Chorley Council

APPENDIX J

Report of	Meeting	Date
Chief Finance Officer	Special Council	27 February 2018

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 2018/19.

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 Council will continue to experience significant reductions in funding. The Final Local Government Finance Settlement 2018/19 to 2020/21 was published on 6 February 2018. This settlement continued with the Government's policy of reductions in funding being administered with the expectation that any budget shortfall is mitigated through increases in council tax.

6. In terms of the 2018/19 budget once again all key budgets have been reworked to align with expected outturn for 2017/18 and therefore reflect the ongoing cost of delivering the current levels of service. The budget contains expenditure

savings targets and increased budgeted income. All expenditure savings included in the 2018/19 budget have been achieved.

7. 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 18 January 2018 that included increases in some of the charges the council makes for its services. A prudent estimate of the increased likely income has been brought into the budget for 2018/19 onwards. Market Walk will continue to be the Council's biggest income generator in terms of fees and charges and to mitigate some of the risks to income money is 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 £300k in 2018/19.

8. The forecast is that the budget will be balanced in 2018/19 and that the Council's general fund balances will be £4m. The target balance of £4m has been achieved a year earlier than budgeted and is set at this level to manage the risks to council's funding over the medium term as well as managing any potential re-profiling of savings the council is required to make. In addition, funds continue to be set aside as earmarked reserves in 2018/19 that will help enable the Council to implement the Transformation Strategy and resultantly the budget strategy included in the MTFS.

9. Key risks remain, in particular the forecasting of business rate receipts in 2020/21 onwards. As part of the final Local Government Finance Settlement 2018 the Government announced a new 75% business rates scheme and a new funding formula that makes longer term financial planning very challenging. As such only growth that is achieved will be built into the base budget and there is zero percent growth assumed in the short to medium term period. The Council does however continue to benefit from being a member of the Lancashire Business Rate Retention Pool in 2018/19.

10. 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.

11. 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

12. 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

13. 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

14. In terms of the budget proposals, once again in 2018/19 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 2018/19 budget these are shown in the main budget report and the medium term financial strategy (appendix C on this report agenda) but are summarised for convenience below

KEY ASSUMPTIONS

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

Key Assumptions	2018/19	2019/20	2020/21
Increase in Council Tax	2.99%	2.99%	2.99%
Growth in Council Tax Base	1.89%	1.5%	1.5%
Growth in Retained Business Rates	0%	0%	0%
Reduction in Revenue Support Grant or equivalent increase in business rates tariff	£0.435m	£0.299m	-
Total Forecast New Homes Bonus	£2.989m	£2.753m	£2.156m
Use of New Homes bonus to Fund the Capital Programme	(£0.400m)	(£0.400m)	(£0.400m)
Total Forecast New Homes Bonus Built Into the Base Budget	(£2.589m)	(£2.353m)	(£1.756m)
Future Service Pension Rate	14.4%	14.4%	14.4%
Additional Business Rates - Lancashire Pooling Arrangement or equivalent business rates retention regime	(£0.716m)	(£0.560m)	(£0.316m)
Income from LCC	(£0.096m)	(£0.096m)	(£0.096m)
Pension Fund Deficit Recovery	£0.841m	£0.966m	£1.016m
Pay Award	2%	2%	2%

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

COUNCIL TAX INCREASES

16. Taking into consideration the large reductions in funding the council will experience in 2018/19 to 2020/21 the administration is proposing to increase council tax by 2.99% in 2018/19. As well as this the MTFS models the forecast impact of a 2.99% council tax increase in 2019/20 and 2% in 2020/21. As the council tax charge is decided annually it will be for the council to determine if any actual increases are implemented. A prudent 1.5% expansion of the council tax base, excluding council tax increases, is being assumed. This growth is lower than has been experienced in previous years and although it is expected that housing expansion will slow, it is still expected that council tax yield will be greater than budgeted.

REDUCTION IN GRANT SETTLEMENT

17. The Local Government Finance Settlement 2016/17 offered all Councils a four year Revenue Support Grant (RSG) settlement from 2016/17 to 2019/20. In accordance with Government requirements an Efficiency Plan was agreed at Full Council in September 2016. This document was published on the Council's website and on 16 November 2016 the Council received confirmation from MHCLG on its four year RSG settlement, including an additional business rates tariff in 2019/20. The risk to the Council now is that we have the certainty of the Revenue Support Grant reductions but the uncertainty of the new business rate system. To mitigate this risk the forward forecasts of business rate income are prudent and I have set out a target for general fund balances of £4m to manage some of this risk. This target balance has been achieved in 2017/18, a year earlier than budgeted.

NEW HOMES BONUS

18. The allocation of NHB has been reduced from 6 to 4 years, in addition the allocation has been reduced using a 'deadweight adjustment'. This assumes that the Council should at least expand the housing base by 0.4% per annum; any growth below this level would not receive funding. For Chorley this is approximately 150 band D equivalents per year. The deadweight adjustment has not been adjusted in 2018/19 but it could be adjusted further in 2019/20 onwards. In order to be prudent I have modelled a tapered reduction in NHB based upon a lower growth in housing stock. It is clear that the NHB system will be part of the local government resource base and in this respect it allows the funding to be used as funding in the base budget as per last year's budget strategy. It therefore allows for the use of the resource to fund core services to a greater extent than previously if this is required.

NET FINANCE OF MARKET WALK

19. In December 2017 £5m of PWLB borrowing was taken to ensure the council managed its cash balances whilst mitigating against potential increases in future interest rates The assumption built into the 2018/19 forecast is that the internal cash position will therefore remain positive for at least the first half of the financial year and that if requires we will be able to 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.

BUSINESS RATE RETENTION (BRR)

20. 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.

21. The forecast of loss of income due to successful appeals is made more complicated in 2017/18 onwards by the 2017 national revaluation and the new 'check, challenge and appeal' process. There is limited information to date on the level of appeals against the 2017 list and therefore it is not straightforward to calculate a sufficient appeals provision. On average businesses in Chorley experienced a reduction in business rate liabilities and therefore the council should expect a lower rate of appeals than in the past. The appeals provision will stand at £2.150m in 2018/19. I am confident this is sufficient to cover the potential cost of appeals in 2018/19.

22. At present any growth in business rates is being offset by losses on appeals and for this reason I am building no estimated growth into any future years forecast which I believe is a prudent approach. With regard to the additional income resulting from being a member of the Lancashire BRR Pooling Agreement, budgeted income from 2018/19 is estimated based on the current level of receipts. Until further information becomes available, I will continue to assume the council it is part of the Lancashire Business Rates Pool in 2019/20 and that it will continue to benefit, albeit by a lesser amount, in 2020/21 from business rates retention.

23. A large risk associated with business rates income relates to two applications for mandatory charitable relief received from Lancashire Teaching Hospitals NHS Foundation Trust. If successful the application would be backdated to 2010 and therefore have a significant negative impact on the Council's revenue budget. A headline figure is a potential £1.5m impact on the Council's general fund and an approximate £200k further reduction in ongoing retained business rates. At present, as per advice from Local Government Association legal advisors, I have assumed this request for relief will not be granted. However I am confident the Council has sufficient working balances to deal with the risk posed from these applications.

PENSION FUND CONTRIBUTIONS

24. As part of a triennial pension review the Lancashire County Pension Fund (LCPF) announced an increase in employer pension contributions for 2017/18 to 2019/20 to meet the future costs of the scheme. The contributions have increased from 11.1% to 14.4% resulting in an increase in the council's contribution of approximately £250k per annum. It is assumed that contributions remain at 14.4% in 2020/21.

25. The pension deficit recovery period is assumed to be made over 19 years however Chief Finance Officer's in Lancashire have raised queries to the LCPF as to whether this should be extended over a longer period as has been experienced in other funds throughout the country. If this is agreed there is the potential for contributions to the pension fund to be lower than currently budgeted in 2020/21.

PAY AWARD

26. The estimates for 2018/19 are based upon the most recent announcement of actual pay award, so in that respect are robust. Future years are based upon the fact that pay increases are on average likely to be 2% in 2018/19, 2019/20 and 2020/21. The increases are budgeted to be higher for those on lower scale points. Chorley Council pays the Living Wage Foundation hourly rates to its employees meaning it will pay more than the National Minimum wage. The council reviewed its staff on lower pay scales in 2016/17 and ensured that any potential increases in the Living Wage Foundation rates could be managed within its current pay structure.

27. Two of the three local government trade unions will reject the 2% pay offer from employers. Their argument is that the headline figure in each year is less than inflation and therefore represents a "pay cut". Chorley Council has modelled for a 2% pay increase year on year over the MTFS period. Every 1% increase in pay increases council expenditure by £120k. A final settlement is not likely to be reached until 2018/19 and so any potential shortfall in the budget will be dealt with through the 2018/19 budget monitoring process.

MEDIUM TERM FINANCIAL STRATEGY

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

Total Summary Budget Resource Options to 2020/21

	2019/20 £m	**2020/21 £m**
Forecast Budget Deficit	**1.614**	**2.213**
Renegotiate Contracts	(0.574)	(0.673)
Transformation – Productivity Gains including shared services	(0.790)	(1.040)
Income Generation – Delivering Market Walk Extension	(0.150)	(0.300)
Income Generation – Delivering Council Owned Housing Stock	(0.100)	(0.100)
Income Generation – Developing Council Owned Employment Land	-	(0.100)
Forecast Adjusted Medium Term Budget Deficit	**(0.000)**	**(0.000)**

29. The strategy shows that broadly speaking the administration will attempt to bridge the gap by generating efficiency savings and additional income of £2.213m. Based upon the analysis of risk I have undertaken this is not unrealistic but it will require the Council to focus in particular upon ensuring a wide range of services are included in the scope of the shared services transformation strategy.

30. Investing in income generating schemes is forecast to generate the Council £500k of additional income. It is recognised that this will require significant early expenditure and this is why the Council has set aside £700k in an earmarked reserve specifically for investment in income generating projects. In addition, the approved changes to the Business, Development and Regeneration Directorate will result in a new structure that will drive forward the expansion of income generation including the development of council owned employment sites that were acquired in 2016/17.

LEVELS OF WORKING BALANCES

31. The previous MTFS indicated that working balances should be no less than £4.0m by 2018/19. This level was based upon risk 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

32. The £4m general fund balance has been achieved a year early in 2017/18, the sufficiency of this reserve will be reviewed annually, as a minimum.

33. 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 of £4m.

IMPLICATIONS OF REPORT

34. 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

35. These are contained within the report.

COMMENTS OF THE MONITORING OFFICER

36. 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	19/02/18	

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

Business Rates Retention – Future Schemes

The provisional finance settlement announced in December 2017 stated the Government's commitment to reforming the business rates retention scheme. From 2020/21 the aim is for Council's to retain 75% of their business rates income. This is understood to mean all authorities would be at 75%, rather than the 75% being an average. However, during this time there will also be a fair funding review that will inform how funds will be redistributed (as they currently are using top-up and tariffs). As such it is not possible at this time to model how the 75% retention will affect Chorley Council. The 2020/21 business rates retention is therefore uncertain, the current MTFS assumes a £400k reduction in funding, through an increased tariff, in keeping with previous years reductions in Revenue Support Grant. It is not clear whether the fair funding review will result in increased or decreased allocations to Chorley Council however the split between district and county areas is also being considered and therefore this could result in redistribution from district to county councils.

Business Rates Pool

Chorley Council currently benefits £715k from being a member of the Lancashire Business Rates Pool. The pool has been confirmed for 2018/19 however the pool is required to request approval for continuation every year. If the request for the continuation of the pool was denied by the Secretary of State the Council the Council would face a £715k budget deficit to manage from further savings and/or the use of general fund resources.

It is assumed the benefit of the pool will remain in 2018/19 and 2019/20. It is assumed that there will be a £156k and £400k increase in the business rates tariff in 19/20 and 202/21. The budget therefore accounts for some erosion of the expected benefit of being in the current pool and any retention scheme that is proposed in 2020/21.

NHS Request for Mandatory Relief

A large risk associated with business rates income relates to two applications for mandatory charitable relief received from Lancashire Teaching Hospitals NHS Foundation Trust. If successful the application would be back dated to 2010 and therefore have a significant impact on the Council's revenue budget. A headline figure is a potential £1.5m impact on the Council's general fund and a further c£200k reduction in ongoing retained business rates. The LGA is representing affected councils nationwide and retain the view that NHS trusts and foundation trusts are not charities and therefore not eligible for mandatory non domestic rate reliefs.

MEDIUM RISKS

New Homes Bonus

The Government has consulted twice on the allocation of New Homes Bonus in the past 2 years. The allocation in 2018/19 will finalise the reduction from 6 to 4 years representing a £1.6m reduction in funding to the Council. The latest government consultation proposed reducing the allocation further by reducing the grant for those homes built following planning appeals. Following consultation the allocation has not been adjusted for 2018/19 however future allocations may still occur.

Chorley Council has been successful in promoting the expansion of housing in the borough. The resultant allocations of New Homes Bonus have allowed the Council to invest in its residents' priorities. The council expects a slowdown in house building over the coming three years as larger housing development sites are already nearing completion and new sites in which to develop housing become increasingly scarce. As a result, the MTFS has built into its forecast a steady reduction in New Homes Bonus allocations. However are greater reduction in housing development would increase the rate at which the grant is reduced.

Business Rates Appeals and Other Business Rates Adjustments

The Council's provision for business rates appeals stood at £1.65m at the beginning of 2017/18. During the year there has been £738k of successful backdated appeals charged to the provision many of which related to health centres in the borough reducing rateable values on appeal.

In April 2017 a new business rates appeal process has been 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.

The budget for 2018/19 includes an provision of £2.150m. This is deemed sufficient to meet the potential successful appeals that may transpire from the outstanding list.

Pay Inflation

The MTFS includes an estimated 2% pay increase from 2018/19 onwards with significantly higher pay increases for staff on lower spinal points. In addition there is to be a national review of the National Joint Committee (NJC) pay spine, the results of which will come into force from 2019/20. Chorley Borough Council is a member of the Living Wage Foundation and therefore pays a higher rate than the required national minimum wage. However the proposed changes to the national spinal points at higher grades could still represent an inflationary risk to the Council's budget from 19/20 onwards.

Two of the three local government trade unions will reject the 2% pay offer from employers. Their argument is that the headline figure in each year is less than inflation and therefore represents a "pay cut". Chorley Council has modelled for a 2% pay increase year on year over the MTFS period. Every 1% increase in pay increases council expenditure by £120k. A settlement is not likely to be reached until 2018/19 and so any potential shortfall in the budget will be dealt with through the 2018/19 budget monitoring process.

MEDIUM RISKS

Universal Credit
The Government is consolidating a number of welfare benefits into a revised Universal Credit Scheme. One of these is housing benefits which is currently administered by the Council. Universal credit will be managed by the Department of Work and Pensions. The full scheme will be rolled out in Chorley in July 2018 and the potential risk to bad debts increasing is when people move to UC and then it becomes more difficult to recover overpayments as there is no ongoing Housing Benefit and the debt might not have the same priority of other debts such as fuel or rent arrears. Currently there has been very little sign up to universal credit however as take-up increases 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 Transformation Board. Risks are reported to senior management team as well as members and actions taken when required. Given the Council's increased dependency on sharing services and 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.

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.

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 and regularly 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.

In addition, the council allocated approximately £400k of new homes bonus to fund capital projects every year. This allows the council the flexibility to fund capital expenditure from revenue resources and reduce the requirement to utilise prudential borrowing.