Folkestone & Hythe District Council

Agenda

Meeting: **Overview and Scrutiny Committee**
Date: **16 October 2018**
Time: **7.00 pm**
Place: **Council Chamber - Civic Centre, Folkestone**

To: **All members of the Overview and Scrutiny Committee**

The committee will consider the matters, listed below, at the date, time and place shown above. The meeting will be open to the press and public.

Members of the committee, who wish to have information on any matter arising on the agenda, which is not fully covered in these papers, are requested to give notice, prior to the meeting, to the Chairman or appropriate officer.

This meeting will be webcast live to the council's website at https://folkestone-hythe.public-i.tv/core/portal/home. Although unlikely, no guarantee can be made that Members of the public in attendance will not appear in the webcast footage. It is therefore recommended that anyone with an objection to being filmed does not enter the council chamber.

1. **Apologies for Absence**

2. **Declarations of Interest**

   Members of the committee should declare any interests which fall under the following categories*:

   a) disclosable pecuniary interests (DPI);
   b) other significant interests (OSI);
   c) voluntary announcements of other interests.

3. **Minutes (Pages 3 - 8)**

   To consider and approve, as a correct record, the minutes of the meeting held on 11 September 2018.

Queries about the agenda? Need a different format?

Contact Kate Clark – Tel: 01303 853267
Email: committee@folkestone-hythe.gov.uk or download from our website www.folkestone-hythe.gov.uk

Date of Publication: Monday, 8 October 2018

4. **Medium Term Financial Strategy 2019/20 to 2021/22 (Pages 9 - 34)**

Report C/18/36 - The Medium Term Financial Strategy (MTFS) is the Council's key financial planning document. It puts the financial perspective on the council's Corporate Plan priorities, expressing the aims and objectives of various plans and strategies in financial terms over the four year period ending 31 March 2023. It covers both revenue and capital for the General Fund and the Housing Revenue Account. Also included are the Council's reserves policies. The MTFS is a key element of a sound corporat governance and financial management.

5. **Treasury Management Monitoring Report 2018/19 (Pages 35 - 50)**

Report C/18/34 provides an update on the council's treasury management activities that have taken place during 2018/19 against the agreed strategy for the year. The report also provides an update on the treasury management indicators approved by Council earlier this year.

*Explanations as to different levels of interest

(a) A member with a disclosable pecuniary interest (DPI) must declare the nature as well as the existence of any such interest and the agenda item(s) to which it relates must be stated. A member who declares a DPI in relation to any item must leave the meeting for that item (unless a relevant dispensation has been granted).

(b) A member with an other significant interest (OSI) under the local code of conduct relating to items on this agenda must declare the nature as well as the existence of any such interest and the agenda item(s) to which it relates must be stated. A member who declares an OSI in relation to any item will need to remove him/herself to the public gallery before the debate and not vote on that item (unless a relevant dispensation has been granted). However, prior to leaving, the member may address the meeting in the same way that a member of the public may do so.

(c) Members may make voluntary announcements of other interests which are not required to be disclosed under (a) and (b). These are announcements made for transparency reasons alone, such as:

• membership of outside bodies that have made representations on agenda items, or

• where a member knows a person involved, but does not have a close association with that person, or

• where an item would affect the well-being of a member, relative, close associate, employer, etc. but not his/her financial position.

Voluntary announcements do not prevent the member from participating or voting on the relevant item

Folkestone & Hythe District Council

Minutes

Overview and Scrutiny Committee

Held at:	Council Chamber - Civic Centre, Folkestone
Date	Tuesday, 11 September 2018
Present	Councillors Peter Gane (Chairman), Clive Goddard, Mrs Claire Jeffrey (Vice-Chair), Mrs Mary Lawes, Michael Lyons, Philip Martin (In place of Miss Susan Carey), Ian Meyers and Russell Tillson
Apologies for Absence	Councillor Miss Susan Carey, Councillor Ms Janet Holben and Councillor Mrs Rodica Wheeler
Officers Present:	Kate Clark (Committee Services Officer), Gavin Edwards, Leigh Hall (Group Accountant), Sue Lewis (Committee Services Officer), Tim Madden (Corporate Director - Customer, Support and Specialist Services), Sarah Robson (Head of Communities), Charlotte Spendley (Head of Finance) and Lee Walker (Group Accountant)
Others Present:	Councillor Alan Ewart-James, Cabinet Member for Housing

121. **Declarations of Interest**

There were no declarations of interest.

122. **Minutes**

The minutes of the meeting held on 17 July 2018 were submitted, approved and signed by the Chairman.

123. **General Fund Revenue Budget Monitoring - 1st Quarter 2018/19**

Report C/18/30 provided a projection of the end of year financial position of the General Fund revenue budget, based on expenditure to the 31 July 2018.

Members noted the report paying particular attention to the projected outturn position across the service units at 2.3 in the report and the main variances at 2.4.

Members were informed that the household waste collection had sold fewer bins this time round and noted that this was mainly due to a change in trends with less take up.

Officers confirmed they would seek to reflect all new trends in income in the detailed budget for 2019/20 which will be tabled later in the year.

Proposed by Councillor Russell Tillson
Seconded by Councillor Michael Lyons and

Resolved: To receive and note Report C/18/30.

(Voting: For 8; Against 0; Abstentions 0)

124. **General Fund Capital Budget Monitoring Position 2018/19**

Report C/18/28 provided a projection of the current financial position for the General Fund capital programme, based on expenditure to 31 July 2018 and identified variances compared to the latest approved budget.

Members noted the report paying particular attention to the projected outturn at 2.1 and the reasons for the variances at 2.2 of the report.

Although projections are made early in the year and are therefore subject to change throughout the year it was noted that capital funding expenditures has not added any additional strain to the Council with revenue consistent with figures as previously reported.

Proposed by Councillor Michael Lyons
Seconded by Councillor Russell Tillson and

Resolved: To receive and note Report C/18/28.

(Voting: For 8; Against 0; Abstentions 0)

125. **Housing Revenue Account Revenue and Capital Budget Monitoring 2018/19 - 1st Quarter**

Report C/18/31 provides a projection of the end of year financial position for the Housing Revenue Account (HRA) revenue expenditure and HRA capital programme based on net expenditure to 30 June 2018.

Officers reported that it is very early stage of financial year but highlighted the summary projected outturn at 2.1 in the report, together with the variances on page 31.

It was noted that the additional loan to East Kent Housing had now been made and repayments were made through instalments. A question regarding the internal and external decorations variance was asked and it was confirmed that any emergency works will still take place until a joint procurement process is agreed.

Proposed by Councillor Clive Goddard
Seconded by Councillor Mrs Claire Jeffrey and

Resolved: To receive and note Report C/18/31.

(Voting: For 8; Against 0; Abstentions 0)

126. **Treasury Management Annual Report 2017/18**

Report C/18/29 reviews the council's treasury management activities for 2017/18, including the actual treasury management indicators. The report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Council is required to comply with both Codes through Regulations issued under the Local Government Act 2003.

It was noted that the Council has fully complied with the approved Treasury Management Strategy and Treasury Indicators for 2017/18. It was also noted the council is now required to comply with both CIPFA's revise revised Investment and Minimum Revenue Provision Guidance. Definitions around these have been widened to include investments in non-financial assets and is seen as a response to the increasing trends for commercial property investments in the local authority sector.

Particular attention was paid to the financial summary, the actual net interest cost for 2017/18 was lower than budgeted due to additional interest received from investments on higher than forecast cash balances.
Members asked a number of questions paying particular attention to the following:

- Public Works Loan Board – members were informed that this is borrowing for capital finance purposes with the majority relating to the HRA. A significant proportion of the borrowing for the HRA relates to 'Self-Financing' reforms introduced by the government in 2012.
- Local Authority Lending – Although the recent financial problems facing Northamptonshire County Council have raised concerns about lending to other local authorities, it is clear that this sector is still viewed as very secure with little real prospect of a council not being able to meet its obligations under these arrangements.
- Investment Guidance changes – government recognises that local authorities are investing in riskier assets, therefore the changes are in response to this and CIPFA. It gives the Council the chance to disclose more information along the way.

Proposed by Councillor Russell Tillson
Seconded by Councillor Michael Lyons and

Resolved: To receive and note Report C/18/29.

(Voting: For 8; Against 0; Abstentions 0)

127. **Digital Strategy 2018-2023**

Report C/18/26 The Digital Strategy summarised the direction the Council is taking with regard to offering a greater range of digital services for our residents and businesses and introducing new ways of working for staff.

Members received a short presentation, which is attached to the minutes for information, and were informed that in UK households 90% of adults now have access to the internet, 85% have either a smartphone or tablet and 78% have a laptop or PC. Our customers expect the same quality and convenience of service from us as they receive in other aspects of their life.

Digital transformation is about how we use our ICT systems, business processes and activities to help us become a more efficient and effective Council, meeting the needs of our customers.

The Strategy recognises that digital transactions may not be suitable for all our customers, particularly the very vulnerable and we will ensure those cannot use digital services are not excluded.

The Digital Strategy has three priorities Digital Customer Service, Digital Workforce and Digital Place, the Council is currently working on the digital workforce with a survey of staff skills as part of transformation.

Members paid particular attention to the following:

- Data Protection – it is clear that the Council must be mindful of security in terms of delivery of ICT procurement and officers are working together to ensure that it is delivered in the correct and secure way.
- Customer telephone contact – some members and customers are currently experiencing being put on hold or being told that the lines are busy. Officers will investigate why this is currently happening and report back to the Committee. However, the Committee did note that digital transformation will help alleviate some of these issues as more customers take up digital services, freeing up officer time to support our most vulnerable customers.
- Digital Place – KCC has responsibility to improve access to superfast broadband services. However, FHDC will help influence and input into any projects being undertaken by KCC in the district.
- Training – where appropriate, training will be given to both staff and customers in respect of new digital services that are provided..

If Cabinet agree the strategy at its meeting on 12 September and once a delivery plan is in place then a digital delivery action plan will be prepared.

Proposed by Councillor Mrs Claire Jeffrey
Seconded by Councillor Michael Lyons and

Resolved: To receive and note Report C/18/26.

(Voting: For 8; Against 0; Abstentions 0)

128. **Quarter 1 Performance Report 2018/19**

Report C/18/25 provided an update on the Council's performance for the first quarter of 2018/19, covering 1st April 2018 to 30th June 2018. The report enables the Council to assess progress against the approved key performance indicators for each service area.

Members were pleased to see the inclusion of Romney Marsh and asked that a number of issues in relation to appearance of the district, particularly around Folkestone East, are raised with the necessary officers to investigate.

Although it is still early in the year members were happy to see the report and agreed that it was laid out in an easy to understand way.

- Romney Marsh – members were happy to see that this has now been included as part of the report.
- Appearance Matters – Issues were raised regarding recycling, street cleansing and bins in Folkestone East, particularly Harbour Ward. Officers will take the comments back to the relevant officers to respond.

Proposed by Councillor Clive Goddard
Seconded by Councillor Michael Lyons and

Resolved: To receive and note Report C/18/25.

(Voting: For 8; Against 0; Abstentions 0)

129. **Equality and Diversity Annual report**

Report C/18/27 The Equality Act 2010 places a statutory duty on the council to prepare and publish information annually to demonstrate compliance with the Public Sector Equality Duty. The draft Equality & Diversity Annual Report was presented for consideration and approval prior to publication.

Members were informed that once the report is approved at Cabinet on 12 September the final version will be published on the Council's website.

The report demonstrated that council's compliance with the Public Sector Equality Duty and that it is fulfilling its statutory obligations. The report also contained a range of information that outlined the district's diversity, highlighted the specific activities undertaken in 2017/18 to support these different customer needs and promote equality, diversity, and inclusion, the positive measures taken to remove barriers, improve access to services and increase customer satisfaction, and the strategies, policies, strategic partnerships in place to meet the current and anticipated needs of our diverse district.

Members were informed that historical population growth in Folkestone and Hythe appears more sporadic in comparison to regional and national comparisons as the smaller geographical area means fluctuations in actual numbers has a greater impact on percentage of growth.

Proposed by Councillor Mrs Claire Jeffrey
Seconded by Councillor Michael Lyons and

Resolved: To receive and note Report C/18/27.

(Voting: For 7; Against 0; Abstentions 1)

This Report will be made public on 9 October 2018.

Report Number: **C/18/36**

To:	**Cabinet**
Date:	**17 October 2018**
Status:	**Key Decision**
Corporate Director:	**Tim Madden, Customers, Support and Specialist Services**
Cabinet Member:	**Councillor David Monk, Leader of the Council**

SUBJECT: Medium Term Financial Strategy 2019/20 to 2022/23

SUMMARY: The Medium Term Financial Strategy (MTFS) is the Council's key financial planning document. It puts the financial perspective on the council's Corporate Plan priorities, expressing the aims and objectives of various plans and strategies in financial terms over the four year period ending 31st March 2023. It covers both revenue and capital for the General Fund and the Housing Revenue Account. Also included are the Council's reserves policies. The MTFS is a key element of sound corporate governance and financial management.

REASONS FOR RECOMMENDATION:

Cabinet is asked to agree the recommendations set out below because:-

(a) The MTFS is the council's key financial planning document.
(b) The strategy defines the financial resources needed to deliver the council's corporate objectives and priorities and covers the financial implications of other key strategies.
(c) The council needs to be able to carry out an early assessment of the financial implications of its approved policies and strategies and also external financial pressures facing the authority to ensure that it has robust budgeting and remains financially viable.

RECOMMENDATIONS:

Cabinet is asked to recommend to Council:

1. **To receive and note Report C/18/36.**
2. **To recommend that the Medium Term Financial Strategy, as appended to this report, is adopted.**

1. THE MEDIUM TERM FINANCIAL STRATEGY (MTFS)

1.1 The MTFS is the council's key financial planning tool and underpins the strategic approach to financial planning. It is a live document which needs to be periodically reviewed to reflect changing priorities and objectives. As the MTFS outlines the financial resources necessary to deliver strategic priorities, it should not be viewed in isolation but as part of the wider corporate process.

1.2 The council last reviewed the MTFS at its meeting of 17 October 2017. The attached MTFS has updated the document agreed at that point based on the work completed to date in preparation of the 2019/20 budget. The detailed budget strategy, which sets out the detailed preparation for the 2019/20 budget, will be presented to Cabinet at its meeting of 14th November 2018. The MTFS provides the medium term view of the financial position of the Council.

1.3 The attached document reflects a summarized version of the key financial elements facing the Council. It covers key areas of the council's finances and in particular updates the financial projections which are of importance at this stage of the process and links to the new corporate plan. The intention is, once the 2019/20 budget is completed, to refresh this document and to present the full version to Cabinet and Council which will take into account the final budget of the Council which will be agreed in February 2019.

1.4 As in recent years, local authority financial management is set against a background of uncertainty and the MTFS is subject to influence outside the authority's control. Nationally, the continued uncertainty around the terms of any "Brexit" agreement and the government's Fair Funding Review means that all local authorities need to try and plan for future uncertainties. These include key changes include the future funding arrangements for Business Rates, the end of the Revenue Support Grant and any structural or devolution proposals which will affect councils in different areas according to local circumstances. These will have a significant impact upon the financial profiling of the Council. The impact of decisions arising from Council policy could also affect the MTFS and therefore further iterations of the MTFS will reflect the financial implications of those decisions taken.

1.5 The current strategy has been developed in the context of this period of uncertainty. As such, assumptions have had to be made with regard to future income streams and assessments of future government grant. Although these are very much best estimates, they are taken in the context of the current economic climate and the uncertainties identified above. As such, a difficult but realistic forecast of income trends has been incorporated into this MTFS model.

1.6 There is significant long term pressure upon the finances of the Council and broadly the financial projection is in line with that in previous years. The key change is the Fair Funding Review (see above) which looks to make significant changes from April 2020 to Council funding nationally.

This gives a level of uncertainty when looking at future projections and developing the underpinning assumptions for the financial forecast

1.7 The current MTFS forecasts a cumulative funding gap of £4.362 million over the lifetime of this MTFS. This is based on the assumption of a 2% annual council tax increase for the period of the MTFS. These will be subject to Political decisions at the appropriate time. The table below also shows the cumulative deficit over the period of the MTFS.

	2018/19 £000	2019/20 £000	2020/21 £000	2021/22 £000
Deficit	721	1,723	3,043	4,362

1.8 The position set out above is in advance of the budget strategy which will be presented to Cabinet at its meeting of the 14th November. That will address the detailed measures to consider the deficit for 2019/20 in terms of identifying savings but also any known cost pressures. In light of the increasing pressures facing the council, all budget considerations will also look at the impact in future years and the sustainability of any options.

1.9 The MTFS covers the key aspects of the Council's future plans to address the projected deficit and also to place the Council on a sustainable and secure footing for the future. This includes the impact of the Council's current transformation programme, its use of flexible capital receipts to support that programme, the future approach to investment in the district and the key drivers associated with the future position. This is an overarching view and detail will be found in subsequent reports to Cabinet and Council.

1.10 The MTFS is included at Annex A to this report and sets out the financial forecast for the Council.

2. RISK MANAGEMENT ISSUES

2.1 A summary of the perceived risks follows:

Perceived risk	Seriousness	Likelihood	Preventative action
The Council does not remain up to date up to date with changes in legislation and other developments.	High	Low	Financial Services are keeping abreast of finance changes. Heads of Service to keep up to date with / communicate changes to their areas of work.
Assumptions may be inaccurate	High	Medium	Budget monitoring process is up to date and a close

			eye is being kept on financial developments nationally. Assumptions are constantly reviewed and amended in light of information received.
Local Government Finance Settlement is worse than anticipated.	High	Medium	Realistic assumptions have already been included and any new information is being assessed as to its likely impact. This is subject to ongoing review especially given the changes in future funding arrangements.
MTFS becomes out of date	High	Low	This is reviewed annually through the budget process.
Significant financial shocks worsen the current position of the council	High	Medium	There is ongoing monitoring of the overall financial position and climate and by adopting the MTFS a longer term time horizon is maintained to anticipate and respond to uncertain events.

3. LEGAL/FINANCIAL AND OTHER CONTROLS/POLICY MATTERS

3.1 Legal Officer's Comments (DK)

There are no legal implications arising out of this report.

3.2 Finance Officer's Comments (TM)

There are no direct financial consequences arising from this report. However the strategy will influence the management of the council's resources ensuring that the focus is on the objectives and targets outlined in the corporate plan.

3.3 **Diversity and Equalities Implications** (TM)

There are no diversity and equality implications arising from this document. When the budget for 2017/18 is prepared, an Equalities Impact Assessment will be completed.

4. CONTACT OFFICERS AND BACKGROUND DOCUMENTS

Councilors with any questions arising out of this report should contact the following officer prior to the meeting

Tim Madden, Corporate Director, Customers, Support and Specialist Services

Tel: 01303 853371 E-mail: tim.madden@folkestone-hythe.gov.uk

The following background documents have been relied upon in the preparation of this report:

No background documents have been used.

Appendices:

Medium Term Financial Strategy 2019/20 – 2022/23

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MEDIUM TERM FINANCIAL STRATEGY

2019/20 TO 2022/23

(Version produced in September 2018)

MEDIUM TERM FINANCIAL STRATEGY

Introduction

This document sets out the key challenges and approach of the Council in relation to Folkestone and Hythe District Council's Medium Term Financial Strategy ('MTFS') for the next four years. The MTFS provides an integrated view of the whole of the council's finances and it also maps out the objectives to be secured, policies to be applied and risks to be managed over the period.

Since the introduction of austerity in 2010, local government has taken a disproportionately large share of the reductions in public expenditure as part of efforts to balance the nation's finances. The financial year 2019/210 will be the first year where the Council no longer receives any Revenue Support Grant. The current national political uncertainty surrounding the shape of Brexit and its continuing priority in the government's agenda suggests it is reasonable to assume the approach adopted by local authorities since 2010 will need to continue for the foreseeable future.

In response to this financial challenge, local government has innovated, streamlined services and increased productivity. The Government's plans to devolve more responsibilities to local government through the localisation of business rates are now intended to take effect from April 2020 although detail as to whether there will be additional responsibilities are not yet clear. The devolution of business rates is intended to be fiscally neutral but the details of how this will work are currently being developed alongside the Fair Funding Review. This will bring both risks and opportunities for the council and will be implemented for the 2020/21 financial year.

The MTFS is the a critical document in setting out the council's approach to establishing a strong financial base to enable the council's policies and priorities to be delivered whilst ensuring the council's finances are sustainable. Within the document are some key issues which will need to be tackled. The annual budget setting process will set out the detailed actions required to meet these but will in all cases be consistent with the direction and objectives of the MTFS.

Folkestone and Hythe Council - the Current Position

Folkestone and Hythe Council covers an area of 140 square miles and has a population of just over 100,000 people with approximately 48,200 dwellings in the district. The council has responsibility for a wide range of services including waste collection, planning, environmental enforcement, housing and homelessness, parking and grounds maintenance. In 2018/19 it planned to spend approximately £17.1 million per annum net revenue expenditure on services.

The Council's Aspirations

The vision and strategic objectives of the council are laid out in the Corporate Plan 2017 to 2020 and are shown below:

The vision for Folkestone and Hythe:

Investing for the next generation – delivering more of what matters

As a council, to help achieve the vision for the district, our strategic objectives are:

- More Homes – Provide and enable the right amount, type and range of housing
- More Jobs – Work with businesses to provide jobs in a vibrant local economy
- Appearance Matters – Provide an attractive and clean environment
- Health Matters – Keep our communities healthy and safe
- Achieving stability – Achieve financial stability through a commercial and collaborative approach
- Delivering Excellence – Deliver excellent customer service through the commitment of staff and members

The council will have a particular emphasis on supporting the growth and sustainability of the economy to increase prosperity, to increase the number of houses in a sustainable manner over the longer term and on improving our effectiveness and efficiency through service design and digital delivery. By focusing on these key priorities, the council will be able to direct resources to achieving its key strategic objectives and to ensure sustainability in its activities.

As part of further strengthening the council's corporate position going forward, in June 2018, the Local Government Association (LGA) Peer Review Team undertook a review of the council's organisational leadership and governance; financial plans; capacity to deliver; and, focus on commercialisation, highlighting both areas of strength and areas for development in the years ahead.

The Council will continue to deliver a range of major projects and initiatives focusing on putting the community and our customers first, whilst ensuring our financial stability, including a Council-wide transformation programme alongside realising development projects at sites including Biggins Wood, Princes Parade and ultimately, Otterpool Park – a garden town for the future.

Strategic Financial Objectives

The MTFS covers all areas of the council spending and is underpinned by the strategic financial objectives as set out below:

- To maintain a balanced Budget such that expenditure matches income from Council Tax, fees and charges, and government and other grants and to maintain that position.
- To maximise the council's income by setting fees and charges, where it has the discretion and need to do so, at a level to ensure at least full cost recovery, promptly raising all monies due and minimising the levels of arrears and debt write offs.
- To ensure a long term sustainable view is taken of any investments and the appropriate risk analysis is provided in considering those.
- To set a rate for Council Tax which maximises income necessary for the council to deliver its strategic objectives but ensures that government referendum limits are not exceeded. The percentage increase will be reviewed annually.
- To ensure resources are aligned with the council's strategic vision and corporate priorities.
- To consider and take advantage of commercial opportunities as they arise to achieve a commercial return
- To maintain an adequate and prudent level of reserves.

The council faces a number of difficult decisions if it is to achieve its corporate priorities. Effective prioritisation and management of resources therefore continues to remain significant for the coming years.

The Efficiency Plan

The government offered local authorities a minimum grant envelope for 4 years starting from 2016/17 through to 2019/20. This has provided a degree of stability in funding for the Council. 2019/20 is the final year of this "offer" and in order to secure this, the Council must produce an efficiency strategy. There are a number of programmes to support this efficiency plan including:

- The Corporate Plan 2017 - 20 the key objectives of which are set out above
- The Economic Development Strategy 2015 - 2020
- The Council's digital delivery programme
- The flexible use of capital receipts (see later in this document)
- The Medium Term Financial Strategy
- The HRA Business Plan
- The investment in longer term strategic developments to secure the financial future of the council
- The development of the garden town at Otterpool Park with a long term financial benefit for the council and establishing sustainable communities for the future
- A sustainable and prudent reserves policy to underpin the financial resilience of the council

- The implementation of the Transformation programme, together with the Council's transformation partners, Iese, to develop new operating model and deliver efficiencies whilst improving the customer experience

The range of documents and approaches provides the overall strategy of the council in delivering its future agenda and as a combination they are owned by the council as a whole. This MTFS brings together the financial strands of that approach in the context of the current financial climate.

Budget Process

The MTFS represents an overarching view of the finances of the organisation. It is the document that takes a longer medium term look at the financial environment the Council is operating in and looks to anticipate future demands and pressures so the Council can take longer term decisions over its financial sustainability. In addition to this, there are a number of key documents which contribute to the overall financial health of the organisation. These are:

- The budget strategy. This is produced on an annual basis and sets out the strategy for setting and managing the budget for the following financial year. It is here the detailed decisions on expenditure are taken.
- The detailed revenue estimates. These are the operational detail for the following years budget and form the basis of the following years budget monitoring and management.
- The capital programme. Which sets out the Council's capital expenditure plans over the medium term. This also informs the revenue budget of the costs and implications of any proposed developments.
- The Housing Revenue Account. This sets out the annual capital and revenue budget for the Council's housing stock and links to the 30 year business plan.
- The treasury management and investment strategy. This sets out the approach to managing the cash available to the Council and how to maximise its value to the Council. It also sets out the Council's investments and plans to achieve future returns over the longer term.
- Fees and Charges. This sets out a corporate view of the fees and charges which are levied by the Council for consideration each year.

Together these reports lead to the final council tax setting report and the agreement of the budget for the following year.

Financial Pressures and Projections

The Council is part of the local government sector which has been one of the areas hardest hit by central government's deficit reduction plan. The spending review 2015 confirmed a transition away from direct central government grant and for Folkestone and Hythe the grant has consistently reduced from £4.901 million in 2013/14 to nil in 2019/20. This is in line with the government's intention to see more money raised locally to provide local services.

The government is currently undertaking a major review of the funding of local authorities known as the Fair Funding Review. This is anticipated to take effect from 2020/21 and includes local business rates retention at 75%, a revised allocation of resources and new arrangements to replace the New Homes Bonus to reward those Councils which support home building. The detail behind much of this review, and therefore the impact upon Folkestone and Hythe, is unclear and does mean that the forecasts from 2020/21 onwards have a level of uncertainty which will need to be monitored as those details become available.

Acknowledging the future uncertainty, the forecasts set out below have recognised the current service levels plus any known and agreed variations. They are based on a continuation of those service levels and reasonable assumptions in relation to pay and price inflation and other known pressures. The forecast is based on a mid range scenario and will need to be updated in line with government announcements and as new information becomes available. The current forecast is set out at Table 1 below:

Table 1 – Medium Term Financial Forecast

Financial Forecast	2019/20	2020/21	2021/22	2022/23
	£000	£000	£000	£000
Cumulative Deficit	721	1,723	3,043	4,362
Annual (y-o-y)	721	1,002	1,320	1,319

The table identifies the ongoing pressure the Council is facing. A more detailed presentation is attached at Appendix 1. Some of the underlying assumptions drivers are set out in the paragraphs below:

Council Tax

The Council Tax is one of the key funding streams for the council and accounts for approximately two thirds of the Council's income. Although this is a significant funding source, it is subject to restrictions by central government. The Localism Act included a requirement to hold a local referendum if any Council Tax increase is deemed 'excessive' and this level is currently set at 3% by central government.

The MTFS has assumed an ongoing Council Tax increase of 2% per annum however this will be subject to a Political decision on an annual basis dependant on circumstances in that time.

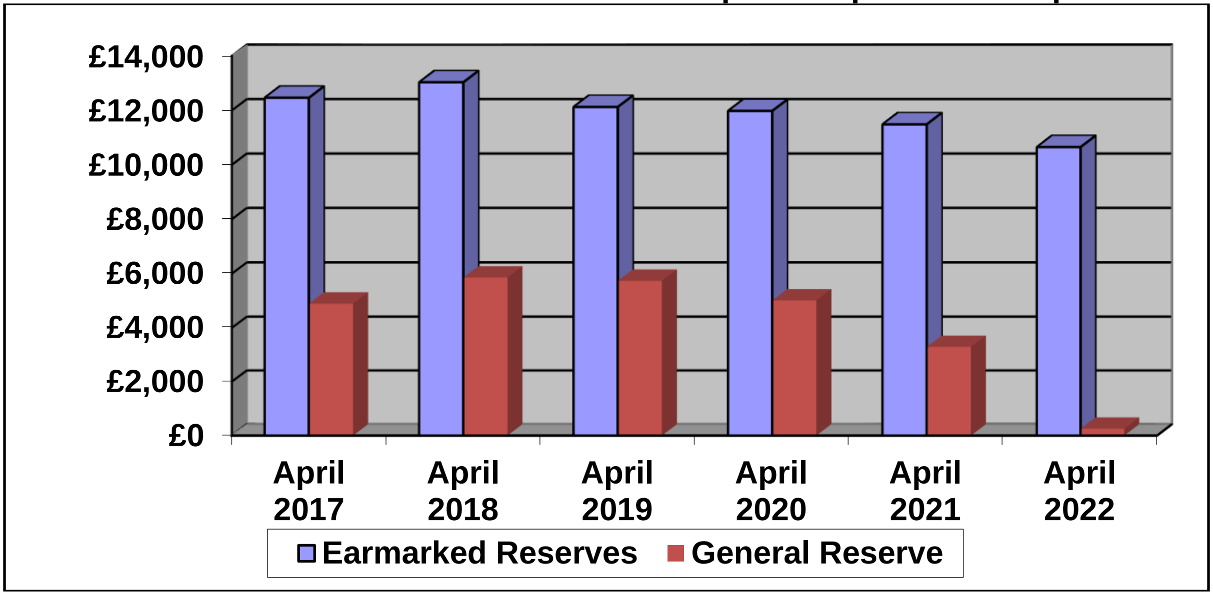
Use of Reserves

The council has a level of reserves which provides it with some protection against the difficult economic times. The level of reserves currently held by Folkestone and Hythe gives it a secure financial base however it is important to have an appropriate balance between supporting the financial position of the Council and planning the delivery of services. The Council has identified specific uses for much of the reserves including setting aside sums to support the planning process for Otterpool Park and the use of reserves will be focussed on specific priorities.

Appendix 2 to this report sets out the council's overall reserves policy and the context in which decisions are made as to the appropriate level of reserves.

The council's prudent approach to reserves means that a number of investments have been made using reserves to support initiatives such as Oportunitas and the Empty Homes programme. Table 2 below shows the forecast level of reserves for the period of this strategy.

Table 2 – Forecast Level of Reserves for MTFS period April 2017 to April 2022



New Homes Bonus (NHB)

The New Homes Bonus was introduced in 2011/12 and has become an important funding source for councils. It is designed by Central Government to incentivise new house building. Local authorities are rewarded with a financial bonus, equal to the national average Council Tax on each additional property built and paid for the following six years after the occupation as a non ring fenced grant. This bonus is currently split in two tier areas 80% to the District Council and 20% to the County Council and includes where properties which have been empty for more than six months are brought back into use. There is also an enhancement for affordable homes.

The future of the New Homes Bonus was reviewed for the 2017/18 financial year with the length of time it is paid reduced from 6 years to 5 years (for the 2017/18 award) and to 4 years from 2018/19 onwards. A "baseline" of 0.4% growth was also established before any bonus was paid. These funds were used to support those authorities with adult social care responsibilities.

The government has set out its intention to end New Homes Bonus from the Fair Funding Review in 2020. The intention is to replace this mechanism with a different means of incentivising and rewarding housing growth. The detail of this is unclear and poses a risk to the future funding of the Council. At present, Folkestone and Hythe utilises a proportion of its existing New Homes Bonus to support services with the remaining amounts being set aside within a reserve to fund the additional cost of services over future years. This reserve will deplete by 2022/23 if the current arrangements come to an end with no compensating alternative.

Business Rates (Non Domestic Rates)

From 2013, the government introduced a scheme through which local authorities would be able to retain a proportion of any business rates growth above a set baseline. The purpose was to give local authorities a financial incentive to encourage and foster economic growth within their area and to work collaboratively with other authorities and business organisations to achieve that growth. Whilst this scheme has been broadly welcomed by local authorities, there are concerns over the potential volatility of this income stream with the level of appeals and that even a small variation in the overall revenue generated can carry a significant financial impact. The government is currently undertaking a review of how business rates operate and has stated its intentions to achieve 75% localisation of business rates from 2020.

With regard to the MTFS, the Council has welcomed the emphasis on economic growth but has been cautious about building this into the base budget. Part of this is due to the impact of appeals and the volatility of the income which makes it more complex to forecast. Where possible, any surpluses have been placed within a reserve until there is a degree of certainty before they can be used which may well not be until the following financial year. This is prudent management to manage the natural fluctuations of the business cycle.

The Council is also part of the successful Kent and Medway Business Rates Pilot which is able to retain 100% of business rates for 2018/19 only. This is a 1 year pilot although further bids are welcome for 2019/20. This is of significant financial benefit to the Council but the Council has set this benefit aside in reserves for future use pending future clarification as to future arrangements.

The role of business rates in the funding of the Council will be affected by the Fair Funding Review which will be introduced from April 2020. The full impact of this will only become clear during 2019/20 as proposals are developed. This adds a further element of uncertainty to the projected position and suggests caution is needed in any future projections.

Future Strategies

The current forecast means that there will need to be significant work undertaken to address the forecast deficit. Set out below are some of the key areas to be developed through the 2019/20 budget strategy and beyond to address those financial challenges.

Transformation: The Council has undertaken a major review of its operations and is working with IESE as its transformation partner to radically change how the Council operates and its relationship with its customers. This is based on a complete review of its operation and involves a significant investment in technology. The programme was approved at Council on the 28th February 2018 and is expected to be implemented within a 2 year programme. It is anticipated that this will produce ongoing savings for the Council.

Strategic Investments: The Council is looking to take advantage of its position with a number of developments to produce financial returns whilst at the same time supporting the delivery of housing and regenerating parts of the district. The largest development is that of the proposed new town at Otterpool Park and options are being explored to generate future revenue and capital streams. Other areas include the developments at Varne, the Bigginswood site and further expansion of Oportunitas, the Council's Housing and Regeneration company. The proposed development at Princes Parade will, if approved, also generate a revenue benefit due to the replacement of the current ageing leisure facility.

Commercial Opportunities: The Council will seek to take advantage of commercial opportunities wherever possible to cover costs and to review our fees and charges in order to maximise benefit in line with corporate objectives.

A **financial review** of previous years' out turn and our base budget to ensure maximum value is obtained from those resources already allocated – effectively to ensure financial discipline and good housekeeping are maintained. This is a fundamental annual review of our current operations in order to maximise the use of our current resources.

Using **reserves** in a sustainable and prudent manner to support the council's strategies and priorities. These are informed by the reserves strategies at Appendix 2 and it is recognised that these can only be used on a "one off" basis. However, they can play an important part in supporting initiatives or investments which can produce benefits in the future.

Using opportunities as they arise including government initiatives or incentives. In particular, the Council will seek to participate in the **Business Rates Pilot** scheme to maximise the financial benefit from this area. It also will seek to utilise **Flexible Capital Receipts** where possible to fund the transformation programme and to take pressure off the revenue account. All these are managed on an ongoing basis.

To maintain the council's financial standing it is important that it continues its proactive approach to financial planning and ensures that the savings plans are deliverable and that any investments are focussed on the financial health of the authority.

Housing Revenue Account

The council has a separate account, the Housing Revenue Account (HRA) which supports local authority housing throughout the district. The HRA is now required to produce a 30 year business plan which demonstrates the affordability and sustainability of the management and investment in the council's housing stock. This full plan was reviewed and agreed by the council's Cabinet at its meeting of 23 March 2016 and can be found at the following link.

http://www.shepway.gov.uk/moderngov/documents/s18931/rcabt20160323%20appendix%20to%20HRA%20Business%20Plan.pdf

The main strategic objectives of the HRA business plan are:

- To provide high quality affordable homes that meet fully the Folkestone and Hythe housing standard.
- To provide an efficient and effective housing management service, and invest in service improvements.
- To maximise the recovery of rental income.
- To build new council homes.

The refreshed HRA business plan agreed the following principles:

- The repayment of the council's HRA debt by year 25 of the business plan (by around 2040-41)
- The implementation of a fully funded Folkestone and Hythe Housing Standard Programme throughout the 30 year life of the Business Plan.
- The provision of resources for a new build and housing acquisition programme. Due to the recent policy changes announced by the Government, it has been necessary to reduce our delivery target of up to 300 homes over the next 10 years, to up to 200 homes over the next 10 years.
- A minimum balance of £2million to be retained within the HRA at all times.
- Minimum borrowing headroom of £2million to be retained at all times.
- The plan should provide sufficient resources to fund environmental improvements to the communal parts on the council's estate areas.

Medium Term Capital Programme

The Medium Term Capital Programme sets out how capital resources are used to achieve the council's vision and corporate priorities. Funding for capital projects is limited and where possible external funding is used to supplement the programme. The council has an affordable Capital Programme and this is assessed against business cases taking into account future resources to support projects. A strategy has been adopted which will look to utilise capital receipts to support investments for the council. Demand for financing potential new projects continues to outweigh the funding available and developments such as Princes Parade and Otterpool Park will need to be prioritised as part of the programme.

The main strategic objectives of the Capital Programme, which provide the underlying principles for financial planning, can be summarised as follows:

- To maintain a five year rolling Capital Programme which remains within the approved affordable, sustainable and prudential limits.
- To ensure capital resources are aligned with the council's strategic vision and corporate priorities by ensuring all schemes are prioritised according to the council's prioritisation methodology.

- Prudential Borrowing to be undertaken to support the councils priorities where there is a business case for it to do so and there are sufficient monies to meet in full the implications of capital expenditure, both borrowing and running costs.
- To maximise available resources by actively seeking external funding to support council priorities and disposing of surplus assets.
- To use internal resources alongside external resources where appropriate to support the capital programme and minimise any borrowing costs.

The council forecasts its capital programme over a 5 year period and the latest position is set out in the report to council on the 22nd February 2017. This can be found at:

http://intranet.shepway.gov.uk/moderngov/documents/s26411/Council%20Version%20MTCPv1.pdf

Risks and Sensitivities

In considering the future projections, it is recognised that there are unknowns which could impact upon the existing forecasts. The MTFS should be seen not as a static document but rather one that is constantly evolving as the environment around it changes. Some of the key risks and sensitivities which need to be monitored are mentioned below.

- Economic conditions. The impact of the economic cycle will need to be considered particularly in relation to business growth, inflationary pressures and interest rate movements. The impact of changes and any impact on public finances will need to be fully evaluated on the financial model.
- Impact of “Brexit”. Whilst the government has underwritten EU funding agreed prior to the 2016 Autumn Statement, the impact of the UK’s departure from the EU is one that is unclear and may impact both politically and economically.
- Government Finance Legislation. There are key pieces of government legislation which will impact upon the future financial position of the council. In particular the impact of the localisation of business rates and any additional responsibilities will need to be fully evaluated as well as the government’s current Fair Funding Review of local government finance which is due to be introduced in 2020.
- Other Government Legislation. There are a significant number of political initiatives particularly in relation to localisation and the role of local government. These will need to be assessed for their relevance to Folkestone and Hythe and the impact on future finances.
- Buoyancy of income streams. These will be sensitive to changes in consumer confidence and the economy so will need to be closely monitored.

Conclusion

The MTFS represents the collation of the key financial documents which looks to forecast the likely financial position the council will be facing over the next 4 years. It is the critical financial planning tool for the council and will provide the overall steer for the ongoing discussions throughout the annual budget cycles in dealing with the current economic climate.

Appendix 1 - Summary of MTFS forecast to 2022/23

	Base Year 2018/19 £	2019/20 £	2020/21 £	2021/22 £	2022/23 £
Heads of Service					
Corporate Director Strategic Development	253,830	253,830	253,830	253,830	253,830
CMT and Leadership Support	912,620	912,620	912,620	912,620	912,620
Head of HR	2,459,240	2,459,240	2,459,240	2,459,240	2,459,240
Communications	253,770	253,770	253,770	253,770	253,770
Democratic Services and Law	4,882,470	5,022,470	5,232,470	6,382,470	6,382,470
Head of Finance	3,311,828	3,311,828	3,311,828	3,311,828	3,311,828
Head of Communities	2,181,620	2,181,620	2,181,620	2,181,620	2,181,620
Head of Planning	765,740	765,740	765,740	765,740	765,740
Head of Commercial and Technical	2,421,570	2,421,570	2,421,570	2,421,570	2,421,570
Head of Strategic Development	1,321,470	302,620	302,620	302,620	302,620
Head of Economic Development	298,540	298,540	298,540	298,540	298,540
Changes not attributed to services	0	147,477	298,641	453,584	612,401
Recharges to non GF accounts	-1,980,500	-1,980,500	-1,980,500	-1,980,500	-1,980,500
Unallocated net employee costs	-6,000	552,249	1,252,879	1,695,974	2,142,623
Head of Service net expenditure	17,076,198	16,903,074	17,964,868	19,712,906	20,318,371
Internal drainage board levies	452,770	461,825	471,062	480,483	490,093
Interest payable and similar charges	452,210	431,000	431,000	431,000	431,000
Interest and investment income	-678,430	-586,000	-514,000	-514,000	-514,000
New Homes Bonus grant	-1,361,666	-1,349,468	-702,403	-336,895	0
Other non-service related grants	-1,240,021	-1,240,021	-1,240,021	-1,240,021	-1,240,021
	14,701,061	14,620,410	16,410,506	18,533,473	19,485,443
Net transfers to/from reserves	-906,650	-146,145	-492,897	-838,975	0
Minimum revenue provision adjust.	373,370	373,370	373,370	373,370	373,370
Financing of fixed assets	197,000	138,000	138,000	138,000	138,000
	14,364,781	14,985,635	16,428,979	18,205,868	19,996,813
Transfer to/from Collection Fund	-100,000	0	0	0	0
Net business rates income	-4,244,104	-4,015,399	-4,095,707	-4,177,621	-4,261,173
Revenue support grant	0	0	0	0	0
	10,020,677	10,970,236	12,333,272	14,028,247	15,735,640
Council Tax Requirement	-9,899,677	-10,248,947	-10,610,735	-10,985,293	-11,373,074
Use of general reserve for financing of fixed assets	-121,000				
Surplus/deficit to General Reserve	0	721,289	1,722,537	3,042,954	4,362,565

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Appendix 2 – Reserves Policy

INTRODUCTION

The establishment, monitoring and review of the levels of reserves and balances are an important element of the council's financial management systems and financial standing.

The Chief Finance Officer (S151 Officer) is required by law to formally report to the Council his/her opinion on the adequacy of the council's reserves. Irrespective of this, a well-managed authority is clear about the reserves it needs now and in the future to support its service aspirations, whilst at the same time delivering value for money within a climate of significant resource pressure and economic/social risk.

This policy does not cover non-distributable reserves required to support financial accounting transactions e.g. the Revaluation Reserve, Capital Adjustment Account and Pension Reserve. (Non-distributable reserves are those that cannot be used for revenue or capital purposes.)

Reserves can be held for four reasons:

- A working balance to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing.
- A contingency to cushion the impact of unexpected events or emergencies.
- A means of building up funds to meet known or predicted liabilities.
- A means of setting aside sums for future identified uses and / or investments

Such reserves are generally referred to as earmarked reserves.

WHAT ARE RESERVES?

There is no clear definition of reserves even though reference is made to reserves in legislation. The Chartered Institute of Public Finance and Accountancy (CIPFA) states "amounts set aside for purposes falling outside the definition of provisions should be considered as reserves." Provisions are required for any liabilities of uncertain timing or amount that have been incurred.

Generally there are two types of reserves, those that are available to meet revenue or in some cases capital expenditure (Usable) and those that are not available to finance revenue or capital expenditure (Unusable). Useable reserves result from events that have allowed monies to be set aside, surpluses or decisions causing anticipated expenditure to have been postponed or cancelled. They can be spent or earmarked at the discretion of the council.

The council must manage its reserves in accordance with its strategic longer term planning process.

LEVEL OF RESERVES

As mentioned above the council's reserves can be regarded as general and earmarked reserves. In addition, the council maintains a Usable Capital Receipt reserve.

Projected Levels

The projected level of reserves over the next five years is summarised at the table below.

Projected level of reserves over next 5 years

	Balance at 31/3/2017	Balance at 31/3/2018	Balance at 31/3/2019	Balance at 31/3/2020	Balance at 31/3/2021	Balance at 31/3/2022
	£000	£000	£000	£000	£000	£000
Total Earmarked Reserves	**12,468**	**13,038**	**12,131**	**11,985**	**11,492**	**10,653**
General Fund Reserve	**4,902**	**5,861**	**5,740**	**5,019**	**3,296**	**253**
Housing Revenue Account reserve	**7,380**	**8,047**	**4,409**	**2,130**	**2,071**	**2,114**
Usable Capital Receipts Reserve	**6,773**	**7,339**	**5,619**	**7,628**	**7,878**	**8,128**

As part of its MTFS, the council also adopts some fundamental principles as to how reserves are used:

- The reserves must only be used to fund one off expenditure.
- Any recurring item may only be funded from reserves if plans are in place to replenish the reserve within 12 months.
- Any unplanned revenue income receipt should be put in reserves pending any future decisions as to its use.
- Reserves should be maintained at a sustainable level to ensure an adequate working balance is maintained.

- Reserves may be used as part of a planned process to balance the budget in order to avoid short term responses which may not be in the best interests of the council.

  The council has prudently built up its reserves in recent years to be able to provide for its priorities when required. The level of reserves has, in recent years, reduced in line with planned activities such as investments in Oportunitas and Otterpool and their use for other investment or in lieu of borrowing. This strategy means that reserves are currently at an adequate rather than excessive level however it is recognised this use is of a one off nature to secure future income streams for the council.

  The use of reserves is a critical part of the council's budget strategy and the level of reserves is kept under ongoing review. Any future calls on the reserves are considered by looking at the whole position and ensuring minimum reserve levels are adhered to. It is vital that the future needs of the authority such as through the VET reserve are continually refreshed and updated and that earmarked reserves are applied appropriately.

ASSESSING THE ADEQUACY OF RESERVES

The Chartered Institute of Public Finance and Accountancy (CIPFA) state that the Institute 'does not accept a case for introducing a statutory minimum level of reserves, even in exceptional circumstances'. It does however confirm that authorities should make their own judgment on such matters, taking into account all relevant local circumstances on the advice of their Chief Finance Officer.

The Local Government Act 2003 requires the Chief Finance Officer to formally report on the adequacy of the proposed financial reserves.

To arrive at assessing the adequacy of reserves a number of issues need to be addressed:

- What are the strategic, operational and financial risks facing the authority?
- Does the authority comply with the requirements to ensure that there is an adequate system of internal control?
- Are the key financial assumptions in formulating the council's budget robust and reasonable?
- Does the council have adequate financial management and cash flow arrangements?

In addition there are a number of questions an authority can ask to demonstrate that it is managing its affairs satisfactorily, such as:

- What is the track record of the council in its budgetary and financial management?
- What is the council's record regarding Council Tax collection?
- What is the council's capacity to manage in-year budgetary pressures?

- What is the strength of the council's financial reporting?
- What are the procedures to deal with under and over spends during and at the year end?
- In the case of earmarked reserves, will there be expected calls on the reserves that prompted the setting up of the reserves in the first place?

Finally, there is a need to look at the assumptions made in setting the budget, not just for the coming year but also under the MTFS.

The budgetary assumptions cover:

- Inflation and interest rate projections.
- Estimate and timings of capital receipts.
- Treatment of planned efficiency savings.
- Financial risks involved in major funding arrangements.

The assessment of the adequacy of the reserves and the robustness of the estimates are contained within the Chief Finance Officers report to council as part of the budget setting process based upon Section 25 of the Local Government Act of 2003.

Allocation of Reserves

There are to be no withdrawals from reserves, unless of a one-off nature, or if they are part of a planned usage which will lead to the elimination of any deficit and the setting of a balanced budget. It is not normal practice to withdraw from the General Fund Reserve to balance the annual budget, unless plans are in place to provide for an ongoing balanced budget.

Budget Assumptions

These are set out in detail within the Budget Strategy and a sensitivity analysis has been undertaken regarding the financial forecasts for the next five years. The council is responsible for a number of demand led budgets which are difficult to control.

The council has identified its strategic financial risks and has carried out an assessment of that risk. Based on this analysis, the following levels are considered appropriate:

Required Levels of Reserves

	Minimum Level £m
General Fund	2.5
Housing Revenue Account	2.0
Capital Receipts	0.5

The minimum level of the General Reserve balance has been arrived at after assessing the strategic financial risks faced by the council.

The table above shows that a minimum General Reserve balance of £2.5 million should be maintained until the 2022/23 financial year. This level will be monitored and should be addressed as savings proposals are developed and implemented over the term of this plan. The HRA minimum balance has been set at £2.0 million as part of the preparation of the HRA business plan.

OPPORTUNITY COST OF HOLDING RESERVES

Having set minimum levels, the opportunity cost of holding reserves needs to be considered. All balances are used to either reduce temporary borrowing or are invested subject to other cash flows. Therefore in measuring any opportunity cost of holding these reserves, consideration needs to be taken of the interest saving. The opportunity cost of holding the reserves is therefore a judgment whether the ‘worth’ of expenditure foregone is more than the income generated. Given the current economic climate it is a balanced judgement as to whether to invest / spend reserves or to hold these. As part of the MTFS and budget setting, an assessment of the adequacy of reserves and the associated risks will be made annually.

REPORTING FRAMEWORK

The level of reserves is continually monitored and a full review is undertaken each year.

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This Report will be made public on 9 October 2018

Report Number: **C/18/34**

To:	**Cabinet**
Date:	**17 October 2018**
Status:	**Non-Key Decision**
Head of service:	**Charlotte Spendley, Head of Finance**
Cabinet Member:	**Councillor Malcom Dearden, Finance**

SUBJECT: **TREASURY MANAGEMENT MONITORING REPORT 2018/19**

SUMMARY: This report provides an update on the council's treasury management activities that have taken place during 2018/19 against the agreed strategy for the year. The report also provides an update on the treasury management indicators approved by Council earlier this year.

REASONS FOR RECOMMENDATIONS:
Cabinet is asked to agree the recommendations set out below because:

a) Both the CIPFA Code of Practice on Treasury Management and the Council's Financial Procedure Rules require Members to receive a report on the Council's treasury management activities during the year.

RECOMMENDATIONS:
1. **To receive and note report C/18/34.**

1. BACKGROUND

1.1 Full Council approved the Treasury Management Strategy Statement for 2018-19, including treasury management indicators, on 28 February 2018 (report A/17/22 refers).

1.2 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised in December 2017) requires the council, as a minimum, to produce a mid-year report reviewing its treasury management activity undertaken so far against the approved strategy for the year and to consider any significant issues which may impact upon the function for the remainder of the year. This includes reviewing the approved treasury management indicators. The Code also now requires the council to report on its non-treasury investments. This report meets CIPFA's reporting requirement.

1.3 The authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. This report covers treasury activity and the associated monitoring and control of risk.

2. ECONOMIC UPDATE AND INTEREST RATE OUTLOOK

2.1 A summary of the key factors affecting the UK economy for 2018-19 is shown below and is based on information supplied by Arlingclose Limited, the council's Treasury Adviser:-

i) The UK's economic outlook remains uncertain as the government continues to negotiate the country's exit from the European Union.
ii) UK Inflation (CPI) fell to 2.4% in June, a 12 month low, mainly due to the falling out of sterling's depreciation which began in 2016. However, inflation ticked up to 2.5% in July, partly due to higher energy costs feeding through from a 15% increase in oil prices since the start of the year.
iii) The Monetary Policy Committee's (MPC) expects inflation to fall slightly over the remainder of 2018, as sterling's previous depreciation continues to fall out, but to remain above its 2% target for the year.
iv) The unemployment rate has fallen to 4%, its lowest level since 1975.
v) Pay growth rose to 2.9%, but real wages (adjusted for inflation) grew by only 0.4%.
vi) UK Gross Domestic Product (GDP) improved to 0.4% in Q2 of 2018 but is still only expected to be around 1.6% for the year, despite seemingly improving labour market data.
vii) Rising fears of a global trade war following the US decision to impose trade tariffs has seen global equity markets fall, most notably in China.
viii) However, the US Federal Reserve (Fed) remains positive about the US economy and has already raised official interest rates in 2018 in small steps to bring them between 2% and 2.25%. The Fed is also expected to raise rates further later this year and in to 2019.

ix) In August 2018 the MPC increased the UK's Bank Base Rate from 0.5% to 0.75% broadly due to inflationary concerns.

2.2 Financial Markets

2.2.1 Gilt yields, which the Public Works Loan Board borrowing rates are linked to, displayed marked volatility so far during 2018. In particular, following Italy's political crisis in late May when government bond yields saw sharp moves similar to those at the height of the European financial crisis with, notably, falls in yield in safe-haven UK, German and US government bonds. Over the period, despite the volatility, the yield on the 5-year benchmark gilt only rose slightly from 1.13% to 1.14%, the 10-year from 1.37% to 1.39% and the 20-year gilt from 1.74% to 1.85%.

2.2.2 Money markets rates remained low: 1-month, 3-month and 12-month LIBID rates averaged 0.45%, 0.60% and 0.87% respectively over the period.

2.3 Interest Rate Outlook

2.3.1 Given the continuing uncertainty over the Brexit negotiations and also the UK's relatively weak economic environment, Arlingclose's central case is for the UK Bank Base Rate to remain unchanged until the Spring of 2019 when it is forecast to rise by 0.25% to 1% with a further rise to 1.25% much later in the year. There is a general expectation that if there were to be further rises to the Bank Rate these will be in shallow steps and over time.

2.3.2 Arlingclose's central case for gilt yields is for them to remain broadly stable for the remainder of 2018/19 with limited rises during 2019/20. However, geo-political events are likely to mean gilt yields will continue to experience periods of volatility.

2.3.3 With the authority's borrowing portfolio currently being virtually all of fixed rate debt, it is its investment portfolio that is much more exposed to changes in interest rates.

3. LOCAL CONTEXT

3.1 On 31 March 2018, the authority had net borrowing of £20.5m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in table 1 below.

Table 1: Balance Sheet Summary

	31.3.18 Actual £m
General Fund CFR	18.1
HRA CFR	47.4
Total CFR	**65.5**
Less: Usable reserves	(41.0)
Less: Working capital	(4.0)
Net borrowing	**20.5**

3.2 The authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, in order to reduce risk and keep interest costs low. The treasury management position as at 31 August 2018 and the change since the 31 March 2018 is show in table 2 below.

Table 2: Treasury Management Summary

	31.3.18 Balance £m	Net Movement £m	31.8.18 Balance £m	31.8.18 Rate %
Long-term borrowing	55.9	-	55.9	3.41
Short-term borrowing	1.9	(1.0)	0.9	1.06
Total borrowing	**57.8**	**(1.0)**	**56.8**	**3.38**
Long-term investments	(13.9)	4.9	(9.0)	3.14
Short-term investments	(19.8)	1.8	(18.0)	0.61
Cash and cash equivalents	(3.6)	(12.5)	(16.1)	0.67
Total investments	**(37.3)**	**(5.8)**	**(43.1)**	**1.16**
Net borrowing	**20.5**	**(6.8)**	**13.7**	

3.3 The overall reduction of £5.8m in net borrowing is not unexpected and broadly represents the in-year benefit of cash flows from local taxation. The cash and cash equivalent investments, investments where the council can normally access its cash immediately or within a short notice period, have increased by £12.5m to £16.1m. This is higher than is typically required to meet the council's normal liquidity requirements. However, a series of planned new long-term investments totalling £10m, covered in more detail in section 5 of this report, will reduce the level of cash and cash equivalents held.

4. **BORROWING STRATEGY AND ACTIVITY 2018/19**

4.1 At 31 August 2018, the Authority held £56.8m of loans, a net reduction of £1.0m compared to 31 March 2018, as part of its strategy for funding previous years' capital programmes. Following the introduction of the Housing Revenue Account (HRA) Self-Financing regime in 2012 the authority operates a two pool debt approach allocating its loans between the General Fund and HRA. The borrowing position at 31 August 2018 compared to 31 March 2018 is shown in table 3 below.

Table 3: Borrowing Position – Two Pool Debt Approach

	31.3.18 Balance £m	Net Movement £m	31.8.18 Balance £m	31.8.18 Rate %
General Fund				
Public Works Loan Board	7.7	(0.5)	7.2	4.69%
Local authorities (short-term)	0.5	-	0.5	0.50%
Total General Fund borrowing	8.2	(0.5)	7.7	4.42%
Housing Revenue Account				
Public Works Loan Board	49.6	(0.5)	49.1	3.21%
Total HRA borrowing	49.6	(0.5)	49.1	3.21%
Total borrowing	**57.8**	**(1.0)**	**56.8**	**3.38%**
CFR	**65.5**	**-**	**65.5**	
Under-borrowed	**(7.7)**	**(1.0)**	**(8.7)**	

4.2 The weighted average maturity of the overall loans portfolio at 31 August 2018 was 13.7 years.

4.3 The authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the authority's long-term plans change being a secondary objective.

4.4 In furtherance of these objectives no new long term borrowing has so far been undertaken in 2018/19, while existing loans of £1.5m have been allowed to mature without replacement. The authority's CFR at 31 August 2018 exceeded its gross borrowing position by £8.7m, i.e. it used internal borrowing from its cash surpluses to meet this difference. This strategy has enabled the authority to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

4.5 Based on the council's approved capital expenditure plans, the CFR is forecast to increase by about a further £7m during 2018/19. This increase was already anticipated to be met from further internal borrowing from available cash surpluses. However, it now seems likely the expenditure for some of the capital investment schemes planned to me met from prudential borrowing in 2018/19 will now be incurred in 2019/20. This will be covered in more detail in a future report to Cabinet as part of the regular budget monitoring process.

4.6 The “cost of carry” analysis performed by Arlingclose has not indicated any value in borrowing in advance for future years’ planned expenditure and therefore none has been taken or, at this stage, is planned to be for the remainder of the current financial year.

4.7 A series of short term loans totalling £0.5m have been borrowed from Folkestone Town Council since 1st April 2018 for cash flow purposes at a variable interest rate set at 0.25% below the official Bank Base Rate.

4.8 **Debt Rescheduling** – Opportunities to undertake debt rescheduling have been monitored during the year in conjunction with Arlingclose. However, as expected, PWLB interest rates have not reached a level where it would be beneficial to undertake debt rescheduling to create a net saving in borrowing costs. The position is not expected to change for the remainder of the current financial year.

5. INVESTMENTS

5.1 The council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the period to 31 August 2018, the authority’s investment balance has ranged between £36m and £49.8m due to timing differences between income and expenditure. The average investment balance held to 31 August 2018 was £43m. The investment position during the period to 31 August 2018 is shown in table 4 below. A list of the individual investments held at 31 August 2018 is shown in appendix 1 to this report.

Table 4: Investment Position

	31.3.18 Balance £m	**Net Movement £m**	**31.8.18 Balance £m**	**Average Return**
Banks & building societies (unsecured)	-	3.0	3.0	0.69%
Covered bonds (secured)	7.3	(3.8)	3.5	1.01%
Government (incl. local authorities)	21.0	(3.0)	18.0	0.61%
Money Market Funds	3.6	9.5	13.1	0.66%
Other Pooled Funds	5.4	0.1	5.5	4.50%
Total investments	**37.3**	**5.8**	**43.1**	**1.16%**

5.2 The weighted average maturity of the investment portfolio at 31 August 2018 was 108 days.

5.3 Both the CIPFA Code and government guidance require the authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

5.4 **Multi-Asset Income Funds**

5.4.1 The authority's medium term cash flow forecast indicates it is expected to hold a minimum level of reserves and working capital of at least £15m over the next 4 to 5 years. Given the relatively low overall returns on cash investments, the authority has been exploring options that will help to mitigate the risk of capital erosion from below inflation investment yields while maintaining good quality security and liquidity for its cash. The authority already has a £5m long term investment in a property fund providing above inflation returns. Following discussions with Arlingclose, multi-asset income funds (also known as diversified income funds) were chosen as the most appropriate investment instrument for the remaining £10m of the authority's available long term cash.

5.4.2 Multi-asset income funds are pooled investment vehicles operated by professional fund managers who invest in a diversified range of good credit quality instruments including:-

- bonds (government and corporate)
- equities (uk and foreign)
- cash
- property
- alternatives, including leasing arrangements

5.4.3 The typical characteristics of these funds are:-

- Longer term investments with a duration of between 3 to 5 years
- Aim to provide an income yield about 3% above the bank base rate
- Able to provide a capital return over time but are subject to some price volatility in the short to medium term.
- Liquid, with funds being accessible within a few days' notice if required
- Require a minimum £1m investment

5.4.4 **Fund Selection Process** – Arlingclose review the relative performance of this class of fund and provide a recommended list of counterparties to invest with. Officers, supported by Arlingclose, met with individual fund managers to explore their products in more detail. Following this process, and in consultation with the Cabinet Member for Finance, it was agreed to invest the £10m across the following four funds:

Fund		Fund Size £m	Investment £m
i)	UBS Multi-Asset Income Fund	41	1.0
ii)	CCLA Diversified Income Fund	103	2.0
iii)	Kames Diversified Monthly Income Fund	467	3.5
iv)	Investec Diversified Income Fund	491	3.5
			10.0

5.4.5 The authority's investment in these funds is expected to be made by early October 2018. Based on the past performance of these funds, the authority is anticipating an additional return from these investments of about £250,000 in a full year. £200,000 of this extra income is already anticipated in the authority's Medium Term Financial Strategy.

5.5 Investment Benchmarking

5.5.1 The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in table 5 below.

Table 5: Investment Benchmarking

	Credit Score	Credit Rating	Bail-in Exposure	WAM* (days)	Income Return
FHDC					
31.03.2018	3.3	AA-	12%	189	0.86%
30.06.2018	4.7	A+	59%	146	1.19%
Similar LAs	4.4	AA-	61%	98	1.37%
All LAs	4.5	AA-	62%	42	1.13%

5.5.2 The investment benchmarking, which is a snapshot at the end of each quarter, demonstrates the authority's risk profile had risen slightly and was just above both its peer group and the wider local authority population at 30 June 2018 (measured against other Arlingclose clients only). This was also reflected in the average credit rating of the investment counterparties dropping one notch to A+ from AA-. The main reason for this margin increase in risk is the authority had an unsecured short term investment of £3m with a bank during this period.

5.6 Given the increasing risk and continued low returns from short-term unsecured bank investments and in line with advice from Arlingclose, it is the council's aim to continue to diversify into more secure and/or higher yielding asset classes during the remainder of this financial year and beyond.

5.7 The authority's best performing investment in 2018/19 remains its £5.5m externally managed pooled property fund. The CCLA Local Authorities' Property Fund generated a total net income return of about £60k or 4.5% for the quarter to 30 June 2018 and the capital value of the Authority's investment increased during the same period by about 0.5% or £30k. Encouragingly, the authority's investment in the fund has grown by approximately 9% or £460k compared to its original investment of £5m while providing an annual income return of between 4.5% and 5%. Because this fund has no defined maturity date, but is available for withdrawal after a notice period, its performance and continued suitability in meeting the authority's investment objectives is regularly reviewed. In light of the fund's continued strong income return and the authority's latest cash flow forecasts, investment in this fund has been maintained for the year.

6. CREDIT RISK AND COUNTERPARTY UPDATE

6.1 Credit Risk

6.1.1 The structure of the authority's approved credit risk methodology for new investments is in line with that suggested by Arlingclose. Based on this approved methodology, Arlingclose provides the authority with a regular up to date list of eligible counterparties to use and also notifies it immediately of any changes required to this.

6.2 Counterparty Update

6.2.1 Broadly UK bank credit default swap prices (the banking sector's insurance against default) rose marginally over the early summer before falling back to their levels at the start of the financial year.

6.2.2 There have been few credit rating changes during the period and none directly affecting the authority's counterparty list adversely.

7. FINANCIAL SUMMARY

7.1 The projected outturn for the net cost of treasury management to the General Fund in 2018/19 is summarised in table 6 below:

Table 6: Financial Summary

	2018/19 Original Estimate	2018/19 Projection	Variance
	£'000	£'000	£'000
Interest on all Borrowing	2,049	2,049	-
Related HRA Charge	(1,597)	(1,597)	-
General Fund Borrowing Cost	**452**	**452**	**-**
Investment Income	(534)	(572)	(38)
HRA Element	75	75	-
Net General Fund Investment Income	**(459)**	**(497)**	**(38)**
Net General Fund Borrowing Cost	**(7)**	**(45)**	**(38)**

7.2 The projected reduction in the net borrowing cost to the General Fund is mainly due to additional investment income expected to be received from a rise in interest rates benefitting the investment portfolio.

7.3 Opportunities to reduce the net cost of treasury management will continue to be sought as part of the pro-active management to the council's debt and investment portfolios by its officers in consultation with the Cabinet Member for Finance.

8. Non-Treasury Investments

8.1 Although not classed as treasury management activities, the 2017 CIPFA Code and the MHCLG Investment Guidance requires the authority to report on investments for policy reasons outside of normal treasury management. This includes service investments for operational and/or regeneration as well as commercial investments which are made mainly for financial reasons. This includes the authority's investment in its wholly owned subsidiary company, Oportunitas Limited. These are summarised in table 7 below:

Table 7: Non-Treasury Investments

Investment Type	Value 31/08/18 £'000	Projected Income 2018/19 £'000	Rate of Return %
Investment Property	**8,000**	**182**	**2.27**
Oportunitas loan & equity	**3,919**	**161**	**4.27**
	11,919	**359**	**2.84**

8.2 The Lloyds Bank Local Authority Mortgage Scheme jointly funded by the authority and Kent County Council ended on 1 August 2018. The Bank repaid the authority's net investment of £0.5m.

8.3 The rate of return on these non-treasury investments is higher than that earned on treasury investments reflecting the additional risks to the authority of holding such investments.

9. COMPLIANCE REPORT

9.1 The Corporate Director for Customer, Support and Specialist Services is pleased to report that all treasury management activities undertaken to 31 August 2018 complied fully with the CIPFA Code of Practice and the authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 8 below.

Table 8: Investment Limits

	Maximum to 31.8.18	**31.8.18 Actual**	**2018/19 Limit**	**Complied**
Any single organisation, except UK Government	£5m	£5m	£5m each	✓
UK Central Government	nil	nil	Unlimited	✓
Any group of funds under the same management	nil	nil	£5m per group	✓
Negotiable instruments held in a broker's nominee account	£7.2m	£3.5m	£10m per broker	✓
Foreign countries	nil	nil	£5m per country	✓
Registered Providers	nil	nil	£10m in total	✓
Unsecured investments with Building Societies	nil	nil	£5m in total	✓
Loans to unrated corporates	nil	nil	£5m in total	✓
Money Market Funds	£24.7m	£13.1m	£25m in total	✓
Any group of pooled funds under the same management	£5.5m	£5.5m	£10m per manager	✓

9.2 Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 9 below.

Table 9: Debt Limits

	Maximum to 31.8.18	31.8.18 Actual	2018/19 Operational Boundary	2018/19 Authorised Limit	Complied
Borrowing	58.3	56.8	87.0	90.0	✓
PFI & finance leases	-	-	-	-	✓
Total debt	**58.3**	**56.8**	**87.0**	**90.0**	✓

9.3 Since the operational boundary is a management tool for in-year monitoring it is not significant if the operational boundary is breached on occasions due to variations in cash flow, and this is not counted as a compliance failure.

10. TREASURY MANAGEMENT INDICATORS

10.1 The authority measures and manages its exposures to treasury management risks using the following indicators.

10.2 **Security:** The authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating *or* of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	31.8.18 Actual	2018/19 Target	Complied
Portfolio average credit rating	A+	A	✓

10.3 **Liquidity:** The authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

	31.8.18 Actual	2018/19 Target	Complied
Total cash available within 3 months	£29.1m	£5m	✓

10.4 **Interest Rate Exposures**: This indicator is set to control the authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the amount of net principal borrowed was:

	31.8.18 Actual	2018/19 Limit	Complied
Upper limit on fixed interest rate exposure	£58m	£66m	✓
Upper limit on variable interest rate exposure	£0m	£0m	✓

10.4.1 Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

10.5 **Maturity Structure of Borrowing:** This indicator is set to control the authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing were:

	31.8.18 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	1.6%	30%	0%	✓
12 months and within 24 months	1.9%	40%	0%	✓
24 months and within 5 years	13.4%	50%	0%	✓
5 years and within 10 years	35.2%	80%	0%	✓
10 years and above	47.9%	100%	0%	✓

10.5.1 Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

10.6 **Principal Sums Invested for Periods Longer than 364 days:** The purpose of this indicator is to control the authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

	2018/19	2019/20	2020/21
Actual principal invested beyond year end	£3.5m	£3.5	-
Limit on principal invested beyond year end	£23m	£18m	£13m
Complied	✓	✓	✓

Note – Although the investment with the CCLA LA Property Fund is viewed as a long term, its terms allow the authority to seek principal redemption on a monthly basis. Therefore this investment is not included within the above indicator.

11. CONCLUSIONS

11.1 The UK's economic outlook means interest rates are expected to remain broadly unchanged for the remainder of the current financial year.

11.2 The authority will maintain its strategy keeping borrowing and investments below their underlying levels (internal borrowing) in order to reduce risk and keep interest costs lower.

11.3 The loan and investment portfolios will continue to be closely monitored to ensure they efficiently contribute towards the authority's medium term financial strategy.

11.4 The authority's treasury management activities undertaken to 31 August 2018 complied fully with the approved Treasury Management Strategy.

12. LEGAL/FINANCIAL AND OTHER CONTROLS/POLICY MATTERS

12.1 Legal Officer's Comments (DK)

There are no legal implications arising directly out of this report. Part 1 of the Local Government Act 2003 gives the Council the power to borrow and to invest for any purpose relevant to its functions or for the purposes of the prudent management of its financial affairs. It also requires the Council to act prudently when carrying out these activities, including an obligation to determine and keep under review how much money it can borrow. In addition, the Council is required by the Local Government Finance Act 1992 to produce a balanced budget. The Council must bear in mind its fiduciary duties to local tax payers and its continuing obligation to ensure it has funding to perform the statutory undertakings it has to comply with.

12.2 Finance Officer's Comments (LW)

Prepared by Financial Services, no further comments.

12.3 Diversities and Equalities Implications

The report does not cover a new service or policy or a revision of either and therefore does not require an Equality Impact Assessment.

13. CONTACT OFFICERS AND BACKGROUND DOCUMENTS

Councillors with any questions arising out of this report should contact the following officer prior to the meeting:

Lee Walker, Group Accountant
Telephone: 01303 853593
E-mail: lee.walker@folkestone-hythe.gov.uk

The following background documents have been relied upon in the preparation of this report:
None

Appendices: Appendix 1 – Investments held at 31 August 2018

APPENDIX 1 – INVESTMENTS HELD AT 31 AUGUST 2018

Counterparty	Amount £	Terms	Interest Rate %
Banks and Building Societies (unsecured)			
Goldman Sachs International Bank	3,000,000	95 day Notice account - Notice given maturity 01/10/18	0.69
Covered Bonds (Secured)			
Royal Bank Scotland	1,000,842	Covered Floating Rate Note to 15/05/20	1.06
Royal Bank Scotland	2,505,138	Covered Floating Rate Note to 15/05/20	0.99
Government			
Peterborough City Council	3,000,000	1 Year Fixed Deposit to 29/09/18	0.40
London Borough Croydon	5,000,000	2 Year Fixed Deposit to 31/05/19	0.80
West Dunbartonshire Council	5,000,000	2 Month Fixed Deposit to 03/09/18	0.50
Eastleigh Borough Council	5,000,000	2 Month Fixed Deposit to 29/10/18	0.65
Money Market Funds			
Federated Investors MMF	3,130,000	Money Market Fund instant access.	0.66
BNP Paribas MMF	4,970,000	Money Market Fund instant access.	0.67
Legal & General MMF	5,000,000	Money Market Fund instant access.	0.65
Other Pooled Funds			
CCLA Property Fund	5,467,152	Commercial Property Fund	4.50
Total Investments	**43,073,132**		
* Net of Fees			

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