APPENDIX K

Report of	Meeting	Date
Chief Finance Officer	Special Council	25 February 2020

REPORT OF THE CHIEF FINANCE OFFICER

PURPOSE OF REPORT

1. To provide advice to the Council as required under s25 of the Local Government Act 2003.

RECOMMENDATION(S)

2. The Council are recommended to note the Chief Finance Officer's comments and advice under Section 25 of the Local Government Act 2003 as set out in this report and have regard to it when considering the budget proposals for 2020/21.

EXECUTIVE SUMMARY OF REPORT

3. This report is required by statute and the Chief Finance Officer should report to members the robustness of the budget estimated including how they have been constructed and the assumptions that underpin them. In addition, the Chief Finance Officer must report to members the adequacy of the proposed financial reserves.

4. This report outlines the key assumptions and risks contained in the budget and identifies that over time working balances will be increased to mitigate some of those risks.

5. The Final Local Government Finance Settlement that was announced on 7 February 2020. Chorley Council will revert to membership of the Lancashire Business Rates Pool. In addition, the Government did not reduce New Homes Bonus allocations in 2020/21 however it will remove New Homes Bonus allocations, a reduction of over £2m to Chorley Council over the next three years.

6. In September 2019 the Chancellor announced £13.8bn of investment in the NHS, Police and social services. Although this investment in public services is welcomed, it is my view that the outcome of the fair funding review, expected for 2021/22, will result in the Government reducing funding for district councils and transferring some of this to upper tier authorities, many of which will continue to struggle to fund adult social care and children's services. The uncertainty created by the new business rates regime means we must be prudent when budgeting for future levels of retained business rates, as such I have assumed that the benefit of pool membership in 2020/21 will not continue in 2021/22 onwards.

7. In terms of the 2020/21 budget once again all key budgets have been reworked to align with expected outturn for 2019/20 and therefore reflect the ongoing cost of delivering the current levels of service. The budget contains expenditure savings targets and increased budgeted income. These targets are prudent and achievable.

8. There has been some increased certainty in the budget this year due to the results of the **triennial pension review** from the Lancashire County Pension Fund. Employer pension contributions for 2020/21 to 2022/23 to meet the future costs of the scheme and have increased from 14.4% to 16.4% resulting in an increase in the council's contribution. This is lower than the 17.1% assumed in the previous year's budget. In other good news the council's contribution to the past pension fund deficit has halved from £900k per year to approximately £450k per year from 2020/21 to 2022/23.

9. There continues to be income targets contained within the budget; these are based upon contractual agreements or have been realigned to reflect the latest performance information. A **fees and charges** report was approved by Executive Cabinet on 16 January 2020 that includes inflationary increases in some of the discretionary charges the council makes for its services. A prudent estimate of £7k increased income has been brought into the budget for 2019/20 onwards. **Market Walk** will continue to be the council's biggest income generator in terms of fees and charges. Voids reduced in 2019/20 with the shopping centre forecast to be fully occupied in early 2020/21. The shopping centre continues to generate £900k net income annually for the council but to mitigate some of the risks to income, revenue budgets are being set aside into an equalisation account to be used should rental targets not be achieved. The balance in the income equalisation reserve will be £490k in 2020/21.

10. The forecast is that the budget will be balanced in 2020/21 and that the Council's **general fund balances** will be £4.0m. The general fund balance is above that of other Lancashire District Councils and is required to manage short-term one-off risks to the revenue budget. These include the impact on the budget of the new revenue generating capital projects all of which opened in 2019. In addition, funds continue to be set aside as earmarked reserves in 2019/20 that will:

    - help enable the council to implement the Transformation Strategy and resultantly the budget strategy included in the MTFS
    - help mitigate some of the risks within the current and proposed new business rates system.

11. Key risks remain, in particular the forecasting of **business rate receipts** in 2021/22 onwards. The council will benefit from being a member of the Lancashire Business Rate Pool in 2020/21. However, the new 2021/22 75% retention scheme is unlikely to resemble the current pool scheme. As such the benefit in 2020/21 will be treated as a one-off and only growth that is achieved in the business rates base will be built into the base budget. There is zero percent growth assumed in the short to medium term period.

12. The council continues to develop its **Capital Strategy**, this report demonstrates that the council's capital expenditure and investment decisions are taken in line with corporate objectives and take account of stewardship, value for money, prudence, sustainability and affordability. I am satisfied the report, Appendix H to the main budget report, provides this assurance to members and outlines what the strategic intent is for the council over the medium to long-term.

13. Having reviewed the underlying assumptions and commented on the position in relation to key risks and working balances I am satisfied that the budget assumptions are reasonable, the key financial risks have been considered and the budget is deliverable.

14. Further analysis of the risks to revenue and capital budgets are analysed at the end of this report.

Confidential report Please bold as appropriate	Yes	**No**

CORPORATE PRIORITIES

15. This report relates to the following Strategic Objectives and to the Council's ability to deliver its corporate plan whilst ensuring a balanced budget is achieved. The MTFS sets out how Council resources will be used to deliver those priorities.

Involving residents in improving their local area and equality of access for all	✓	A strong local economy	✓
Clean, safe and healthy communities	✓	An ambitious council that does more to meet the needs of residents and the local area	✓

BACKGROUND

16. Under the requirements of Section 25 of the Local Government Act 2003 the Chief Finance Officer is required to advise members when setting the budget as to the robustness of the estimates and the adequacy of working balances.

THE ROBUSTNESS OF ESTIMATES

17. In terms of the budget proposals, once again in 2019/20 a thorough reassessment of the budgets has been undertaken by budget holders, service managers and directors and their accountants based upon the latest information available. In terms of the key assumptions contained particularly in the 2020/21 budget these are shown in the main budget report but are summarised for convenience below

KEY ASSUMPTIONS

18. The table below shows the key assumptions made in forecasting forward the Council's financial position.

Key Assumptions	2020/21	2021/22	2022/23
Growth in Council Tax Base	1.20%	1.20%	1.00%
Council Tax Increases	0.00%	0.00%	0.00%
Increase in Retained Business Rates through Growth	0%	0%	0%
Total Forecast New Homes Bonus	£2.346m	£1.125m	£0.550m
Future Service Pension Rate	16.4%	16.4%	16.4%
Pension Fund Deficit Recovery	£0.416m	£0.432m	£0.450m
Additional Business Rates - Lancashire Pool	(£0.800m)	£0.000m	£0.000m
Income from LCC	(£0.210m)	(£0.210m)	(£0.210m)
Pay Award	2%	2%	2%

In terms of the key assumptions I would make the following comments to confirm their validity:-

COUNCIL TAX INCREASES

19. The administration is proposing no increase in council tax in 2020/21. The MTFS does not model any future increases however it is acknowledged that this will be revisited every year and will depend upon the outcome of the business rates and fair funding review. A prudent 1.2% expansion of the council tax base, excluding council tax increases, is being assumed which reduces to the 1.0% in 2022/23. These assumptions in growth are significantly lower than has been experienced in most of the previous years.

REDUCTION IN RETAINED BUSINESS RATES

20. The council will benefit from being a member of the Lancashire Business Rates Retention Pool in 2020/21. However, the 75% business rates regimes, expected in 2021/22, is unlikely to resemble the pool and therefore the council may experience a reduction in retained business rates in the medium term, for example:
    - the final scheme may change the tier splits and provide more of the retained rates to upper tier authorities
    - when the new system is reset the Government may reduce or remove the section 31 grants, these are grants that compensate councils for Government initiatives that reduce locally generated business rates e.g. small business rates relief or retail reliefs. These grants currently equate to

£1.6m a year and therefore any reduction in these grants poses a large risk to the council.

- the quantum of business rates in the system may include the New Homes Bonus allocations that the government is phasing out over the next three years.

21. The new business rates regime will dictate the quantum of business rates to be shared nationally and locally however it is the fair funding review that will dictate how this is shared out. The fair funding review is expected to generate new funding 'baselines' for all councils in 2021/22. How these will be calculated, and therefore how much the council will be allocated, is still not finalised however it is believed it will be based on factors such as population growth, rurality, deprivation levels and other local area adjustments such as local labour costs. The fair funding review will allocate retained business rates based on a council's relative need to all other councils, as a result of this it is not possible for the council to conduct any meaningful analysis of the likely outcome of this review. At this stage Chorley Council will assume the benefit of pool membership, approximately £800k, will be permanently lost as a result of the business rates and fair funding review.

22. The budget report explains the volatile nature of this particular core income stream and why accurate forecasting of future receipts is problematic. The income levels contained within the retained business rates budget are based upon a set of assumptions that may impact on the total amount collected in future years, in particular the outcomes within the appeals process. The council has set aside approximately £900k in reserves to manage one-off fluctuations in retained business rates.

23. A large risk that was associated with business rates income related to two applications for mandatory charitable relief received from Lancashire Teaching Hospitals NHS Foundation Trust. If successful the application would have been back dated to 2010 and therefore have a significant impact on the Council's revenue budget. A headline figure is a potential £2.4m impact on the Council's general fund and a further c£280k reduction in ongoing retained business rates. However, the High Court has ruled that NHS Trusts and Foundation Trusts are not eligible for mandatory business rates relief. Although a favourable outcome for councils, given the large amounts of money involved for Foundations Trusts across the country it seems likely that an appeal will be submitted.

24. A final consideration to the council's retained business rates income is the potential for there to be a national economic slow-down. A more detailed analysis of this is given in Appendix F – General Fund Forecast Assumptions. In brief this may result in an increase in the number of appeals against rateable values as well as reducing local economic activity and therefore reducing retained business rates. The councils provision for appeals will stand at approximately £4.5m in 2020/21 which is comparable to the national average.

NEW HOMES BONUS

25. The spending review announced a gradual reduction and ultimate removal of New Homes Bonus. Government proposals are for allocations to reduce as follows:
    - 2020/21 – 4 year allocation - for Chorley Council approximately £2.3m
    - 2021/22 – 2 year allocation - for Chorley Council approximately £1.1m
    - 2022/23 – 1 year allocation - for Chorley Council approximately £550k

26. The following announcement was made with the provisional finance settlement:

    It is not clear that the New Homes Bonus in its current form is focussed on incentivising homes where they are needed most. I am therefore announcing that the government will consult on the future of the housing incentive in the spring.

    This will include moving to a new, more targeted approach that rewards local authorities where they are ambitious in delivering the homes we need, and which is aligned with other measures around planning performance.

27. As such there may be a replacement to New Homes Bonus however nothing can or has been assumed in the budget.

BORROWING

28. The council has taken £5.5m of additional PWLB borrowing in 2019/20 to ensure the council manages its cash balances. The assumption built into the 2020/21 forecast is that the internal cash balances will not be sufficient to manage the cash flow requirements of the council, especially as the council continues to invest in large scale capital projects. It has been assumed that the council will borrow £6-8m in late 2019/20 or early 2020/21.

29. So long as the internal cash position remains positive the council will temporarily continue to internally finance some of the debt required rather than borrow. The rationale for this approach is that the interest earned on deposits is significantly less than borrowing costs and in treasury management terms is financially advantageous to the council. However, I need to be able to respond to what happens in the financial markets and as borrowing rates fluctuate be able to react. If rates are forecast to change it will be appropriate to take on some additional borrowing. For this reason, although I have built in some savings, I have also left some headroom for in year borrowing.

30. The treasury announced a 1% increase in PWLB rates of borrowing, the £33m borrowing and purchase of the Logistics House site was done prior to this increase. In addition, the increase in interest rates will not affect the borrowing levels already assumed on the major projects that went live in 2019.

PENSION FUND CONTRIBUTIONS

31. As part of a **triennial pension review** the Lancashire County Pension Fund announced an increase in employer pension contributions for 2020/21 to 2022/23 to meet the future costs of the scheme. The contributions have increased from 14.4% to 16.4% resulting in an increase in the council's contribution. This is lower than the 17.1% assumed in the previous year's budget.

32. The Lancashire County Pension Fund has outperformed most local authority pension funds over the past 3 years. Looking forward the pension fund has provided figures that forecast Chorley Council's contribution to the prior year deficit will reduce by approximately £500k, reducing the council's budgeted contributions by over £1.5m over the next three years.

PAY AWARD

33. An average 2% pay increase per year has been assumed for 2020/21 to 2022/23. However, Unions are strongly supporting a 10 per cent pay increase and a £10 minimum hourly rate claim for local government workers in England, Wales and Northern Ireland for the year starting April 2020. Every 1% increase in pay results in over £100k of additional expenditure to Chorley Council.

34. There has been a recent announcement from Government that the national living wage will increase by 6.2% in 2020/21. This will not affect Chorley Council's pay bands for 2020/21 as the council pays above this level already.

MEDIUM TERM FINANCIAL STRATEGY

35. The MTFS sets out the Council's plans to bridge the funding gap as summarised below:

Chorley Borough Council Transformation Programme

	2020/21 £m	2021/22 £m	2022/23 £m
Adjusted Budget Deficit/(Available Resources)	**0.000**	**1.087**	**2.061**
Contract Savings			
Leisure Centre Management (expires October 2020)	-	(0.446)	(0.446)
Income Generation			
Investment Sites	-	(0.200)	(0.200)
Parking Income	-	-	(0.200)
Total Income Generation	**0.000**	**(0.200)**	**(0.400)**
Efficiency Savings			
Efficiency Savings		(0.441)	(1.215)
Adjusted Budget Deficit/(Available Resources)	**0.000**	**0.000**	**0.000**

36. The strategy shows that broadly speaking the administration will attempt to bridge the gap by generating efficiency savings and additional income of £2.061m. Table 4 of the main budget report outlines that the council expects to generate £975k per annum net income from its recent investments by 2022/23. Further analysis of the risks associated with these investments is given in Appendix H – Capital Strategy Report - to the 2020/21 budget report.

37. The council will continue to build on its success with a £200k net income target from investments site in 2021/22. This is achievable given the number of different income generating projects the council has in development. There remains preparatory expenditure to bring investment sites forward and this is why there is £250k of uncommitted resources in an earmarked reserve specifically for investment in income generating projects. New posts have been recruited to and external expertise commissioned to drive forward the expansion of income generation.

38. The greatest budget challenge for the council is to generate £1.2m of efficiency savings by 2022/23. This target is dependent upon the outcome of the funding review in 2021/22 as well as the council pursuing other measures to meet the budget gap, such as increasing council tax. £1.3m represents approximately 12% of the staffing budget. Significant savings have already been identified from the first phase of shared services and both councils are looking to expand these arrangements. The council is also investing in ICT to help deliver front line efficiency savings in services such as streetscene and the single front office. As such, although £1.2m is a large target I also believe it to be achievable given the reviews we are already undertaking.

LEVELS OF RESERVES

39. The target level of general fund reserves is £4.0m over the medium term. This is higher than general fund balances at most Lancashire District councils and importantly the MTFS does not rely on utilising balances to meet deficits over the three-year period. General fund balances are there to manage potential risks contained in the budget particularly around:
    - the volatility in the funding system in relation to business rate retention
    - possible re-profiling of savings and income generation proposals into future years
    - risk of loss of deposits should a future banking crisis occur

40. In relation to the Treasury Strategy, individual deposit levels were increased to £3m to enable better rates to be accessed, but investments of up to £4m can be placed with part-nationalised UK financial institutions. One of the lessons for Councils who were affected by the Icelandic banking crisis was that they should at least have the minimum level of working balances to cover any potential loss of deposits should a banking crisis occur. For this reason, I think it appropriate to keep working balances to a minimum of £4m.

41. There are risks to revenue budgets surrounding the major capital projects that will begin to generate income in 2019/20. These include the possibility that occupancy rates for Market Walk Extension, Strawberry Fields or Primrose Gardens are lower than budgeted in the MTFS. In addition to this, there continues to uncertainty surrounding the United Kingdom's withdrawal from the EU. Further analysis is provided in Appendix F to this report. I deem the general balances of £4m is prudent given these risks. In addition, the council holds earmarked reserves such as income equalisation reserves to help manage large one-off reductions in income at its investment sites.

IMPLICATIONS OF REPORT

42. This report has implications in the following areas and the relevant Directors' comments are included:

Finance	✓	Customer Services	
Human Resources		Equality and Diversity	
Legal	✓	Integrated Impact Assessment required?	
No significant implications in this area		Policy and Communications	

COMMENTS OF THE STATUTORY FINANCE OFFICER

43. These are contained within the report.

COMMENTS OF THE MONITORING OFFICER

44. The report is designed to ensure that the relevant legislation is complied with in terms of Statutory Officer advice.

GARY HALL
CHIEF EXECUTIVE

There are no background papers to this report.

Report Author	Ext	Date	Doc ID
Gary Hall	5151	13/02/2020	

RISKS TO MEDIUM TERM FINANCIAL STRATEGY

The Medium-Term Financial Strategy outlines how the Council will achieve its corporate strategy priorities whilst recognising the budgetary pressures it will experience over the coming 3 years. Within the strategy are a number of risks that are outlined below.

RISKS TO REVENUE BUDGET

HIGH RISK

75% Business Rates Retention
The government continues its ambition to implement a new 75% business rates retention scheme for all local authorities by 2021/22. The current 75% Lancashire Pilot will be abolished, and the council will revert to the Lancashire Business Rates Pool in 2020/21. Forecasting the effects of the new retained scheme using prior year data is challenging for the following reasons:

- The local preceptors should receive more of the locally generated business rates (from 50% to 75%) however, the government may introduce a less favourable split between lower and upper tier authorities
- The level of locally generated business rates may be reduced if the government reduces its allocations of section 31 grants – grants used to compensate councils for Government policies that reduce business rates e.g. small businesses and retail reliefs
- The current pool uses historic baseline funding levels however, the result of the government's fair funding review will see this baseline adjusted with the potential for Chorley Council to receive less of its retained NDR income.

The government continues to develop the fair funding review and new business rates system however it remains uncertain when the new system will be introduced. There remains a lot of work to be completed by the Government including the need to develop transitional arrangements. After this a consultation exercise will need to be undertaken. The budget is prudent and assumes implementation of the fair funding review and 75% business rates regime in April 2021.

NHS Request for Mandatory Relief
A large risk that was associated with business rates income related to two applications for mandatory charitable relief received from Lancashire Teaching Hospitals NHS Foundation Trust. If successful, the application would have been back dated to 2010 and therefore have a significant impact on the Council's revenue budget. A headline figure is a potential £2.4m impact on the Council's general fund and a further c£280k reduction in ongoing retained business rates. However, the High Court has ruled that NHS Trusts and Foundation Trusts are not eligible for mandatory business rates relief. Although a favourable outcome for councils, given the large amounts of money involved for Foundations Trusts across the country it seems likely that an appeal will be submitted.

MEDIUM RISKS

Business Rates Appeals and Other Business Rates Adjustments
The Council's provision for business rates appeals stood at £2.95m at the beginning of 2019/20 and allowance has been made for additional provision of £1.2m during the year. Of this, during the year there has been approximately £26k of successful backdated appeals charged to the provision.

In April 2017 a new business rates appeal process was introduced called 'Check, Challenge and Appeal'. The benefit of the multi-stage process is that it requires businesses to complete its own 'Check' and therefore should discourage speculative appeals. To date there has been no successfully challenged appeal reported by the VoA against the 2017 list. The VoA has focussed on clearing the backlog of prior year appeals and so it is prudent to assume more appeals will be coming through from the 2017 list in 2020/21.

The budget for 2020/21 includes further additional provision of £1.2m. This is deemed sufficient to meet the potential successful appeals that may transpire from the outstanding lists.

Pay Inflation
An average 2% pay increase per year has been assumed for 2020/21 to 2022/23. However, Unions are strongly supporting a 10 per cent pay increase and a £10 minimum hourly rate claim for local government workers in England, Wales and Northern Ireland for the year starting April 2020. Every 1% increase in pay results in over £100k of additional expenditure to Chorley Council.

New Major Projects
The assumptions in the revenue budgets relating to the council's major capital projects are outlined in the Capital Strategy report. The net income profile for these projects estimates a total of £975k income by 2022/23. The revenue models for some of these projects include a gradual increase in occupancy rates, these assumptions are ambitious but not unachievable given the interest the council currently has in filling these units. However there remains a risk that slower than budgeted occupancy will impact on the revenue budget. This will be managed through in-year budget variances and through the general fund.

Universal Credit
The Government is consolidating a number of welfare benefits into a revised Universal Credit Scheme. One of these is housing benefit which is currently administered by the Council. Universal credit will be managed by the Department of Work and Pensions. The full scheme was rolled out in Chorley in July 2018 however take up has been slow. There is the potential risk that bad debts will increase when people move to UC as it becomes more difficult to recover overpayments. This is because the housing benefit element of debt might not have the same priority over other debt recover such as fuel or rent arrears. We have seen an increase more over the last 12 months from HB to UC as take-up has increased and therefore, there is a possibility that the council's bad debt provision will need to be increased with a subsequent charge to the general fund.

Delivery of Budgeted Savings and Additional Income
The MTFS includes a number of challenging saving proposals and innovative plans for income generation. Achieving these goals will require a change in organisational culture, enhanced sharing of services across organisations and commercial negotiations. The monitoring and robust challenge of all proposals is overseen by the council's Senior Leadership Team. Risks are reported to Corporate Leadership Team as well as members and actions taken when required. Given the council's increased dependency on generating income there will always be risks that sit outside of the council and are therefore more difficult to manage.

The council's general fund balance of £4m has been set such that potential delays in bringing forward income or generating savings can be temporarily managed within council resources.

LOW RISK

Inflation
The council's expenditure is subject to annual inflation based on indexation that is determined by external stakeholders. Sharp increases in inflation would result in higher day to day expenditure and possible budget overspends. Inflation forecasts from the Office of National Statistics (ONS) have been used to inform the budget over the coming 3 years. This will be reviewed annually to ensure budgets are sufficient to meet inflationary pressures.

Existing Income
The major income streams the council benefits from include car parking, planning as well as commercial income from units the council owns including Market Walk Shopping Centre. Uncontrollable reductions in income could leave services under-funded. The council has been prudent when budgeting for income and there is relative certainty from the income gained through lease of commercial units. There has been £490k set aside to manage any in-year reductions in income from unbudgeted voids at Market Walk and the planning budget was reduced in 2019/20 by £100k to better reflect forecast activity.

Interest Rates
As a result of the capital investment in the borough the council does not hold large cash reserves and therefore changes in the rates on deposits do not represent a large risk to the council. Potential increases in the rate of PWLB borrowing may result in the council taking long-term borrowing earlier to ensure it finances its capital programme at the most economical rate. The Financial Accounts team monitor changes in PWLB rates closely as well as receiving updates from our treasury management specialists. This enables the team to regularly update and advise the Chief Finance Officer.

RISKS TO CAPITAL BUDGET

MEDIUM RISKS

Overspends on Capital Projects
All capital projects are monitored on at least a quarterly basis, with the major capital projects monitored on an ongoing basis by council officers and commissioned external project managers. Any potential overspends are highlighted by the relevant project group or officer and reported to the Chief Finance Officer.

Actions plans are agreed to manage potential overspends and managed by the project officer. If necessary, financing is identified within the capital programme to meet any additional required resources. Changes to the capital programme are reported quarterly to Executive Cabinet. Changes to a capital project between these periods are taken on a separate report to Executive Cabinet or Full Council.

LOW RISK

Insufficient Financing to Delivery Capital Programme
The council continues to have a significant gap between its capital funding requirement and current borrowing levels. As such borrowing is available to the council if funding sources previously allocated to projects no longer become available.

Insolvency of Major Contractor
As part of the tender process the financial standing of each contractor has been thoroughly assessed. These checks are regularly and the council's subscription to a credit check agency provides alerts were the credit status to change.