APPENDIX A

NORTH HERTFORDSHIRE DISTRICT COUNCIL

MEDIUM TERM FINANCIAL STRATEGY

2018-2023

CABINET (25.7.17)

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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 as new opportunities, or policy decisions, affect the bottom line.

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 savings 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 reserves over the last few years, and is planning to use them to soften the impact of 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.

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 2018/19 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 2017-22 MTFS set the following budgets for four years:

£000	**2017/18**	**2018/19**	**2019/20**	**2020/21**
Net revenue expenditure	15,978	15,762	15,348	15,162
Estimated Funding	15,235	14,873	14,108	14,641
Use of reserves	743	889	1,240	520
General Fund brought forward	6,061	5,319	4,430	3,190
General Fund carried forward	5,319	4,430	3,190	2,670
Assumed savings and income efficiencies to be delivered (cumulative)	**800**	**1,500**	**2,150**	**2,750**

2.2 Whilst the MTFS is for a five year period, detailed forecasts are only provided for a four year period. This reflects 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 2016/17 was a General Fund Balance that was significantly higher (£8.235 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 2017/18.

2.4 To refresh the MTFS for the period 2018-23 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 The budget for 2017/18 includes a pressure of £558k in relation to lump sum pension payments. The Council's revenue contributions to the pension fund consist of two elements. The first is an annual contribution as a percentage of payroll, which is the employer's contribution to cover for the future benefits of the current employees. The second is the annual lump sum payment, which is the contribution towards the fund deficit and the benefits gained by previous employees in previous years. The Council had hoped to make an up-front lump sum payment into the pension scheme in 2016/17, funded from capital. This was the same as had been done in 2014, and doing the same again would have reduced the revenue impact of pension costs in future years. This use of capital resource required approval from the Department of Communities and Local Government (DCLG), but this request was turned down. The Council will try again to obtain permission but, in forecasting, a prudent assumption is that this will be unsuccessful.

2.6 Last year's detailed budget (agreed by Council in February) highlighted a risk in relation to a review that was due to be carried out by the National Joint Council (NJC) on Local Government pay scales. This was in relation to the impact of pay freezes, the increases for the new National Living Wage and that salaries are no longer in line with the general market. The outcome of this review has still not been finalised, but it is looking increasingly likely that the Council should make budgetary provision above previous assumptions (i.e. 1% wage inflation per year). This revised MTFS therefore assumes a 3% increase in 2018/19 and 2019/20, followed by a 2% increase each year thereafter. This would require a change to the current national 1% public sector pay cap policy for these pay increases to take place. If this cap was not lifted, then this pressure would reflect the cost pressures to maintain the staff resources to deliver services.

2.7 The Council submitted a 4-year sustainability (also known as efficiency) plan last year. This provided certainty over the level of Revenue Support Grant (RSG) that the Council will receive up to 2019/20. This currently includes an additional Business Rate tariff (known as Negative RSG) from 2019/20 of over £1 million. It was expected that 100% Business Rate Retention would have been implemented from 2019/20. Whilst this was not expected to provide any additional funding for Local Government, it could have resulted in a fundamental change to the distribution of resources. It would have also have given Local Authorities a greater share of any growth in Business Rates. However the required legislation was not passed prior to the General Election in June, and it did not feature in the Queen's speech. The DCLG have said they are still committed to Local Authorities taking greater control of their income and are planning to resume working on Local Government finance reform, but without an imminent Bill. Given this, and that any new system would provide some transitional protection, RSG and Business Rates are assumed to be in line with previous indications.

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. We have, therefore continued to use the baseline need figures.

2.9 In February, Council agreed an increase in Council Tax of £5 for a Band D property (with other properties pro rata to this) for 2017/18. 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. At the moment this is the higher of 2% or £5 (Band D). Last year's MTFS assumed 0.5% growth in the Council Tax base (i.e. number of Band D equivalent properties paying Council Tax). Actual growth in the Council Tax base in recent years has exceeded 1% per year. It is expected that this level of growth will continue going forward and therefore the assumed growth has been changed to 1% per year.

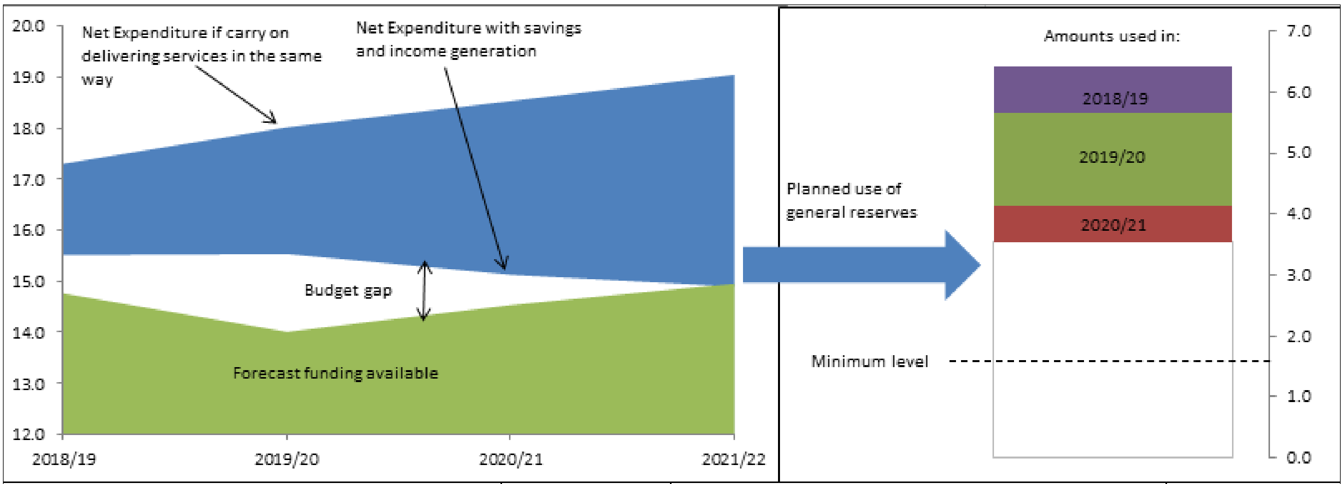
2.10 There were significant changes to New Homes Bonus (NHB) funding announced in December 2016. As expected this reduced the period over which the Bonus is paid. However it also introduced a baseline percentage of 0.4%, which meant that only growth above that level in each year would receive the bonus. For example, in 2017/18 the baseline was set at 0.4% of 56,942 properties = 228. So the Council did not receive a bonus for the first 228 properties, and therefore received a bonus based on 249 homes rather than 477. 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 provide 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 2020/21 show a significant increase (936 new homes in 2021/22 compared with 608 in 2019/20). 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 is assumed to be the same as in 2020/21 (i.e. £1.25 million rather than the £1.80 million which would be received if it was based on 936 new homes). 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.

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

£000	**2018/19**	**2019/20**	**2020/21**	**2021/22**
Gross expenditure brought forward	28,764	27,998	28,352	28,263
Ongoing base budget adjustments, including previously identified savings	-1,041	-191	-169	0
Estimated savings from Waste Vehicle purchase	-500	0	0	0
Additional savings or income generation to be identified*	-250	-500	-750	-750
Pay inflation	375	375	250	250
Contractual inflation	400	420	430	430
Pension scheme contribution increases	100	100	0	0
Investment budget	150	150	150	150
Total gross expenditure (excluding Housing Benefit subsidy)	**27,998**	**28,352**	**28,263**	**28,343**
Sales, Fees and Charges	-8,709	-9,048	-9,304	-9,565
Interest and commercial rental income	-1,347	-1,313	-1,313	-1,313
Specific Grants and Contributions	-2,428	-2,458	-2,520	-2,570
Net Expenditure- to be funded from taxation and general grants	**15,513**	**15,534**	**15,127**	**14,896**
Council Tax	-10,906	-11,263	-11,627	-11,996
Revenue Support Grant	0	1,070	1,125	1,159
Business Rates- including tariff adjustment	-2,628	-2,721	-2,803	-2,887
New Homes Bonus	-1,265	-1,119	-1,252	-1,252
Other	39	24	24	24
Net funding position (use of reserves)	**754**	**1,525**	**595**	**-56**
Reserve balance b/f	6,407	5,653	4,128	3,534
Reserve balance c/f	5,653	4,128	3,534	3,589

** These amounts are not cumulative. The total additional annual savings that need to be delivered by 2021/22 are £2.25 million.*

2.12 The Council's General Fund balances are being used to cushion the impact of the reduction in funding and the requirement to make efficiencies in the early years. The Council has deliberately increased its General Fund balances for this purpose. A minimum General Fund balance of around £1,600k has been calculated 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. The very high uncertainty for year 5 (2022/23) makes it difficult to estimate what further savings will need to be delivered. However targeting a balanced budget by 2021/22 (with reserves remaining) would put the Council in a good position. The information above is presented graphically below:



Savings and Income generation required by 2021/22	**£4.2 million**	Savings and use of reserves by 2021/22	**£7.0 million**

Equivalent to 12 houses in Hitchin or Letchworth	Equivalent to 20 houses in Hitchin or Letchworth
Equivalent to the full time salary of 150 people in North East Hertfordshire	Equivalent to the full time salary of 250 people in North East Hertfordshire
Equivalent to 145 new cars	Equivalent to 250 new cars
Equivalent to 27% of the net budget	Equivalent to 46% of the net budget

2.13 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 (reduced) use of reserves over 4 years (£000)
Council tax base growth at 0.5% per year (rather than 1%)	573
Council Tax increases at 2% rather than £5	287
Additional 1% pay inflation per year	500
10% reduction in previously identified savings that are delivered	98
New Homes Baseline at 0.5% (rather than 0.4%)	911
Additional 100 household growth per year for New Homes Bonus	(1,094)

2.14 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 will be substantially 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 Corporate Board are detailed in Annex 2. In summary the actions that will be required are:

- Officers (including Corporate Board) 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 a continued focus on Commercialisation. Work will be on options for generating revenue income from capital investment and/ or trading. 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 Head of Finance, Performance and Asset Management 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 5 years from 2017/18 and 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.
- 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
- Contract inflation in accordance with the individual contract terms.
- Pay inflation at 3% in 2018/19 and 2019/20, and 2 % each year thereafter.
- Pension fund contributions do not include the assumption of making a capitalised lump sum payment, as permission has been declined by Department for Communities and Local Government. Making a £2.5 million capitalised up-front payment would firstly reduce the lump sum payments in each of the next 3 years by £834k (revenue saving). Additionally the up-front payment will be invested by the pension fund on a long-term basis so it would be likely to improve our funding position (and therefore reduce our contribution rates) following future revaluations. The pension fund made investment returns of 22% over 3 years.
- 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 (i.e. would not lead to a profit) and subject to market impact assessment.
- The overall Council tax base figure will rise by 1% per annum.
- Council tax precept will be increased by £5 (band D equivalent), or 2% where this is higher.
- 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 savings target set at approximately 2.5% of salary budget to yield in the region of £0.23 million is included in the base budget in each year.
- Any investment in Area Committee budgets to reflect additional responsibilities will be offset by reductions in Directorate budget
- 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.
- Full Council may approve as part of the annual budgetary process that unallocated Area Committee budgets can be carried forward from one year to the next and not be subject to the normal rules for carry forward budgets.

- All assumptions are subject to further refinement as we go through the budget process and 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 fairly significant capital balances, but over the life of this MTFS they are expected to be substantially diminished. The latest forecast (as per the Capital Programme Outturn for 2016/17) is that the Council will only have £1.7 million of capital reserves by the end of 2019/20, and this is assumes that £4 million of incoming receipts from land and property disposals can be generated. The supply of surplus land with development potential is reducing and therefore the opportunity for future capital receipts is limited.

When the Council has used all its capital reserves, future capital spending can be funded from borrowing as long as it is affordable, prudent and sustainable (Prudential Code for Capital Finance in Local Authorities, 2004). 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 Corporate Board of officers 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 and scoring process before inclusion in the draft budget. The strategic priorities fund can be allocated by the Board for short-term investments.