APPENDIX C

LOCAL GOVERNMENT ACT 2003 – REPORT BY THE CHIEF FINANCIAL OFFICER

1. SUMMARY

1.1 This report assesses the risks arising from the budget proposed for 2020/21, and the adequacy of the available mitigations, in the context of the proposed reserves and the outlook for 2021/22 and beyond.

1.2 It concludes that the estimates as proposed are sufficiently robust to allow the Council to set the budget but raises some concerns about the longer term sustainability in view of the uncertainties regarding the local government finances beyond 2020/21.

2. INTRODUCTION

2.1 The Chief Financial Officer has a statutory duty under Section 25 of the 2003 Local Government Act to make a statement on the adequacy of reserves and the robustness of the budget.

2.2 In the context of its service and financial planning the Council's overall approach to risk management is to take appropriate action to mitigate risks, or ensure that sufficient contingency exists, so that service provision is not threatened by unforeseen financial problems during the financial year.

2.3 Making changes to service provision at short notice in order to resolve a budget problem can have a number of undesirable consequences. These can include:

(a) damage to the Council's reputation and customer relationships if advertised services are unavailable or delayed

(b) failure to meet agreed performance targets

(c) inefficiencies in overall service provision

(d) associated costs of reducing service provision, such as staff redundancies, when planning changes over a longer timescale would allow greater flexibility

(e) potential problems for partner organisations that are dependent upon Council financial support to achieve agreed goals.

2.4 To avoid such problems the Council manages its financial risks by ensuring that its annual budget represents a reasonable estimate of the costs of providing agreed service levels. It also holds appropriate balances and reserves so that resources are available to allow a managed and considered response should any significant variations or emergencies arise.

2.5 This report considers:

- The robustness of the budget and key budget areas.
- Adequacy of General Fund balances.
- Review of Earmarked Reserves and risks to incentivised income.
- Future Years beyond 2020/21.

3. ROBUSTNESS OF THE 2020/21 ESTIMATES AND TAX CALCULATIONS

3.1 The Council Tax calculations for 2020/21 are based upon forecasts of expenditure, income and council tax revenues up to 31[s]March 2021, with some significant assumptions made in order to prepare these forecasts. When setting its Council Tax for 2020/21 the Council needs to be satisfied that these assumptions are reasonable. In order to ensure the robustness of the budgeting, the Council's budget process commenced in September 2019 and progressed with Cabinet's consideration of the MTFS in February 2020.

3.2 All areas of budgets have been reviewed by Heads of Service. In addition, a number of budgets are subject to overall cross-service review, including the Council's employee budgets.

3.3 Some comments on the areas of the budget having key financial impacts are set out below:

(a) **Pay and Pensions**

The budget includes provision for an increase of 2% per annum and continues to provide for annual progression through pay scales where this is part of the terms and conditions of employment. A 1% change in pay amounts to around £230,000 per annum.

From April 2014 the Local Government Pension Scheme has moved to a career average scheme that combines an increased accrual rate of 49ths with commensurate changes to employee contributions. The latest triennial actuarial valuation of the assets and liabilities of the Suffolk County Pension Fund was completed on 31 March 2019. The Council has been advised that its share of the pension fund was 98% fully funded at this date. The proposed employers pension contribution rate for 2020/21, 2021/22 and 2022/23 is 34%, 33% and 32% and is a reduction on the current rate for East Suffolk of 35.4%. The current rate is based on a Primary Rate of 22.8%, plus a deficit payment of £2.6 million at 12.6%. For 2020/21 to 2022/23 onwards there will not be a deficit payment, and instead it is incorporated into the primary rate.

The Council's establishment budget is based on a full establishment. To allow for in-year vacancy savings the budget includes an annual vacancy saving of £300k. This is based on previous years' out-turn.

(b) **Price Increases**

Provision has been made for known price increases including the effects of utilities and business rates. Unless specifically requested by services, the budget assumes any price inflation is absorbed by the service.

(c) **Income from Fees and Charges**

A significant part of the Council's costs continues to be met from fees and charges. Progress against income targets will need to be monitored throughout the year, particularly in the light of continuing economic volatility.

The budgeted increases in fees and charges are based on three key principles; cost recovery, market value and inflationary increases. The budget also includes those increases that are set and proposed by Government.

(d) **Investment Income**

Since March 2009 interest rates have continued to produce low returns from investments. On 29 January 2020 the Bank of England maintained the Bank of England rate at 0.75% (increased from 0.50% to 0.75% on 2 August 2018).

Security of the Council's cash is the over-riding consideration in setting its Treasury Management Policy Statement. During the year the Council constantly receives advice from its Treasury Advisors with regard to the creditworthiness of financial institutions.

Following advice from the Councils external treasury advisors Arlingclose the Council has invested just under £10 million into a pooled Local Authorities Property Fund (LAPF) to increase return on investment and to also diversify the portfolio from just purely investing with banks and building societies. The Property fund's value is derived from a mixture of capital values and rental income. The current projected dividend yield is 4.69% (the projected capital return when the investment is redeemed). With any investment there is risk and fluctuations in market activity or a downturn in the property market could affect the capital return on investment.

The budget takes a cautious view on interest rates, making allowance in line with forecast inter-bank lending rates.

(e) **Housing Benefit**

At a forecast £41 million, Housing Benefit remains the Council's largest financial transactions and subject to increasing risk and change. Welfare and benefit changes, and localised council tax support, which all began in April 2013, together with the planned introduction of Universal Credit, serve to make the existing arrangements more complex.

Welfare changes will continue to be closely monitored in order to continue to protect the Council from any emerging risks and liabilities.

(f) **Business Rate Retention**

From April 2013, councils have been able to retain a proportion of the business rates generated within the district and benefit from business growth over the longer term.

As business rates is an increasingly important income source for the Council, measures for closer monitoring of the local economy and its performance, and the impact on business rates have been put in place.

The significant reform in the local government finance system which will include resetting business rates baselines that was intended for 2020/21 has now been deferred until 2021/22. Reset of the system and the establishment of new funding formulae could result in the Council losing its financial advantage under the current system – predecessor Council, Suffolk Coastal, benefited from actual business rates income being significantly above the baseline, which was set at a low level in 2013/14. The postponement of these proposed changes has effectively enabled the Council to set a balanced budget in 2020/21 and contribute to reserves, continuing ongoing community initiatives and provide a further degree of security against future uncertainty.

As a prudent budgeting approach, the Council's MTFS from 2021/22 onwards only includes business rate income at the government baseline level, assuming that the reset of the system will eliminate this current advantage in whole or in part.

(g) **Government Grant**

As part of continued public sector deficit reduction measures, and as part of moves to address social care expenditure pressures in local government, the Council has seen large reductions to Revenue Support Grant (RSG). The announcement of a one year Local Government Finance Settlement for 2020/21 means that the Council will receive RSG of £327,700 in 2020/21, a roll forward of the 2019/20 RSG updated by inflation, and £248,100 of Rural Services Delivery Grant (RSDG). Given the uncertainty of the local government finance environment beyond 2020/21, the MTFS has assumed RSG and RSDG will not be received in future years.

(h) **Council Tax Income**

Council Tax income is one of the most important and stable income streams to the Council, funding approximately 50% of the Council's Net Budget Requirement. The change from council tax benefit to council tax support in April 2013 saw a reduction in the tax base of some 9,700 band D equivalents, with one implication being that the Council needed to try and recover council tax from low income claimants. Collection rates have been carefully monitored, and in calculating the 2020/21 tax base, the Council was able to maintain the estimated collection rate at 99%.

(i) **Council Tax Levels**

In the 2020/21 Final Local Government Finance Settlement, Council Tax increase referendum limits for shire districts is a maximum of £5 or 2%, whichever is the greater. The 2020/21 Budget incorporates a council tax increase of 2.98%. This equates to an increase of £4.95 and generates an additional £435,000 of income to the Council in 2020/21.

(j) **Capital Investment**

The forecast costs of specific schemes included in the approved capital investment plans are based upon reasonable estimates of cost and capacity to deliver the programme. If additional works are proposed during the year, these will be subject to formal approval and the financial implications will need to be considered at that time.

The capital investment proposals rely upon an overall funding envelope made up of a number of sources, including internal borrowing, capital receipts, and capital grant and revenue contributions. In determining the overall affordability of its capital programme, the Council has taken a prudent approach of not including anticipated capital receipts as a source of funding in the programme until such a time when the income is received and realised.

The capital investment programme for the Council is partly funded by borrowing (internal and external). The Council is required to complete a range of calculations (Prudential Indicators) to evidence that borrowing for capital expenditure is affordable, prudent and sustainable over the medium term. This makes sure that the cost of paying for interest charges and repayment of principal by a minimum revenue contribution (MRP) each year is taken into account when drafting the Budget and Medium Term Financial Strategy.

The Council makes use of the Short Life Assets Reserve to purchase a number of short life assets, such as vehicles and ICT acquisition and replacement. Funding of new assets from the Reserve is repaid over the life of the asset from the revenue budget recognising the use of the asset. This approach ensures that the Council's borrowing approvals are used for funding spend on assets with a longer life, such as land and buildings.

The Council also makes use of the Capital Reserve to fund revenue contributions to the capital programme.

(k) **Transformation and Efficiency**

The Council has an enviable record of delivering its efficiency targets and once again the budget includes a number of efficiencies and savings that will need to be achieved in the coming year. However, finance settlements continue to make increasing demands on the Council to balance its resource and spending plans. Over the coming months the Council must continue to develop more innovative and some radical solutions to service delivery in order to address the estimated cumulative shortfall in resources. The Council remains committed to fund initiatives and projects that will produce savings or deliver additional income in future years' revenue budgets and has sufficient earmarked reserves for this purpose.

3.4 The Council's integrated performance management process includes a requirement for Cabinet to review the overall financial position every quarter. This review monitors revenue and capital budgets, and Treasury Management. In addition, key high profile General Fund revenue budgets are subject to additional review by the Council's Corporate Management Team. This helps to ensure that the Council takes appropriate action to resolve any financial issues as they arise and reduces the possibility of significant unforeseen problems during the year.

4. CHIEF FINANCE OFFICER BUDGET ASSESSMENT

4.1 I hold the view that the assumptions made in preparing the Budget for 2020/21 are reasonable and that the resulting estimates and Council Tax calculations are robust.

5. ADEQUACY OF GENERAL FUND BALANCES

5.1 The Council holds a number of reserves and balances to enable it to plan and manage its finances soundly. The Council's General Fund is estimated to have a balance of £6 million as at 1 April 2020 with no further use anticipated for the future years (subject to on-going review). At that level the General Fund Balance is within the thresholds established as part of the MTFS and represents a strong component in the Council's overall financial wellbeing.

5.2 I consider that the General Fund Balance is adequate to:

a) provide cover for a reasonable level of variation in spending or income in the case of reserves held to mitigate against possible future events

b) meet unforeseen variations in the assumptions underlying the budget

c) address the risks arising from the Government's transfer of business rates, council tax and welfare changes

d) meet expenditure in advance of income being received

e) allow emergencies to be dealt with quickly.

5.3 With the significant financial challenges and opportunities facing the Council over the medium term, the Council should continue to maintain a robust level of General Fund Balance of about 3% to 5% of budgeted gross expenditure. This equates to about £4 million to £6 million.

5.4 The main budget risks and sensitivity to the Council's key in-year income and expenditure variables are shown below. The Council has sufficient contingencies and balances to manage these key risks.

Review & Risk Assessment of General Fund Revenue Balances 2020/21

Risk Area	**Identified Risk**	**2020/21 £'000**	**Risk Likelihood / Sensitivity %**	**Risk Value £'000**
Pay Costs	Additional 1% on pay award	230	5%	12
Investment Income	Reduction in investment rates by 0.5%	550	10%	55
Car Parking Income	Economic, environmental, and market risks to income budgets	4,728	10%	473
Planning Fee Income	Economic, environmental, and market risks to income budgets	2,245	15%	337
Building Control Income	Economic, environmental, and market risks to income budgets	863	15%	129
Land Charges Income	Economic, environmental, and market risks to income budgets	415	50%	208
Garden Waste Income	Economic, environmental, and market risks to income budgets	2,366	30%	710
Waste Recycling Income	Possible decline in dry recyclables market	2,400	30%	720
Housing Benefit Subsidy	Possible adverse variance on subsidy	41,008	0.5%	205
Housing Benefit Overpayments	Possible adverse variance on overpayments recovered	1,314	10%	131
Council Tax Support	Possible increase in caseload - Effect on tax base	1,626	10%	163
Homelessness Administration	Possible increased caseload resulting from economic factors and welfare changes	764	15%	115
Partnerships	Potential operational failures and need to implement transitional arrangements	1,556	20%	311
Savings and Efficiencies	Non-achievement of vacancy saving	400	20%	80
Business Rates	Reduction in income to Safety Net level	530	50%	265
Risk Value Sub Total				**3,914**
Add: Contingency for unforeseen factors				550
Total Risk Value				**4,464**

6. REVIEW OF EARMARKED RESERVES AND RISKS TO INCENTIVISED INCOME

6.1 In addition to the General Fund Balance, the Council holds a range of Earmarked Reserves as part of its overall financial management. Two of the most significant Earmarked Reserves that the Council currently holds have been built up from incentivised income under the current arrangements for financing local government. These reserves form an extremely important part of delivering a range of Council objectives and are subject to specific risks in the medium term. These are referred to in more detail below.

Business Rate Equalisation Reserve

6.2 The Council operates an earmarked Business Rate Equalisation Reserve. This Reserve holds additional business rates income over and above the baseline level required for the General Fund Budget. Increased use of business rates income in support of the budget constitutes an increased risk to the council, as this income is subject to uncertainty and volatility, especially in respect of economic factors.

6.3 Due to reform of the Business Rates system and the re-set of the business rates baselines from April 2021 the funding picture for 2021/22 onwards is one of significant uncertainty.

New Homes Bonus

6.4 The New Homes Bonus (NHB) is funding allocated to councils based on the building of new homes and bringing empty homes back into use. It has become an extremely important source of incentivised income for the Council.

6.5 The Council makes use of up to 70% of its in-year NHB allocation (average of £1.3 million across the MTFS period) to support community initiatives and projects, with the remaining 30% being made available to support budget pressures if required. Unused NHB funding is held in a reserve. This approach adopted by the Council provides continued support to community initiatives but balances it against the overriding need to retain financial sustainability.

6.6 As part of the one-year roll-forward Settlement the Government will retain the £900 million top-slice of RSG to fund NHB payments in 2020/21. In addition to funding legacy payments associated with previous allocations, there is a new round of allocations for 2020/21. As the roll forward is for one year, with any funding beyond 2020/21 subject to the 2020 Spending Review and potential new proposals, new allocations in 2020/21 will not result in legacy payments being made in subsequent years on those allocations. The payment of an allocation for one year instead of four years has a significant impact on NHB funding availability, as current annual allocations amount to over £500,000 per year.

6.7 The Government will be consulting in the Spring on incentivising housing growth, and there are indications that NHB may be phased out more rapidly than previously anticipated and may be abolished altogether in its current form.

6.8 The forecasts included in the Budget and MTFS indicate the continuation of healthy balances on the incentivised income reserves, albeit with considerably more rapid reductions in the NHB Reserve for the reasons outlined above. It is important in this Chief Financial Officer report that the Council's attention is drawn to the risks associated with such significant areas of the Council's overall financing.

7. FUTURE YEARS BEYOND 2020/21

7.1 The Council is faced with significant challenges over the coming years. The Council will have to monitor the impact on its financial position and service provision arising from:

(a) managing and addressing the impact of welfare changes on residents and the delivery of services

(b) the introduction of Universal Credit

(c) its success or otherwise in being able to promote a sustainable local economy in order to maintain and or increase its income derived from Government's business rate retention scheme

(d) ensuring that its planning policies continue to support a proportionate and sustainable growth in employment, the local economy, housing and infrastructure

(e) significant reform in the local government finance system from 2021/22, including an updated, more robust and transparent distribution methodology to set baseline funding levels and resetting business rates baselines. This reform places greater uncertainty and income risk on the Council

(f) changes to the NHB funding system and the resulting sustainability of continuing to support community initiatives and projects that have benefited from this incentivised income.

7.2 With continued substantial change and further significant reductions in public sector funding, the Council will need to respond in increasingly innovative ways to support its communities and maintain the momentum of improvement over the medium and longer term. Overall, the Council's budget is robust, and it has sufficient earmarked and general balances to manage key risks and deliver on a range of objectives. However, it is important that the Council recognises the risks to incentivised income areas outside of the budget itself and does not become over reliant on these sources to both balance the budget and finance its longer-term ambitions.

8. CIPFA FINANCIAL RESILIENCE INDEX

8.1 In December 2019 CIPFA introduced the Financial Resilience Index, which is a comparative analytical tool that may be used by chief financial officers to support good financial management, providing a common understanding within a council of their financial position. The index shows a council's position on a range of measures associated with financial risk. The selection of indicators has been informed by the extensive financial resilience work undertaken by CIPFA over the past four years, public consultation and technical stakeholder engagement.

8.2 Together with taking into account the Auditors VfM Assessment of the authority, the Index assesses risk on the following indicators of financial stress:

- Reserves Sustainability Measure.
- Level of Reserves – further subdivision into Unallocated and Earmarked Reserves.
- Change in Reserves – further subdivision into Unallocated and Earmarked Reserves.
- Interest Payable / Net Revenue Expenditure.
- Gross External debt.
- Social Care Ratio.
- Fees and Charges to Service Expenditure Ratio.
- Council Tax Requirement / Net Revenue Expenditure.
- Growth above Baseline.

8.3 This report has been prepared with reference to the CIPFA Financial Resilience Index for 2018/19, although it is difficult to relate this directly to East Suffolk Council as it has been prepared in respect of the Council's predecessor authorities of Suffolk Coastal DC and Waveney DC. None of the financial stress indicators for either authority gives particular cause for concern, and it will be useful to assess the comparative position for East Suffolk when the Index is produced for 2019/20 which will feature the new authorities. Going forward, the Financial resilience Index is expected to be a useful tool in supporting assessment of financial risk.

9. FINANCIAL GOVERNANCE

9.1 Given the forecast financial position of the Council in the medium term, and in particular the reductions in Government funding and the risks and uncertainties concerning incentivised income, it is imperative that the Council's commitment to strong financial governance is maintained and strengthened. During 2020/21, the Council will be implementing the CIPFA Financial Management Code, for which CIPFA intends the first full year of compliance to be 2021/22. The FM Code is designed to set the standards of financial management for local authorities, support good practice in financial management, and assist local authorities in demonstrating their financial sustainability.

Simon Taylor (CPFA)

Chief Finance Officer (S151 Officer)