OS217
THE OVERVIEW AND SCRUTINY COMMITTEE

REPORT TITLE: MEDIUM TERM FINANCIAL STRATEGY

28 JANUARY 2019

REPORT OF PORTFOLIO HOLDER: CLLR GUY ASHTON (PORTFOLIO HOLDER FOR FINANCE)

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WARD(S): ALL

PURPOSE

The Medium Term Financial Strategy sets out the forecast financial position and the proposed strategic direction in order to provide a balanced budget over the medium term.

RECOMMENDATIONS:

That the Overview and Scrutiny Committee raises with the Leader or relevant Portfolio Holder any issues arising from the information in this report and considers whether there any items of significance to be drawn to the attention of Cabinet.

IMPLICATIONS:

1 COUNCIL STRATEGY OUTCOME

1.1 The Council Strategy is the core strategic document, the MTFS (Medium Term Financial Strategy) is guided by this and informs the budget framework for the delivery of the Council Strategy.

2 FINANCIAL IMPLICATIONS

2.1 As detailed in the main body of the report.

3 LEGAL AND PROCUREMENT IMPLICATIONS

3.1 Any implications arising from budget options within this strategy will be dealt with in the individual business cases and committee papers relating to those specific decisions.

4 WORKFORCE IMPLICATIONS

4.1 None directly relating to this paper, which sets out the strategic budget planning direction.

5 PROPERTY AND ASSET IMPLICATIONS

5.1 A key strand of the Council's financial and treasury strategies is to maximise income from its assets and seek to manage risk by achieving a balanced portfolio of assets. Options considered during the budget planning process may therefore involve either the acquisition or disposal of assets, requiring a full business justification case.

6 CONSULTATION AND COMMUNICATION

6.1 The medium term financial strategy has been part of the budget consultation process and follows the Medium Term Financial Planning (CAB3103) which went to December Cabinet.

7 ENVIRONMENTAL CONSIDERATIONS

7.1 Environmental considerations will be part of the business case supporting any budget proposals.

8 EQUALITY IMPACT ASSESSEMENT

8.1 This is a strategic budget planning document, equality impact assessments will be considered alongside any relevant budget options.

9 DATA PROTECTION IMPACT ASSESSMENT

9.1 None

10 RISK MANAGEMENT

Risk	Mitigation	Opportunities
Significant reductions in government funding over the medium term	*Financial projections are shown up until 2028/29 and the scenario planning highlights the potential sensitivities.*	*Development of locally generated income streams with less reliance on government funding*
Council's service priorities are not reflected in the budget	*The use of Outcome Based Budgeting as a method of delivering the budget from 2019/20 onwards.*	*Ensure the prioritisation of resources to best meet the Outcomes of the authority*
Failure to set a balanced budget over the medium term	*The MTFS shows the latest financial projections up until 2028/29, and the scenario planning highlights the sensitivities around these projections. Planning over a longer period will help to ensure understanding of the scale of the financial challenges and ensure that early planning enables enough lead in time for the implementation of budget options.*	*Long term strategic planning* *Innovative funding streams* *Transformational efficiency savings*
Delays to or failure to deliver major capital schemes leaving future years forecast deficits	*Ensure robust business cases are taken forward and sufficient resources are available to deliver the projects.* *Scenario planning to ensure that a multitude of options are available for consideration.*	*Consideration of a wide base of potential capital / investment schemes to enable a balanced risk portfolio and options for other schemes to be chosen should any existing schemes not progress*
Failure to adequately manage major contracts including planning for contract renewal	*Ensure adequate contract management and monitoring arrangements are in place.* *Ensure sufficient time for review of contract options prior to contract renewal.*	*Ensure contracts are aligned to the council's requirements and council strategy.* *Transformational efficiency savings.*

11 SUPPORTING INFORMATION:

Executive Summary

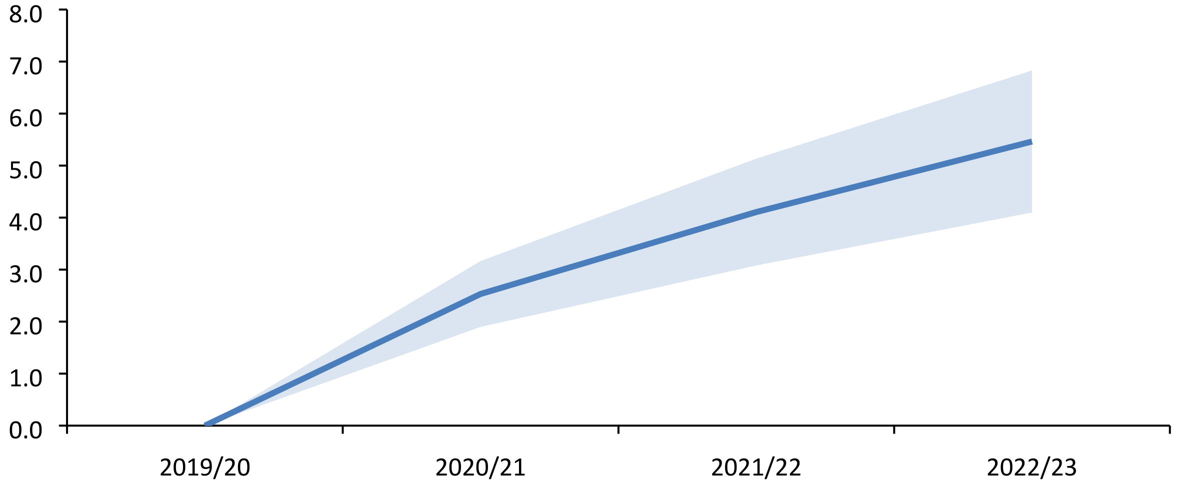
11.1 The Medium Term Financial Strategy (MTFS) is intended to set out the Council's strategic approach to the use and management of its financial resources and provide a framework within which decisions can be made.

11.2 The outcome based budgeting proposals are initially focused on a rolling four year period from 2019/20 to 2022/23 in order to provide focus on the medium term financial challenges and ensure that proposals can be drawn up and introduced in time to meet the forecast stepped increase in the annual deficit in 2020/21 caused by the expected reset of business rates retention. Financial projections are shown over a ten year period to 2027/28 in order to provide insight into the longer term financial sensitivities and the earmarked reserves strategy.

11.3 The Cabinet report (CAB3103) on Medium Term Financial Planning provided an update on the Council's financial position. This included the projections in receipts from the main funding sources of Council Tax, Retained Business Rates and New Homes Bonus as well as the Revenue Support Grant.

11.4 Alongside the changes to funding highlighted previously, the Council has other cost pressures such as contractual inflation, rising costs for infrastructure schemes and other unavoidable financial pressures, such as any contractual inflation and the national pay award. The scenario planning highlighted below in Figure 1 highlights the potential impacts over the longer term.

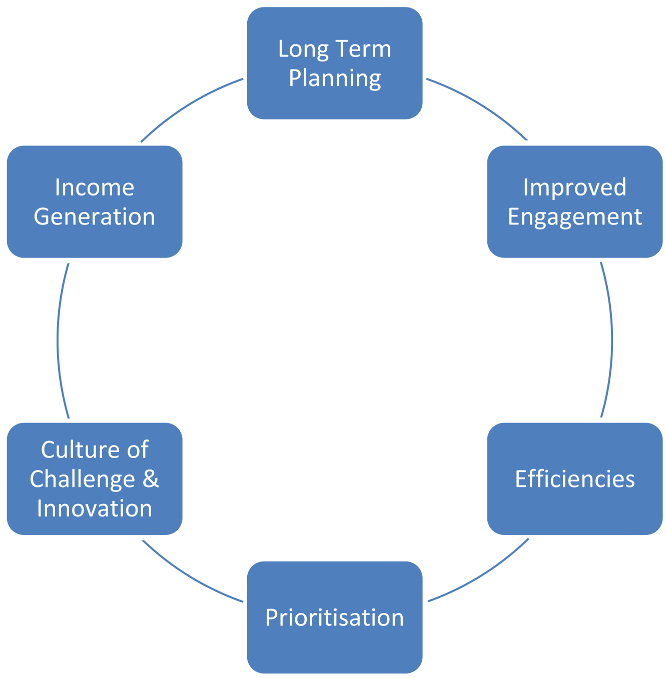
Figure 1 - Cost base reduction required for a balanced financial position (£m)



11.5 The Council Strategy articulates the service and outcome priorities of the Council for the coming years. In order to deliver these, different options need to be considered and their financial impacts assessed. This is the principle behind Outcomes Based Budgeting (OBB), that the financial position should deliver the overall outcomes of the Council, rather than a pure cost-cutting exercise that limits the ability of Council to remain resilient to future funding challenges.

11.6 To consider which options are available to the Council, consideration has been given to the different practice that exists across peers / other councils as well as assessing the current areas of strength that the Council can build upon. The current focus of the OBB has been to identify high-level options to meet the financial challenge over the coming four years including short-term options and those requiring a longer lead-in time to develop the business case. Delivery of these options may require capital, revenue funding or the use of reserves.

11.7 Overall, the OBB approach is focused on the following key benefits:



Proposals for the medium term financial position

The Council has grouped its medium term financial challenge options around four different areas; efficiency, asset management, transformation and income generation.

EFFICIENCY

11.8 Efficiency review and planning plays a critical role in the continuing provision of high quality services by the most efficient and value for money method of delivery. This strand of the OBB process is aimed at looking in detail at internal processes and ensuring these support the Council in delivering excellent services in the most effective way.

11.9 Contract review and management is a key element in this strand, with total third party payments budgeted at almost £7m. The Council operates a number of significant ongoing contracts such as: leisure centre management, environmental services contract, and the park and ride bus contract. Ensuring that both current and future contracts offer the best possible value to the Council is of high importance.

11.10 The Council will also need to consider how much funding it provides to a range of discretionary services. The Council has a very buoyant grants and commissioned service budget that has been protected from funding reductions. This funding programme will need to be kept under review to ensure that it contributes to the Council Strategy and that it remains affordable within the overall financial context.

ASSET MANAGEMENT

11.11 The Council operates an extensive portfolio of property assets which are either used in the delivery of services or generate an income to the Council which in turn provides the resources to deliver services. With the significant reductions in government funding it is important to ensure that existing assets are used in the most effective way.

11.12 The Council operates a significant property portfolio which generates rental income in excess of £3m per annum. Properties are let at commercial rates with rent review periods built in as standard. A number of existing leases are due for review within the next few years and overall rental income is expected to increase significantly as a number of rent reviews are due in the life of the MTFS. There are substantial known rent reviews due that are expected to raise at least an additional £300k of income to the Council.

11.13 The Council has commenced an asset challenge programme. This process is reviewing all of the Council’s assets on a rolling basis to establish why the Council holds assets, what options the Council has e.g. to increase income, dispose, hold or develop, and when these can be realised. Initial progress has been positive and has highlighted three assets that the Council is considering disposing of. It is expected that these assets will generate capital receipts of over £1m.

11.14 It is recognised that making the best use of existing assets can provide significant savings as well as increasing collaboration with other organisations and complementing existing skills within the Council with relatively little risk exposure. The Council has let office space in the Guildhall to South East Employers (SEE) which will provide an assured income and increase occupancy in the Guildhall. The Council is reviewing the operation of the Guildhall overall and is seeking to make a substantial reduction to the cost of the Guildhall that is currently paid for by taxpayers. This longer term review will consider all options available and will also look at the wider Colebrook Street asset holdings including the existing council offices.

11.15 An extensive programme of refurbishment works have been completed at the Council's City Offices recently in order to extend the life of the building in the short term, provide environmental enhancements in the form of lower energy consumption, and to ensure the offices remain fit for purpose. A further minor programme of works is planned for the West Wing offices to ensure the offices remain fit for purpose and any opportunities for efficiency and environmental improvements can be taken.

11.16 The capital strategy provides the opportunity for investment in new or existing assets should they meet the aims of the council strategy and generate a financial return to the Council. A review of existing assets is underway to determine what opportunities are available and any new opportunities will be considered and developed as they come forward.

11.17 In order to ensure that expenditure is accurately allocated to the creation of assets it is proposed that employee costs are capitalised when an employee's activities have 'contributed directly to bringing an asset to a location and into a condition so that it is capable of operating as intended'. This will enable those costs to be spread over the useful life of the asset rather than taken as an up-front cost. A strict regime of timesheet recording and review of activity will be implemented in order to ensure that eligible expenditure is identified and evidenced.

TRANSFORMATION

11.18 The Council continues to explore ways of transforming both operations and service delivery in order to generate efficiencies wherever possible. The core principle is delivering services in the most efficient way in order to achieve value for money. The Council has a good track record of exploring opportunities for transforming services, with the shared IT services with Test Valley Borough Council a good example of this. Pooling resources has helped to make revenue savings to both councils, has helped to mitigate against increases in infrastructure costs, and helps to ensure there is sufficient resilience built into the service to meet the needs of both authorities. The potential to expand this service further in order to generate additional savings is currently being explored.

11.19 As highlighted above, the Council is undertaking a transformation programme. This is expected to yield financial savings to the Council through greater efficiencies. Though it is premature to set out the exact savings amount, similar council programmes have delivered substantial savings of in excess of

£250k. Aligned closely with work to improve digitalisation of services, this programme will be a key part of the medium term financial strategy.

11.20 Digitalisation is one particular area for review. As technologic advances continue to be made and the use of technology (particularly portable technology) increases, it is important that the Council takes advantage of these digital channels. The potential benefits are a reduction in costs through the automation of internal processes, and increased customer satisfaction through simple interaction which is available whenever the customer needs it. This approach also has the opportunity to deliver new revenue and services, for example through exploring a new mobile app for Winchester.

11.21 It is also important that the Council is reviewing other options to transform services and offer different solutions. One area under consideration is setting up a housing company to provide a different housing offer to residents and that also provides a financial benefit to the Council (see **Housing Company Options** CAB2990 (HSG)).

INCOME GENERATION

11.22 Opportunities to invest which also generate a financial return, either through reductions in cost or income generation, are assessed on a case by case basis. The roll out of LED lighting across car parks, the Guildhall, and offices, is a good example of capital investment which has generated a recurring cost saving.

11.23 The Council Strategy guides the budget requirements and prioritisation of resources across the Council. The introduction of outcome based budgeting, and not focusing purely on cost reductions, will play a key role in helping to ensure that priority investment continues to take place.

11.24 Treasury management plays a key role in the delivery of projects and services. The Council currently has cash resources in excess of £50m which are invested on the basis of minimising exposure to risk whilst also generating a return. The current average return in 2018/19 of >1% has exceeded targets and is expected to generate a revenue income of around £0.55m. As the council continues to invest in its capital programme, cash balances are expected to reduce; however, some of those new assets are expected to generate a revenue return instead.

11.25 The projections in 11.33 below are based on the existing capital programme estimates. Any changes to timescales and/or investments will have revenue implications which will feed into the final budget recommendation in February. In particular, large capital projects are likely to have material revenue implications and a financial lead in period where significant borrowing and other implementation costs are incurred before any income generation commences.

11.26 General Fund income is an important source of funding, helping the Council to continue delivering high quality services despite reductions in government funding. In 2018/19 general fund income is budgeted at £13m, which is planned to fund 38% of gross general fund expenditure. This compares to the next highest source of funding, Council Tax, which is planned to fund 22% of gross general fund expenditure.

11.27 In order to continue delivering services consideration of full cost recovery is an important principle to be considered. This ensures the user of these services is paying a fair price, that the services remain available, and that there is no unnecessary burden on the council tax payer. The provision of discounts for certain groups or a universal subsidy could be considered when in direct support to principles within the Council Strategy.

11.28 Fees and charges are reviewed and benchmarked individually rather than adopting a ‘one size fits all’ approach. Consideration is given to cost recovery, current and forecast inflation rates, and how our charges compare both within the Winchester district and against neighbouring authorities.

11.29 It is important to note that a number of chargeable areas are governed by statute and charges are therefore set by central government.

11.30 **Fees & charges are subject to ongoing review to align with key strategies and seek new trading opportunities** – over the life of the Medium Term Financial Strategy through seeking new opportunities to trade, understanding subsidies and increasing activity.

INVESTMENT

11.31 The Council is investing in a kerbside glass collection service which will commence in 2019. Investing in green measures and increasing recycling rates is a priority outcome.

11.32 The Council Strategy guides the budget requirements and prioritisation of resources across the Council. The introduction of outcome based budgeting, and not focusing purely on cost reductions, will play a key role in helping to ensure that priority investment continues to take place.

11.33 Treasury Management plays a key role in the delivery of projects and services. The Council currently has cash and investment balances of around £50m which are invested on the basis of minimising exposure to risk whilst also generating a return. The current average return in 2018/19 of 1.09% is slightly above the target of 1%. The Council has a forecast increasing capital financing requirement (borrowing need) due to the planned capital programme over the coming years, and the Council’s reserves will gradually reduce over the same period. If the capital programme is delivered as planned, this will require the Council to take out new external borrowing from 2019/20. To provide liquidity, the Council will maintain a minimum balance of £10m; this will reduce typical returns on investment from over £0.5m per annum now to around £0.1m. Further details can be found in the Treasury Management Strategy (CAB3133) and the Capital Investment Strategy (CAB3134).

Summary of Financial Position

11.34 In light of the above financial analysis, the 'central case' is shown below. The most significant impact and risk relates to government funding changes planned from 2020/21. It is currently assumed there will be a maximum total annual resource reduction of 5%, with potential funding reductions from the withdrawal of the new homes bonus and business rates retention temporarily and in part replaced by a government damping grant. At present it is difficult to forecast this reduction, but recent government announcements suggest a transition period which is reflected in the revised forecast.

Table 1: Cost base reduction required for a balanced financial position

Cumulative cost base reduction / £m	2019-20	2020-21	2021-22	2022-23
December 2018 – CAB3103	1.1	5.2	5.7	7.2
Current Forecast	Balanced per CAB3132	2.5	4.1	5.5

Table 2: Outcome Based Budgeting 2018/19 – 2019/20

Cost base reduction / £m	2018-19	2019-20	Total
Savings	1.1	1.0	2.1
Investments	(0.4)	-	(0.4)
NET	0.7	1.0	1.7

Scenario Planning

Government funding and other updates

11.35 A **Fair Funding Review** is currently underway by the MHCLG in order to redefine the basis of distributing the settlement funding assessment (SFA). The results of this review are expected to be implemented in 2020/21. The settlement funding assessment includes the Revenue Support Grant (RSG) and Baseline Business Rates (i.e. the non-growth related element).

11.36 The **Retained Business Rates** forecasts are based on the assumption there will be a full reset of retained growth in 2020/21 which is expected to cause a significant reduction in funding. The current retained growth of c£2.5m would be allocated using the SFA, which is expected to bring a much lower allocation of funding. How the reset process will work after 2020/21 (i.e. frequency and whether the resets will be full or partial) is currently under consultation.

11.37 Following the Local Government Finance Settlement in December 2017, the Government has announced plans for the sector to move to retain 75% of

Business Rates from 2020/21. The exact details of the system from 2020/21 will be subject to consultation during 2019 with no decisions yet made around important matters such as whether the tier splits (e.g. District/County) will be changed. Therefore projections have been made based on the current retention system.

11.38 The **New Homes Bonus** has been a significant source of funding over recent years, with the current figure at £2.3m and having peaked at £3.3m in 2016/17. Government have announced that the current reward system will end in 2019/20 but no details have yet been announced over whether (and if so in what form) there will be a replacement reward system or even whether the current four year rewards will continue until 2022/23 (i.e. under the current system the reward for 2019/20 would be received each year until 2022/23). The current forecast is based on the current four year rewards continuing until 2022/23.

11.39 Historically, funding changes have been phased in over a period of years where individually authorities would otherwise face significant ‘cliff edge’ changes in funding. Forecasts have therefore assumed that any funding changes would be subject to a maximum reduction of 5% of ‘total funding’ in 2020/21 and then phased in so the full effect is not reached until 2025/26.

Council Tax

11.40 Government projections assume that councils will increase council tax by the maximum allowable within the current referendum limits. The forecasts in Appendix B assume that district council tax will be frozen in 2019/20 and then increase in line with CPI inflation over the forecast period.

11.41 Council tax will only be increased when there is a clear requirement in order to protect core services and deliver the council strategy. The significant forecast reductions in government funding means that council tax is expected to increase as a proportion of overall funding, putting pressure on the council tax requirement. The OBB strategy aims to deliver cost base reductions in order to provide a balanced budget over the medium term, restricting council tax increases to a maximum of CPI inflation.

11.42 The council tax base is forecast to increase by 1.2% per annum over the forecast period, based on recent average increases. Whilst this generates additional income there are also associated costs (such as waste and recycling collections).

Reserves

<u>Strategic Reserves</u>

11.43 The Council holds strategic reserves for specific purposes which are consistent with corporate priorities. These reserves are a key source of funding, helping to support specific service strategies and plans. They are also critical to our ability to fund the transformation of services and ability to invest in order to generate the necessary savings to balance the budget over future years.

11.44 In summary, reserves are used to support:

I. Funding of the Capital Programme

II. Investment in transformation

III. Providing one-off support for service budgets (such as the local plan)

IV. Community Infrastructure plans

V. Council Strategy Support

VI. Asset Management Plans, IT Strategy, Car Parking Strategy

VII. Winchester Town Account (notably major play area refurbishment and replacements)

11.45 It is important to note that reserves are finite and can therefore only be used to fund one-off expenditure. One-off expenditure can include projects which span a number of financial years but cannot include recurring expenditure such as utilities.

11.46 In order to support the Council Strategy, ensure resources are available and the requirements are consistent on a year-on-year basis, a number of revenue contributions are made to earmarked reserves:

i. Property Reserve - £300k

ii. IMT Reserve - £280k

iii. Car Parks Property - £200k

Balances / Risk Reserves

11.47 The Council also holds a general balance which is held to mitigate against any potential financial risks, these could be known risks or completely unforeseen risks. As a general guide the minimum balance will be 15% of net revenue expenditure and so the current balance of £2.789m can give some additional cushion particularly against the uncertainty of government funding over the medium term projections.

11.48 A minimum balance of £1m is held within the business rates retention reserve in order to provide mitigation against the short term risks of a reduction in income, for example an unexpected increase in successful appeals.

Scenario Planning Summary

11.49 As part of the medium financial planning process, there are a number of unknown elements. The table below highlights some of the upside and downside risks that the Council faces to provide an overview of the key financial risks compared to the 'likely' financial forecasts:

Table 2: Scenario Planning – financial impact

Risk item	Favourable / Adverse £000 per annum
75% Business Rates retention – 10% increase or reduction in growth retention	200
Fees and Charges – 5% increase or decrease	550
Property Rental Income – 10% increase or decrease	350
Inflationary impact on contracts – 5% increase or decrease	500
Fair funding review (starting 2020/21) – 25% change in Settlement Funding Assessment (SFA)	500
Brexit – many potential implications including treasury management	Cannot be quantified specifically in relation to Brexit but included within the risks above

12 OTHER OPTIONS CONSIDERED AND REJECTED

12.1 None

BACKGROUND DOCUMENTS:-

Previous Committee Reports:-

General Fund Budget 2019/20 – CAB3132 – February 2019

Medium Term Financial Planning – CAB3103 – December 2018

Council Strategy Refresh – CAB2980 – December 2017

Efficiency Plan 2016 – 2020 - CAB2827 – September 2016

Other Background Documents:-

None

APPENDICES:

Appendix A: Medium Term Financial Projections