ARUN DISTRICT COUNCIL

REPORT TO AND DECISION OF CABINET
ON 21 SEPTEMBER 2020

SUBJECT: Financial Prospects 2020/21 to 2025/26
REPORT AUTHOR: Alan Peach, Group Head of Corporate Support **DATE:** August 2019 **EXTN:** 37558 **PORTFOLIO AREA:** Corporate Support
EXECUTIVE SUMMARY: The Council's Medium-Term Financial Strategy (MTFS) covering the period up to 2025/26 rolls forward the data in the existing approved MTFS. The Strategy amends certain assumptions contained in it to reflect changes in the Council's circumstances and other issues that have a strategic bearing on the Council's financial prospects.
RECOMMENDATIONS: Cabinet is asked to: 1. Agree the core assumptions set out in the Medium-Term Financial Strategy and the current financial position; 2. Note and agree the significant risks to local government finance that have been clearly outlined in the report; and 3. Approve that the Medium-Term Financial Strategy is to be used to set the Budgetary framework in preparing the 2021/22 Budget.

1. BACKGROUND:

1.1. It should firstly be stressed that this report only covers the Council's General Fund and the Housing Revenue Account has its own business plan and financial model. The latest financial forecast has been prepared against a continuing backdrop of unprecedented uncertainty over Government funding and the economy which has, inevitably, been compounded by significant issues connected with the COVID-19 crisis. This report contains the latest version of the MTFS which uses the most recent information available to forecast the Council's income and expenditure over the next 5 years. The situation is even more fluid than last year as the COVID-19 crisis has created greater uncertainty. The Chancellor has announced that the spending review will be completed in the autumn and he has stated that there is no "spending envelope" in advance of the spending because of the "unprecedented uncertainty" caused by COVID19. He has, however, "confirmed that departmental spending (both capital and resource) will grow in real terms across the CSR period".

1.2. On the face of it, this suggests that there will be no return to austerity but the redirection of resources within the public sector means that there will still be cuts in lower-priority services. The Chancellor refers to the "tough choices in other areas of spending" and that "departments have been asked to identify opportunities to reprioritise and deliver savings". Local government will certainly not be immune to these cuts, although we should expect funding increases (alongside reform) in adult social care. This doesn't really provide any further information re the funding that will be available for shire districts but does give us some idea of the timetable.

1.3. The Fair Funding Review was anticipated to take effect from 2021/22 but it has been announced that this has been postponed. It was anticipated that this would coincide with a reset of business rates baseline which would have, effectively, wiped out the considerable business rates growth that has accrued to the Council since the inception of the scheme in 2013/14. There has been no explicit announcements regarding the postponement of the business rates reset but the government have stated "The Government will work closely with local councils as it determines how best to treat accumulated business rates growth and the local government finance settlement in 2021-22." This leaves the whole situation extremely uncertain as this is an extremely significant source of funding for the Council and makes forecasting an inexact science. We have, inevitably, had to make an informed assumption on this key variable and have assumed that there will be no adjustment to the scheme in 2021/22, but will have to be aware that there will be a huge detrimental effect on the Council if the accumulated growth is distributed across the country in 2021/22. However, it is extremely probable that the overall level of rates across the district will reduce, anyway, as businesses struggle to recover, and this could partially offset any potential benefits of a delayed reset.

1.4. The financial effects of COVID have been severe for the Council, in common with other local authorities across the country. Whilst we have had to rely on a number of assumptions in many areas, especially losses from Council Tax and business, the latest return to the government estimates our income losses as £879k (after mitigation) and additional expenditure as approx. £1.8M**.** We have been given grants from government (currently £1,939,019) and there is an income compensation scheme whereby the Council bear 5% of losses and the government support 75% of the remainder. It is clear, however, that this funding will be inadequate, and in any case will just be a temporary one off allocation

1.5. A number of more detailed assumptions have also been reviewed and, have been input into the financial model. This uses a wide range of strategically important financial assumptions and variables to obtain an informed view on year end balances, and to quantify the potential of any capital programme resources whilst maintaining a minimum level of General Fund balances of £4million. The assessment of the various assumptions is always considered carefully whilst taking a prudent view. An important point to appreciate with a financial strategy is that it consists of a series of assumptions using the best available information to inform a financial forecast. This year as explained above, is even more challenging than previous years.

1.6. It has been considered necessary to make changes/updates to some of the previous assumptions to address both announcements from government and wider economic factors which affect the Council. The principal assumptions made are:

- Council Tax increases by £5 per annum which is currently the maximum allowed for District Councils in our position.
- Salary costs increase by 2.5%, to reflect the trend in recent public sector pay awards, over the period of the strategy.
- The model assumes inflation for goods and services of 2**%** for the period of the strategy
- It has been assumed that there will be gradual decreases in the lump sum payable to the pension fund which was reflected in the latest report from the actuary.

1.7. It has been problematic to model enhancements to the capital programme as it has been difficult to calculate the resources that will be available due to the reasons outlined above. There is, inevitably, a requirement to allow for business-critical IT systems and infrastructure as systems fall out of maintenance/support and become life expired. It is clear that the Council will have to take a prudent approach regarding capital/one off schemes. This model has assumed that we continue with the enhanced capital programme, but this will have to be a subject for discussion given the financial challenges that the Council is facing. As in previous years the Council will underpin it's capital programme with the use of capital receipts to protect scarce revenue resources.

1.8. The most volatile and significant variable continue to be the Retention of Business Rates, as detailed above, but a further significant funding source is New Homes Bonus (NHB) which is dictated by housing growth within the District. However, the assumption made for NHB is that the government will only pay legacy payments i.e. the system will wind down and no new years will be taken into account which has severely depleted our funding from central government.

1.9. The following section outlines a number of risks that are associated with the MTFS and how these may be mitigated.

2. **PROPOSAL(S):**

2.1 Risks

2.1.1 The most serious financial risk that the Council is facing is the potential implications of changes in Local Government funding as outlined in the preceding section.

2.1.2 There are a number of risks around the retention of Business Rates which is the major funding source from central government and may, ultimately, be the sole source, although a review of business rates has been announced. The effect of COVID19 on the economy and on business rates has made fundamental changes to business rates or, even, replacement with a different business tax much more likely. Whilst we have used, what we consider to be, the best available information, as outlined above, there is also a risk that the level of business rate appeals will be more than has been anticipated and this risk lies with local government. As mitigation against this significant risk we have enhanced the Funding Resilience Reserve, as detailed at the last Cabinet meeting and this currently totals approx.£5.8M. This will provide a valuable buffer when the funding is anticipated to reduce and will act as a hedge against the economic effects of COVID19. However, this reserve should not, solely, be used for supporting the budget as it could also, potentially, be used to pump prime transformational projects. It does have to be accepted, however, that this is only a temporary measure and the underlying funding gap will will have to be addressed by the Council. A further mitigation is the risk assessment data that we will be receiving from external consultants.

2.1.3 The proposals concerning NHB are a significant concern and the assumption that this will be confined to legacy payments is exactly that as there is no information currently available. Again, all that can be done is to monitor the situation closely and retain a reserve, as outlined above, to address the anticipated funding shortfall.

2.1.4 The income from Council Tax is generally relatively certain but the recession, resulting from COVID19, and the inevitable increase in unemployment has meant that there could be an adverse effect on the Council’s taxbase (i.e. could offset or wipe out any gains from new dwellings). This would happen if the increase in unemployment caused an increased number of people to seek support from the Council Tax Reduction Scheme which reduces the taxbase. This creates greater risks and uncertainty in forecasting.

2.1.5 There are also other expenditure pressures in a number of areas, notably leisure, especially since reopening the leisure centres, and these will be monitored closely and the effect of these reflected in the financial strategy.

2.1.6 Whilst the extent of funding cuts on Arun remains unknown it is vitally important to mitigate, as much as possible, against such significant risks. The most effective mitigation against this is to hold sufficient balances to ensure that the Council has enough time to plan and implement any reductions in expenditure and are not obliged to make ill informed decisions. It is also important to ensure that we adopt a robust approach to any investment decisions and stipulate that all are accompanied by a thorough business plan which clearly outlines all costs and benefits. In addition, we need to ensure that all decisions are prudent, affordable and sustainable and that any savings are retained.

2.2 Indicative Projections

The following table shows the current situation given all of the assumption and omissions outlined above. These will be, inevitably, be fine-tuned as more information becomes available and have to be read in conjunction with all of the caveats and uncertainties outlined earlier in the report. It should be stressed that the negative balances are purely indicative and show what the situation would be if no remedial action were to be take. In practice, the Council will need to fully assess the implications of any reductions in external funding and develop a strategy to make the necessary reductions in net expenditure to ensure a prudent level of balances is maintained.

2.2.1 The effects of the above assumptions are summarised in the table below:

	2020/21 £'000	Revised 2020/21 £'000	2021/22 £'000	2022/23 £'000	2023/24 £'000	2024/25 £'000	2025/26 £'000
Net Expenditure	26,238	26,238	27,397	27,545	27,842	27,266	27,913
Surplus/ (Deficit)	(617)	(617)	(2,812)	(4,103)	(5,501)	(5,347)	(5,224)
Funding Resilience Reserve			353	4,103	1,370		
Balances	6,459	6,459	4,000	4,000	(132)	(5,479)	(10,702)

2.2.2 When considering the figures above it is important to consider the issues outlined earlier in the report and, especially, the uncertainty regarding central government funding and they can only be regarded as indicative at this stage. The underlying financial position is masked to a certain extent by the earmarked reserve contribution, from the Funding Resilience Reserve to cover the reduction in external funding, but the effect of that can be seen above. However, given the reduction in funding the trend of increasing deficits is not surprising. We are fortunate that the Council's prudent financial management has resulted in sufficient balances which will enable us to formulate a strategy with a measured approach. In addition, we will refresh the strategy once more as detail emerges at the earliest opportunity.

2.2.3 The Council are already taking positive steps to address the sizeable deficit outlined above and all vacant posts have to be approved by Corporate Management Team (CMT) before they are filled and managers are expected to make savings when recruiting. In addition to this, the Chief Executive is leading on a comprehensive savings exercise which will make significant reductions to the Council's base budget. However, given the huge additional problems caused by COVID19 it is not a practical proposition to address the entire deficit in the 2021/22 budget despite the vigorous efforts that are being made. Therefore, it is recommended that the Council should develop a strategy to address the savings target indicated in the table above. This strategy and savings should be implemented in time for inclusion in the 2022/23 budget which will mitigate the effect on the reserves. This strategy should be implemented regardless of the outcome of the business growth as outlined above in para. 1.3 and will require close working between officers and members.

2.2.4 This will give us the opportunity to assess the lasting financial effects of the pandemic and fine tune the extent of the deficit as more detail emerges. Notwithstanding this it is clear that there will be a significant deficit in time for the 2022/23 budget.

3. OPTIONS:

1. To accept the assumptions outlined in the strategy
2. To not accept the assumptions outlined in the strategy

4. CONSULTATION:

Has consultation been undertaken with:	**YES**	**NO**
Relevant Town/Parish Council		✓
Relevant District Ward Councillors		✓
Other groups/persons (please specify)		✓

5. ARE THERE ANY IMPLICATIONS IN RELATION TO THE FOLLOWING COUNCIL POLICIES: (Explain in more detail at 6 below)	**YES**	**NO**
Financial	✓	
Legal		✓
Human Rights/Equality Impact Assessment		✓
Community Safety including Section 17 of Crime & Disorder Act		✓
Sustainability	✓	
Asset Management/Property/Land	✓	
Technology		✓
Other (please explain)		✓

6. IMPLICATIONS:

To formulate the Council's Financial Strategy and to inform any consequent decisions on capital investment and revenue savings plans to be taken by Full Council and Cabinet.

7. REASON FOR THE DECISION:

To formulate the Council's Medium-Term Financial Strategy and set the financial context and framework for decisions to be taken by the Council

8.	**EFFECTIVE DATE OF THE DECISION: 30 September 2020**
9.	**BACKGROUND PAPERS:** None