain and could be affected by collection rates, revaluations and appeals. Therefore the baseline need figures are used.

2.9 A further announcement in December (by the MHCLG) was an increase in the amount that Council Tax can be increased by without the requirement for a local referendum. To reflect increases in inflation (for 2018/19 and 2019/20) Council Tax can be raised by the higher of (up to) 3% or £5 for a Band D property (with other properties pro rata to this). It is assumed that for 2020/21 onwards the allowable increases (without the need for a local referendum) will revert back to the higher of (up to) 2% or £5 for a band D property. The MTFS assumes that the Council will continue to raise Council Tax by as much as it is allowed to without triggering a local referendum. This will be 2.99% in 2019/20 and then £5 (band D) in each year thereafter. Last year's MTFS assumed a 1% growth in the Council Tax base (i.e. number of Band D equivalent properties paying Council Tax), which was an increase from the assumed 0.5% in previous years. Actual growth in the Council Tax base in recent years has generally been at least 1% per year and is expected that this level of growth will continue going forward and therefore the growth is assumed to be 1% per year.

2.10 There were significant changes to New Homes Bonus (NHB) funding announced in December 2016. As expected this reduced the period over which the Bonus is paid. However it also introduced a baseline percentage of 0.4%, which meant that only growth above that level in each year would receive the bonus. For example, in 2018/19 the baseline was set at 0.4% of 57,288 properties = 230. So the Council did not receive a bonus for the first 230 properties, and therefore received a bonus based on 153 homes rather than 383. The bonus is funded from a fixed pot that has been top-sliced from the overall resources for funding Local Government. There is the scope for the baseline percentage to be adjusted in future years. The expectation is that it is only likely to increase e.g. to reallocate funding for specific services (such as social care) or to maintain the affordability within the overall fixed pot. This further reduces the funding the Council receives. Forecasts of housing growth in the District from show a significant increase. As the overall pot is fixed, the Council should only expect a significant increase if the growth was exceptional. This is unlikely to be the case, so the forecast in 2021/22 and 2022/23 is assumed to be the same as in 2020/21. Without any further information, the 0.4% is used as a baseline in each year. The above is on the assumption that the Local Plan is adopted. If it is not adopted then housing growth is likely to be lower and it is also possible that the Bonus could be withdrawn.

2.11 During 2017/18 there were substantial savings identified, particularly in relation to the retendered waste contract. This has significantly reduced the value of the savings or income generation that still need to be identified.

2.12 Expenditure and income over the next four years is therefore forecast to be:

£000	2019/20	2020/21	2021/22	2022/23
Net expenditure brought forward	14,549	14,496	14,812	15,085
Ongoing base budget adjustments, including previously identified savings	(663)	(29)	(84)	90
Additional savings or income generation to be identified*	(100)	(200)	(200)	(200)
Pay inflation and increments	448	250	250	250
Contractual inflation	444	420	430	430
Income inflation	(332)	(275)	(273)	(298)
Pension scheme contribution increases	0	0	0	0
Investment budget	150	150	150	150
Net Expenditure- to be funded from taxation and general grants	**14,496**	**14,812**	**15,085**	**15,507**
Council Tax	(11,417)	(11,781)	(12,152)	(12,529)
Revenue Support Grant	0	0	0	0
Business Rates- including tariff adjustment	(1,609)	(1,658)	(1,708)	(1,759)
New Homes Bonus	(1,119)	(1,252)	(1,252)	(1,252)
Other	24	24	24	24
Council Tax Collection Fund surplus	(260)			
Net funding position (use of reserves)	**115**	**145**	**(3)**	**(9)**
Reserve balance b/f	7,240	7,125	6,980	6,983
Reserve balance c/f	7,125	6,980	6,983	6,992

** These amounts are not cumulative. The total additional annual savings that need to be delivered by 2022/23 are £700k.*

2.13 A minimum General Fund balance of around £2.2 million was calculated in setting the 2018/19 budget for the purpose of protecting the Council against known and unknown financial risks. The Council is required to consider and maintain a minimum General Fund balance, as part of prudent budget planning. This minimum balance is partly based on the net budget of the Council. As the Council becomes more focused on income generation this will mean that the net budget is maintained at a similar level but both gross expenditure and gross income are higher, which brings with it greater risk. It is therefore reasonable to have a position where the General Fund balance is planned to be significantly above the minimum. As mentioned previously, the balance can also be used to provide a cushion against future expected funding reductions.

2.14 There are a number of assumptions built in to this analysis. The table below shows the sensitivities of some of these assumptions and the potential impact on budgets:

	Additional use of reserves over 4 years (£000)
Council tax base growth at 0.5% per year (rather than 1%)	600
Council Tax increases at 1.99% rather than 2.99% (2019/20) and £5 (thereafter)	575
Additional 1% pay inflation per year	500
New Homes Baseline at 0.5% (rather than 0.4%)	765

2.15 The Council currently has capital reserves that it can use to fund its capital programme. This means that the revenue impact of capital investment is minimal as it is just the lost interest from treasury investments. Over the life of the MTFS the available capital resources are likely to be diminished. After this the cost of capital investment will be substantially higher as it will incorporate borrowing charges and Minimum Revenue Provision. The capital programme (for all projects that are not committed to start) should be reviewed on the following basis:

- Is it necessary for continued service provision?
- If it is for investment, what return does it provide? Does it still provide a positive return if it was necessary to borrow money to fund the project?

3.0 Next Steps- Bridging the Gap

3.1 Corporate Business planning will need to be undertaken to identify how the required savings and income efficiencies will be delivered.

3.2 The roles and responsibilities of Councillors, Officers and the Senior Management Team are detailed in Annex 2. In summary the actions that will be required are:

- Officers (including the Senior Management Team) will continue to review current models of service delivery, and put forward proposals as to potential changes and the savings that could be achieved. Options may include:
    - Up-front (capital) investment to enable change
    - Working with others e.g. joint provision, joint procurement
    - Challenging the extent to which they deliver Corporate Priorities
    - Determine what non-statutory services are being provided (including services that exceed the statutory level of provision) and ensure that there is a case for continued delivery
    - Review of the capital programme
- There will be an increased focus on Commercialisation. This could include generating revenue income from capital investment, selling existing services on a more commercial basis or developing new services that are income generating. These options are likely to involve a lag between investment and savings generation.
- Councillors will be required decide on whether to take forward the options presented.
- The Service Director- Resources will monitor the assumptions made in funding and expenditure levels. When there is information that these will change, the MTFS will be updated and the implications presented back to Cabinet.

ANNEX 1 Budget Assumptions and Policies

Key Budget Assumptions

Inflation indices are reviewed on an annual basis and the forward budget projections amended accordingly. At this stage in the budget planning process, it is prudent to take a cautious approach and, in identifying the likely Council Tax requirement, the strategy focuses on the pressures on expenditure and assumes that income will rise in accordance with the determined policy. The figures presented in the MTFS financial projections appendices include the following assumptions in line with the current financial strategy

- Investment income is based on cashflow projections and a 1% return. This is significantly affected by the timing of expenditure in the capital programme.
- New Homes Bonus (NHB) will be awarded for 4 years from 2018/19. A 0.4% baseline (dead-weight) has been assumed. The split between District and County is assumed to remain at 80:20. It is assumed that the Council will have a Local Plan which will allow it to continue to receive NHB. The number of new homes per year is based on prudent estimates and could be higher. However it is assumed that there will not be any growth in the NHB received as it is funded from a fixed overall pot.
- The majority of the New Homes Bonus is used to continue the delivery of services in the face of other government funding reductions and is built into the base budget. Given the high uncertainty over this funding, it would be better if it was not used for core budgets, but it is appreciated that this is not currently feasible.
- Contract inflation in accordance with the individual contract terms.
- Pay inflation at 2.68% in 2019/20 (to reflect 2% pay award and additional allocation for lower grades to reflect National Living Wage increases), and an average of 2 % each year thereafter.
- Pension fund contributions do not include the assumption of making a capitalised lump sum payment, as permission was declined by Department for Communities and Local Government (now Ministry for Housing, Communities and Local Government).
- No allowance is made for general inflation on remaining expenditure. Although after allowing for salary and contractual inflation, the remaining amount is insignificant.
- Discretionary fees and charges income will be increased by CPI at November, plus 2%. This will be where it is legally possible and subject to a market impact assessment.
- The overall Council tax base figure will rise by 1% per annum.
- Council tax precept will be increased by the maximum amount allowed without the need for a local referendum.
- An assumed 99% collection rate for the purposes of calculating the Council tax base.
- An assumed 97% collection rate for Business Rates
- The minimum General Fund balance will be maintained at 5% of net expenditure plus an allowance for known financial risks.
- Any future changes to the local Council Tax Reduction Scheme will aim to have a cost neutral impact.
- The current assumption is that payments from Hertfordshire County Council as part of the Alternative Financial Model (AFM) for waste will continue. Pressures in relation to waste growth and cost of disposal may affect this in the future.
- A vacancy factor set at approximately 2.5% of salary budget to yield in the region of £300k is included in the base budget in each year.
- The Council will not subsidise areas which are the responsibility of another precepting body other than through a one-off match-funding arrangement where this is in the interests of the local Council tax payers.
- All assumptions are subject to further refinement during the budget process as more certain information becomes available.

Income Policy

As a minimum in recent years, where legally possible, the Council has sought to increase discretionary fees and charges annually in line with inflation, as measured by CPI plus 2% (at November).

The Council has previously taken the decision that certain discretionary services should move towards a break-even position, and some specific services must be provided at a net nil subsidy to the taxpayer wherever possible, and in these cases fees and charges may already be increased at a higher rate should it be required. Any other deviations from the strategy of increases by CPI plus 2% have to be explained and reported.

Generally speaking, charges are optimised to a level where we are reasonably confident they will not deter use of the service or impact on achievement of the policy objectives the Council is pursuing. We are conscious of the price sensitivity for some areas of our charges and that some charges can be in the upper quartile. It is therefore important that, as part of any review, we consider charges levied by competitors, and similar local authorities, to inform our own fee setting. The charging policy and particularly the level of subsidy for some charges is under constant review, as is applicability of charging for the use of our assets, as well as services.

Reviewing service provision

As part of further developing the Medium Term Financial Strategy, we continue to investigate the appropriateness of service subsidies and also the funding of functions which are the responsibility of other bodies. We recognise that we should give careful consideration to each individual case before reaching a decision and should apply the test: "should the Council Tax payer pay for all or part of a service or should it be the service user?" Many of the services we provide are subsidised and during the budget setting process, service managers are now asked to review the extent of the subsidies and are asked the following questions:

- Does the service support the Council's high level objectives and priorities?
- Is the service statutory or discretionary and, in either case, do we have discretion over the level at which it is provided?
- What proportion or sections of the population use the service?
- What is the level of subsidy?
- What is the reason for the service subsidy?
- Is there a strategy in place which determines the level of subsidy going forward?
- Is there the opportunity to make greater use of or secure external grants to reduce the subsidy?
- What impact would a reduction in the level of subsidy have on the service?
- How much income could be generated by a removal of the subsidy?
- Should any removal be subject to a phasing in process and if so over how many years?

Changes made to service delivery are required to include an equality analysis.

The Council will seek to manage all its assets cost-effectively, including opportunities to optimise income from the use of these assets, offering concessions (as appropriate and affordable) to encourage use by all members of our community in pursuit of our priorities. We will also continue to explore opportunities in regard to our assets, including long term leases which effectively constitute a transfer, whereby community groups take on responsibility for the operation and overall facility management.

The Local Government Act 2003 permits local authorities to trade with both public and private sector bodies. In broad terms authorities may not trade for profit unless that activity is performed through a company. The Localism Act 2012, while vesting a general power of competence, retains this requirement. Section 4 of the Localism Act restricts the ability of a local authority to carry out activities for a commercial purpose using the general power. Section 4 (2) provides that if a local authority undertakes a commercial activity in exercise of its general power it must only do so through a company (for this purpose this covers limited or "registered society" i.e. formerly co-operative, community benefit society or industrial provident society). Consequently, these provisions will be considered when exploring alternative service delivery models.

Risks and General Fund Level

Best Practice guidance issued by CIPFA states that the general fund balance may be between 5% and 100% of net expenditure. With an original estimate of net revenue expenditure of around £16 million and a Bellwin Threshold of £32k, the minimum 5% balance is in the region of £800k.

When setting the budget each year, the Council considers the potential impact of the risks in the assumptions made and adjusts the minimum 5% figure accordingly. Where there is the potential for increased volatility in funding levels, it is prudent to **either** consider increasing the minimum level of General Fund balance to around 10% to cope with any sudden change in income **or** to review the allowance made for a specific risk

Specific risks are identified and classified as high, medium or low risk and allowance is made for a proportion of the risk value. For high risk items, 50% of the risk value, for medium risk, 25% of the risk value and for low risk items, 0%. This is regarded as an appropriate risk management approach to risk likelihood and value.

In addition to the General fund balance, the Authority maintains a number of earmarked reserves and provisions, one of which is the special reserve.

Use of Capital

The Council still has had fairly significant capital balances, but it is expected that they will be diminished during the life of the MTFS. This will mean that future capital expenditure will need to be funded from new capital receipts (generated from sales of land and buildings) or from borrowing. It needs to be recognised that the supply of surplus land with development potential is reducing and therefore the opportunity for future capital receipts is limited. When the Council needs to borrow then it needs to ensure that it is affordable, prudent and sustainable (Prudential Code for Capital Finance in Local Authorities, 2017). The affordable criteria relates to the revenue impact of borrowing, which is made up of interest charges and a Minimum Revenue Provision (MRP). These costs can be significant.

Local Authority capital spending improves services, protects the value of the Council's portfolio of assets and replaces existing assets as they reach the end of their useful lives. Capital investment is not a luxury since without it, local authorities would become unable to deliver even their existing services let alone respond to new demands. For all capital schemes there needs to be a consideration of the benefits that are generated, which will include:

- Is it necessary for continued service provision? What would the impact on the service be? Is the service statutory or does it deliver the Council's vision or high level objectives?
- If it is for investment, what return does it provide? Does it still provide a positive return if it was necessary to borrow money to fund the project (including MRP)? What is the level of risk in the expected returns?

These reviews should be carried out on an annual basis, and before any scheme commences. Inclusion on the capital programme is for the purposes of future planning, and does not guarantee that a scheme will go ahead.

ANNEX 2 Roles and Responsibilities

The role of Councillors in this process is to:

- set vision and strategic direction
- agree the Council's high level objectives and priorities
- agree the specific projects to achieve the priorities
- agree the rolling MTFS including decisions on the time-frame to be covered, external influences to be considered and included, strategy for use of balances, assumptions regarding government support and the implications of doing so, income policy, capital strategy and setting indicative council tax levels for future years
- scrutinise proposals for funding prioritisation and de-prioritisation as set out by managers
- decide between options presented
- decide on options for increasing fees & charges where a proposed approach varies from that outlined in the income policy
- give due consideration to both the risks and opportunities of options as the council necessarily explores new avenues
- discuss savings suggestions and income generation proposals with relevant Officers.
- take a corporate overview of the budget position once decisions on individual prioritisation have been taken.
- set the level of Council Tax each year
- scrutinise and monitor the budget throughout the year

The role of all Officers is to:

- put forward suggestions for actions to deliver the objectives and new opportunities
- ensure that existing spend and new projects link to and deliver one (or more) of the Council's objectives
- manage services to deliver the actions in the plan within budget allocations
- explore alternative ways of delivering services, including assessment of risks and opportunities
- propose income generation and service transformation opportunities
- report on value for money and continuous improvement
- monitor the budget throughout the year and ensure spending is in line with policy requirements

The Senior Management Team is led by the Chief Executive. The group:

- facilitates a critical review of existing expenditure. This involves reviewing the base position, challenging existing budget allocations and creating the ability to reallocate money to strategic priorities.
- reviews service areas in comparison to other authorities to determine opportunities for improvements and cost reductions, or to explain reasons for any differences.
- reviews bids for additional resources/ investments. All bids will be subject to detailed scrutiny before inclusion in the draft budget. The strategic priorities fund can be allocated by SMT for short-term investments.