Report to:	**Cabinet**
Date of meeting:	**8th July 2013**
Report of:	**Head of Strategic Finance**
Title:	**Medium Term Financial Statement 2013/2014 to 2016/2017**

1.0 SUMMARY

1.1 This report updates Cabinet regarding the Council's Medium Term Financial Statement (MTFS).

2.0 RECOMMENDATIONS

2.1 Cabinet consider the contents of this report, provide guidance if it feels the need, and note a detailed analysis and revised MTFS will be reported to the 9th September Cabinet.

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3.0 INTRODUCTION

3.1 The Medium Term Financial Strategy (MTFS) provides an overview of the main components of Watford's revenue expenditure and available finance. For the document to be meaningful for financial planning it is necessary to forecast likely scenarios over a medium term perspective (four years 2013/ 2017). The current policy of the Council is to produce a sustainable budget by the end of that four year period. A budget where expenditure and annual income are in tandem without the distortion caused by the use of reserves. The current MTFS (prepared in January 2013) is attached at **Appendix 1** but does need substantial review.

3.2 As part of this review, it is necessary to evaluate the future profile of all expenditure on services and includes:

- salaries and associated costs
- expenditure on goods and services
- the cost of outsourced contracts
- the cost to the Council of administering the local 'welfare' service
- any revenue effects consequent upon completion of the capital programme

The Council also has control over a number of income sources, the major income coming from its commercial rent portfolio.

3.3 The effect of its expenditure and local income projections will result in a net expenditure figure that has to be funded from:

- central government grant
- re-distribution of business rates
- new homes bonus specific grant
- council tax freeze grant
- levels of council tax
- use of revenue reserves

3.4 Subsequent sections of this 'overview' will cover all major issues that affect Watford's budget and will include latest 'intelligence' that needs to be properly evaluated.

4.0 THE COUNCIL EXPENDITURE PROFILE

4.1 Salaries and Associated Costs

4.1.1 The total salary and agency bill in 2012/2013 was circa £14.5m but, paradoxically, is often one of the easiest to control. If the budgets were forecast to overspend then a recruitment freeze can be introduced. The current MTFS has assumed a 1% vacancy level across most services (although this has not been imposed for services such as waste collection which is a front line service and needs to be adequately resourced at all times).

4.1.2 The MTFS also has to make provision for future pay awards and had allowed for an effective 2% award in 2013/2014 and 1% a year thereafter. It is likely that local government trade unions will accept a 1% award from 1st April 2013 (with an additional 1.4% for the lowest paid). Watford has no staff that fall within the definition of 'low paid' so we are likely to have a 1% cushion within our revenue budget.

4.1.3 The Chancellor of the Exchequer announced on June 26th that the public sector would be limited to a 1% pay award in 2015/2016 (which although not binding on local government, does generally set a benchmark). The Chancellor has also announced that there will be no automatic progression (increments) permitted in future for the civil service, schools, hospitals, prisons and the police. Again he has no direct control over local government but the Secretary of State at the DCLG may adjust government funding to achieve the same effect. In reality, for Watford, most staff are on the top point of their grades so the financial effect would be limited either way.

4.1.4 Of far greater concern however is the future effect upon the salaries bill of potential changes to employers contributions to national insurance where government pronouncements need to be carefully analysed as no additional cost has been reflected within the MTFS.

4.1.5 Similarly, there is to be an actuarial review of all local authorities pension schemes as at 31st March 2013 (results known in December 2013) and it is widely anticipated that current deficits will have increased due to the combination of people living longer and poor investment returns due to the 'low interest rate' environment. Watford has always followed the HCC actuary's advice which aims to cover any deficit over a 20 year perspective. The current MTFS had anticipated an increase in employer contribution rates by 1% in April 2014 and again by a further 1% in April 2016. The April 2016 increase may have to be brought forward to April 2014 and this needs further evaluation.

4.2 **Goods and Services**

4.2.1 The MTFS has generally expected Heads of Service to live within cash limited budgets (if inflation goes up, volumes must go down). In reality improved procurement and consequent lower unit costs has meant this has not been a pressure area.

4.2.2 This cash freeze has not been applied to energy/ fuel costs where a 10% a year increase has been built in. Similarly business rates on our own properties has been allowed (2.6% for 2013/2014) and welfare payments such as housing benefit has also taken into account annual uplifts; and finally where there are outsourced contracts with an inflation factor then this has been applied.

4.3 **Outsourced Contracts**

4.3.1 The past 15 months has experienced considerable change to the way Council services are provided and has resulted in the following:

- ICT outsourced with effect from 20th May 2013.
- Waste, Cleansing, Recycling, Parks and Open Spaces outsourced 1st July
- Market being transferred to a private operator
- Charter Place being managed by INTU
- CCTV relocated
- Internal Audit transferred to a Shared Internal Audit Service

4.3.2 In addition there could potentially be further change in areas such as Building Control. All these changes have a significant effect upon council budgets with anticipated savings forecast not just in the direct service area but also within support costs. All of these now need to be evaluated so that the revised MTFS can reflect revised budgets. This will need to be finalised within the next 6 weeks.

4.4 **Cost of Welfare Benefits**

4.4.1 Unquestionably the most volatile, uncertain and high risk area of the Council's revenue budgets. Recent changes include a reduction in subsidy for council tax benefits, implementation of a benefit cap, and withdrawal of an element of benefit where there is an under occupation of bedrooms. For the future, there will be the phased implementation of universal credit with the transfer of responsibility for administration from local authorities to the HMRC. This could well affect levels of staffing but the current timescales may well slip. An evaluation does need to take place as the potential effects of universal credit have not been factored into the MTFS.

4.5 **Revenue Effects of the Capital Programme**

4.5.1 The Council has a number of major projects which are now well developed. It is therefore timely to evaluate any revenue costs/ income that will be incurred as the projects develop. Some provision has been made for ongoing maintenance associated with the Cultural Quarter/ High Street improvements and this evaluation needs to be extended to all other projects.

4.5.2 One clear revenue effect is the loss of investment interest as projects utilise the Council's holding of capital receipts and this has largely been factored into the MTFS. In addition, however, there is the probability that over the next four years the Council will borrow up to £4m from the PWLB to finance up front costs relating to the Health Campus. In isolation this £4m would require an annual Minimum Revenue Provision of circa £150k per annum and needs to be reflected within the MTFS at some point.

4.6 **Miscellaneous Revenue Expenditure**

4.6.1 There will be some cyclical items of expenditure that need to be reviewed so, for example, it has been announced that European elections will be held on the same day as local elections on May 22nd 2014 and this may result in a saving to the Council.

4.6.2 Other issues that need to be addressed include homelessness volumes/ potential use of bed and breakfast; the repair and maintenance programme to reflect a number of assets falling under the remit of outsourced suppliers combined with the fact that the 'reactive' repair programme has largely been completed. Recently the West Herts Crematorium Joint Committee has set a target to create a 'dividend' equivalent to an annual payment of £50k per annum to each of the constituent bodies with effect from April 2014 to March 2018 and this needs to be factored into the MTFS.

4.6.3 The Outturn for 2012/2013 will also be a useful reference document with a need to determine whether there will be ongoing costs/ savings in future years.

4.7 **Local Sources of Income/ Fees and Charges**

4.7.1 The Council raises circa £14m annually from rents and fees and charges and these areas are overdue for a further review. For example, pessimistic assumptions have been made regarding loss of rental income from commercial property and which, from the 2012/2013 outturn, do not appear to have materialised. We also now have in place a rent guarantee at Charter Place but this may be offset by a loss of rent income at Cardiff Business Park as it is developed as part of the Health Campus. It is therefore a constantly changing horizon and the MTFS needs to have properly evaluated the profile of these changes.

5.0 FUNDING OF THE REVENUE BUDGET

5.1 Central Government General Support.

5.1.1 For 2013/2014 the MTFS included the receipt of £5,724k by way of Formula Grant/ NNDR and Council Tax Reduction Grant (£4,765k; and £958k respectively). For 2014/2015 these three sources of funding have been absorbed into one payment notified as being £4,963k (the MTFS at Appendix 1 showed the sources of funding separately for ease of comparison). The MTFS however assumed a combined figure of £5,247k in 2014/2015 and will need to be adjusted downwards.

5.1.2 The Chancellor of the Exchequer announced on 26th June 2013 public expenditure targets for 2015/2016 (one year only, to be reviewed for future years after a General Election). For local authorities the headline figure was a further 10% reduction in government support and which can only be assumed will include a reduction in the council tax benefit reduction element which has now been subsumed within the general external support.

5.1.3 He further stated that in fact 8% of this 10% cut will be returned to local authorities by way of special funding. It will almost certainly be the case that this funding will be earmarked towards adult social care and that no funding will be allocated to district councils. As further information becomes available then this source of external funding can be adjusted.

5.1.4 At the present time however the revised MTFS will assume £4,963k in 2014/2015 and £4,467k in 2015/2016. For future years it is not anticipated that the situation will improve and further year on year reductions of 10% will be factored in. This will considerably change the shape of the current MTFS.

5.2 Redistribution of Business rates

5.2.1 One of the major changes to local government funding has been the incentive for local authorities to grow their business rates base. Formerly all business rates income was collected on behalf of central government and then redistributed back to authorities on the basis of need. This however provided no incentive for local authorities to seek to maximise business rates income or indeed improve their collection rates.

5.2.2 With effect from 1st April 2013, a base level of business rates income was to be established for each local authority area and that was to remain unchanged (as a base) for a seven year period. For Watford the base position was estimated to be £65,374k. Having determined this, central government expected 50% (£32,687k) to be paid over with the residual 50% being retained locally and divided up between Watford/ HCC.

5.2.3 Should the actual business rates for each year (in the seven year period) exceed this base position, then the government take 50% of any gains and the two authorities split any surplus on a fixed percentage (80% Watford; 20% HCC). Equally however should there be a deficit then it is shared 50% government/ 50% Watford and HCC (again Watford would suffer 80% of any shortfall).

5.2.4 This is a very simplistic analysis as the system has built in tapers/ top ups/ and safety nets but the key issue remains that the government are effectively transferring 50% of business rates risk to local authorities. A review is taking place internally within the Watford Revenues Division to seek to ascertain how realistic is the total business rates base position of £65,374k. A key component of this review is to obtain latest data from the Valuation Office Agency regarding the likely result of business rates appeals in the pipeline. Currently there are circa £3.4m of rating appeals in the Watford area and, if these were totally successful then it is probable that a shortfall in the base position would be experienced (and that this would be enshrined for the next 7 years).

5.2.5 It is therefore a significant risk area and the effects need to be reflected within a revised MTFS. Running parallel with this review, HCC has been carrying out modelling across the county area to seek to establish whether risk can be mitigated by way of business rates pooling amongst all districts. Its initial conclusion was that Stevenage, Hertsmere and Broxbourne would benefit from pooling but for most authorities it would be marginal. This information must be treated with a great degree of circumspection as HCC officers must be using out of date information and that the key issue is to seek to identify the likely cost of appeals.

5.2.6 For the future, the MTFS will need to profile any significant future gains or losses to the base position and again the Health Campus development programme needs to be factored in. The Economic Development Officer to the Council needs to be involved in these forward projections.

5.3 **New Homes Bonus Grant**

5.3.1 The government has set a priority to build more homes and to encourage authorities to make more land available / and to facilitate development. As a consequence, a significant amount of funding has been made available for authorities that produce a net increase in available homes in any one year. The funding to be distributed and called 'New Homes Bonus Grant' and the size of any individual distribution to be related to past achievement in the previous year.

5.3.2 The available funding is not 'new' money but has been generated by top slicing it from general Revenue Support Grant. This redistribution has not been appreciated by the less prosperous parts of the country (typically the north east) where there is little residential development actually being constructed. The south east has been the main beneficiaries with Watford having received significant amounts of NHB.

5.3.3 It is necessary to review our current model relating to the future receipt of NHB and this will involve firstly an internal review to determine the net number of additional units (this is effectively those properties coming on stream less those properties lying empty). There is also a premium if the units are deemed 'affordable' so that needs to be evaluated at the same time.

5.3.4 The current MTFS has been based upon historic data and needs to be revisited (for example, the net number of housing completions in 2012/2013 was 541 homes whereas the NHB model has assumed 408 net completions. Any review needs to involve the Planning Policy Team, the Housing Division, a representative from Revenues, and financial back up. Ideally the results of this review should feed through to the revised MTFS in September.

5.3.5 The Chancellor's statement on 26th June 2013 was silent regarding the New Homes Bonus but made much play of the fact that £2bn is to be made available in 2015/2016 onwards for the creation of a Single Local Growth Fund with funding for transport, skills, and housing and to be allocated through the Local Enterprise Partnerships. Subsequent clarification has been received that £400m of this £2bn is to be top sliced from New Homes Bonus (estimated at 30% of total NHB). This is extremely disturbing news for Watford as the £2bn may well be redistributed from the South East and this again will need to be reflected within the revised MTFS.

5.4 **Council Tax Freeze grant**

5.4.1 The current situation is that the MTFS in 2014/2015 includes £204k of freeze grant that relates to the initial freeze guarantee made in 2011 that if authorities froze council tax in 2011/2012 they would receive freeze grant equivalent to a 2.5% increase in council tax for the four years 2011/2015. In 2015/2016 onwards no freeze grant had been assumed. The MTFS also includes an assumption that a further £84k would be received in 2014/2015 for freezing council tax in 2013/2014 and equated to a 1% council tax increase. These numbers need to be revisited as the change in the council tax base 'methodology' in 2013/2014 has reduced this level of grant marginally.

5.4.2 The Chancellor of the Exchequer, in a statement to the House of Commons on 26th June, announced that grant would be available for councils freezing council tax in 2014/2015 and 2015/2016 and will almost certainly be geared to a 1% tax increase (£80k using new tax base). This needs clarification however as it is uncertain whether there will be a further grant in 2014/2015 in addition to what has been assumed and also the cumulative position in 2015/2016.

5.4.3 The MTFS needs to evaluate the reducing benefit of this grant as it further distorts the relationship between the council's ongoing expenditure and its ongoing local income base (council tax). It is increasingly likely that authorities will decline this inducement as it is important that the local tax base does not lose its real value.

5.4.4 The Chancellor also announced that council tax capping will continue to apply and that a referendum will be required should the council tax increase by more than 2% (assumed to affect 2014/2015 as well as 2105/2016). It is probable that some authorities will actually test the 'will of the people' in 2014/2015.

5.5 **Council Tax Base, Collection Fund and Collection Levels**

5.5.1 Within the current MTFS, the council tax base for 2013/2014 was estimated to be 29,418 Band D equivalents with annual increase of 350/ 350/ 250 in the three years 2014/2017. The latest schedule of council tax indicates that the base for 2013/2014 will actually be 30,007 and shows a 589 (Band D equivalent) increase to the base and equates to an additional £147k income for Watford services (and which will be ongoing throughout the MTFS period.

5.5.2 Whilst this is a reliable starting point, it is important that future projections of growth in the council tax base mirror assumptions within the Planning Policy Division regarding future residential development projects (including the Health Campus).

5.5.3 The Collection Fund is a statutory account which charts the amount of council tax anticipated to be collected against the amounts actually collected. The MTFS has made no assumptions for either surpluses or deficits on this Fund throughout the four year period. This needs to be reviewed (the outturn for 2012/2013 indicates a £189k surplus was recorded (£31k to Watford, the rest to the preceptors).

5.5.4 Finally the MTFS needs to review collection levels of council tax to seek to establish are they still realistic (97% collection rates has been assumed throughout the four year period).

5.6 **Use of Reserves/ Balances**

5.6.1 These need to be kept under regular review as they may no longer be required for the purpose for which they were created. Also a key issue revolves around whether they are too large/ too small and any review does need to focus over the medium term and will be influenced by all the other factors within this report to Cabinet. The use of reserves can best be reviewed when the Revised MTFS has actually been populated as it is only then that a true financial profile will be known.

5.6.2 It is important to emphasise that the use of reserves can only be considered as a short term expedient and that, at some point, the need to balance expenditure and available ongoing funding will be of critical importance to the financial resilience and health of any local authority.

6.0 CONCLUSION

6.1 The aim of the MTFS is to provide a reliable forecast over a four year planning timescale to enable a sustainable financial environment to be in place where ongoing expenditure and income are in tandem. The MTFS can only be as good as the assumptions and realism reflected within it. Should an over optimistic view be taken then, in the fullness of time, shortfalls in funding will appear and reserves or knee jerk service reductions will be necessary. Equally however an overly pessimistic view will probably result in a greater degree of service reductions being imposed. It is a balancing act and that is why the MTFS should be reviewed on a regular basis.

6.2 This paper has highlighted a number of issues that need to be re-evaluated in the light of the considerable changes that have occurred over the past twelve months. It is suggested that these reviews take place over the next 6 weeks so that an up to date position statement can be produced. This will enable the MTFS at Appendix 1 to be populated with latest projections and supporting notes of the assumptions made.

6.3 Discussions can then be held between Leadership Team/ Elected Mayor/ and Portfolio Holders so that a revised financial strategy can be developed. In that process it will be important that Budget Panel on 10th September is provided with all information so that it can play a vital role in shaping the next four years.

6.4 A bi-product of these reviews will be that the newly appointed Joint Section 151 Director of Finance will have all available information and projections and will be able to provide essential advice.

10.0 FINANCIAL IMPLICATIONS

10.1 These have been included within the report.

11.0 LEGAL IMPLICATIONS

11.1 There are no legal implications in the report.

12.0 POTENTIAL RISKS

Potential Risk	Likelihood	Impact	Overall Score
That the Medium Term Financial Strategy will be based upon unreliable data	2	4	8

13.0 EQUALITIES

13.1 Watford Borough Council is committed to equality and diversity as an employer, service provider and as a strategic partner. In order to fulfil this commitment and its duties under the Equality Act 2010 it is important to demonstrate how policies, practices and decisions impact on people with different protected characteristics. It is also important to demonstrate that the Council is not discriminating unlawfully when carrying out any of its functions.

13.2 The reporting of issues that need to be reflected within a review of the Medium Term Financial Strategy does not equate to actually making any firm proposals and will not therefore have equality implications.

Appendices:
Appendix 1 Current Medium Term Financial Strategy