MEDIUM TERM FINANCIAL STRATEGY

2018/19 TO 2021/22

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Folkestone
Hythe & Romney Marsh
Shepway District Council
www.shepway.gov.uk

MEDIUM TERM FINANCIAL STRATEGY

Introduction

This document sets out the key challenges and approach of the Council in relation to Shepway 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. Whilst the promotion of "austerity" seems to be on the decline, there is no indication of a change at a national level in terms of the funding for local government. The current national political uncertainty and the priority of Brexit 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 have currently been delayed although it is to be expected that this direction of travel will continue, particularly in relation to business rates and additional responsibilities to be funded through this source. The devolution of business rates is intended to be fiscally neutral but the details of how this will work have yet to be determined. This will bring both risks and opportunities for the council.

The MTFS is 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.

Shepway Council - the Current Position

Shepway 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 2017/18 it planned to spend approximately £15.4 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 Shepway:

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.

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 has offered local authorities a minimum grant envelope for the 4 year period of this strategy. In order to secure this, the council must produce an efficiency strategy which was originally set out in the previous MTFS. Although the strategic financial approach is set out within this document, it is more than just an MTFS. It represents the council's ambition to not just to survive financially, but to thrive and develop a sustainable future for the district. The key strands of this are:

- The Corporate Plan 2017 - 20 the key objectives of which are set out above
- The Shepway Economic Development Strategy 2015 - 2020
- The councils 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
- Looking at opportunities for commercial activity to generate income to support the financial position of the council and maintain services
- A fundamental review of the council's operating model in order to ensure it is fit for the future and maximises efficiencies.

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.

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. The current financial forecast anticipates that 2018/19 will be the final year of Revenue Support Grant from the government. **Table 1** below shows the decline in RSG from 2013/14 and indicates the reduction in financial support the council has had to address over the last 5 years.

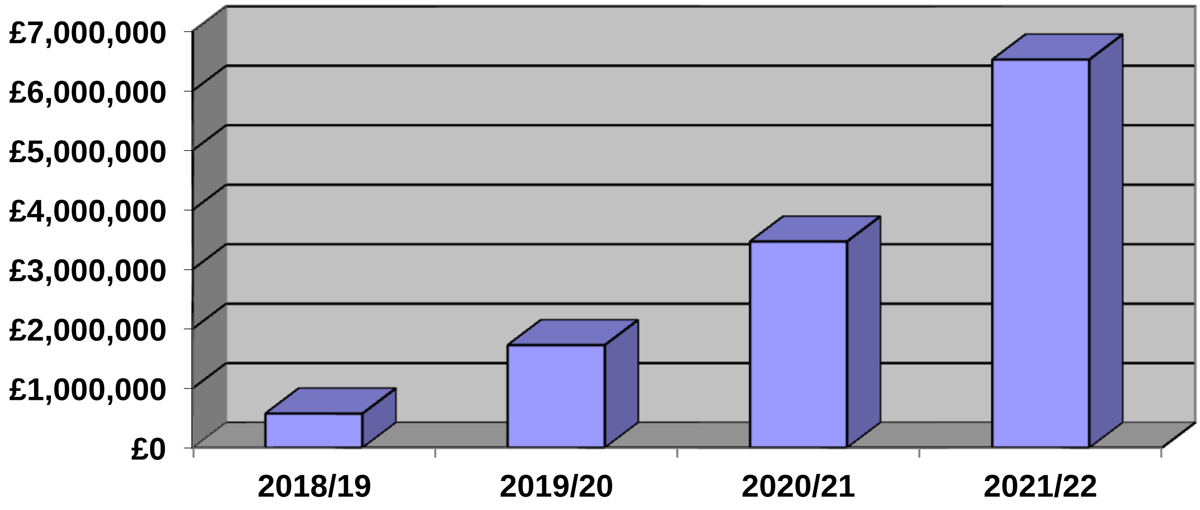
Table 1 – Forecast Level of Revenue Support Grant

Financial Year	Revenue Support Grant
£000	£000
2013/14	4,901
2014/15	3,828
2015/16	2,753
2016/17	1,736
2017/18	848
2018/19	305
2019/20	0

The table shows that the forecast level of grant for 2019/20 is nil and this is expected to be the "new norm" although the government is also currently undertaking a "fair funding review" of local government finance which is expected to be implemented in 2020. In some respects the reduction in funding and the elimination in grant are consistent with the government's desire to see more money raised locally to provide local services. Proposals to localise business rates by 2020/21 will place significant responsibility in local areas with significant risk but also with opportunity. It also requires the Council to take control of its financial future in the knowledge that the uncertainty around the level of central government grant is no longer a factor in planning the authority's finances.

This reduction in grant, when taken together with a range of elements including inflation, legislation and the general economic climate have meant that the financial projections for the council continue to show an ongoing deficit which the financial planning processes of the council will need to address. The level of the deficit projection for the period to 2021/22 is detailed in **Appendix 1** and is shown in **Table 2** below:

Table 2 – Cumulative Deficit over the MTFS period



The above represents the cumulative deficit position based on the current actions and an annual 2% increase in council tax. . It is worth noting that these challenges are being faced across the country by the local authority sector and are not in themselves unique to Shepway. However, the ongoing impact of reduced government funding, price and pay inflation, service pressures, customer demands and changing legislation have resulted, over the medium term, in an extremely challenging financial position.

In particular key pressures such as the impact of the waste contract from January 2021and uncertainty around New Homes Bonus have significantly impacted upon the worsening financial position. This does not include emerging pressures such as the rise in homelessness and bed and breakfast costs to the council.

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 2018/19 budget strategy and beyond to address those financial challenges.

- Take advantage of commercial opportunities wherever possible to cover costs and to review our fees and charges.
- Alternative income streams. Looking to generate future income sources through investments in the district which can generate a return over the longer term for the council including the development of Oportunitas Ltd to increase those income streams. The development of Otterpool Park provides the opportunity to explore options for longer term income generation and once planning permission is achieved a strategy will be put in place to achieve this. Other developments will be considered within the context of achieving an ongoing return for the council to support its future revenue position.
- Continuing to transform the way we work to maximise operational efficiencies. Following on from the “ways of working” project, further investment is to be made on utilising digital delivery to gain significant efficiencies but also to improve the customer experience. The council is currently exploring the development of a new future operating model to modernise technology across

the council and also to change how the council interacts with its customers and residents. Agreement for exploratory work was given at Cabinet in June 2017 with a further report and plan, setting out further actions and an implementation timescale, due in January 2018.

- 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
- Taking advantage of any grants where they align with the council's priorities but also to ensure there are arrangements in place for when those grants cease
- Considering the use of reserves in a sustainable and prudent manner to support the council's strategy.

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.

Council Tax

The Council Tax is one of the key funding streams for the council and accounts for approximately 50% 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 2% by central government.

If a council wishes to increase its Council Tax levy beyond pre-determined levels it will have to produce a 'shadow budget' at the maximum level allowed and implement this if the referendum is lost and also to bear the costs of any referendum. It should be noted that the government has the ability to either increase or decrease the level at which a referendum would be triggered.

The government has previously provided funding for a council tax freeze however there has been no funding for this policy in recent years and it has been assumed that there will not be a freeze over the period of this strategy. Appendix 1 has assumed a council tax increase of 2% per annum for the period of this strategy (a 1% increase has an effect of approximately £85,000 per annum).

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 Shepway gives it a secure financial base however the changing environment means the approach to reserves will change for the following key reasons:

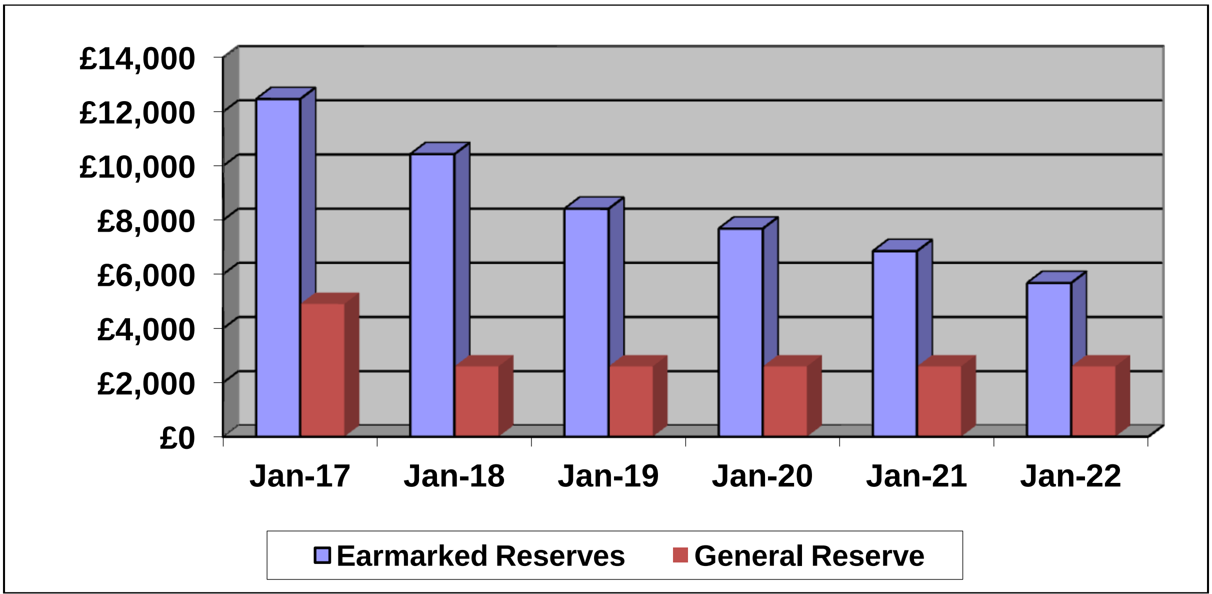
Firstly, the reducing level of government grant as identified above means that it is vital to consider how to achieve income streams in the future. Whilst it is feasible to borrow additional funds and in many ways this is appropriate given the current low interest environment, this does come at a cost so at times it can be more prudent to apply the reserves especially given the lack of return on any cash holdings.

Secondly, central government has indicated that local authorities should look to use their reserves as part of their financial planning and not to hold high levels of reserves without a clear purpose.

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. However, Table 3 below shows that reserves are moving to a more justifiable but lower level. Whilst this provides a reasonably secure basis for the council, it does indicate a reduced level of flexibility for the future. The projected level of reserves for the next 4 years is shown as a bar chart in **Table 3** below. The actual figures are shown in Appendix 2.

Table 3 – Level of Reserves for MTFS period 2017/18 to 2018/19



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 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. This provides a bonus system that gives a fiscal incentive to encourage local authorities to facilitate housing growth. The first bonus was paid in the financial year 2011/12 and builds successively in the following financial years to 2016/17 after which the bonus will be paid on a rolling basis. However, after the initial funding that the Government has set aside for the scheme has been exhausted, the cost of paying the New Homes Bonus will be met by top slicing formula grant.

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.

Shepway currently utilises half 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. Whilst this strategy has allowed the council to build up its reserves which will give it some future stability, careful attention will need to be given to any changes within this income stream particularly towards the end of this strategy and beyond and whether it will continue in the longer term as the financial landscape changes.

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 undertaken a major consultation exercise with a view to achieving 100% localisation of business rates by the end of the current parliament.

With regard to the MTFS, Shepway 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 also, in 2015/16, joined the Kent business rates pool on the basis of financial modelling which demonstrates a financial gain to the authority due to a reduction in the amount being paid to central government. This has been extended into 2017/18 and the benefits of pooling are under consideration for future years.

The Chancellor of the Exchequer has announced further changes to the Business Rates regime with proposals being presented which will devolve 100% of business rates to local government rather that the current 50%. These proposals were under discussion but have been delayed by the 2017 general election. It is still expected that the changes will be forthcoming and will be fiscally neutral at a national level and that there will be additional responsibilities given to councils as part of these arrangements. These are subject to the current consultation with legislation being introduced in April 2017.

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 Shepway 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 Shepway 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.
- A detailed review of the Business Plan should be completed every year (previously stated as every 5 years)

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://www.shepway.gov.uk/moderngov/documents/s23154/rcoun20170222%20gen%20fund%20mtfp%20and%20quarter%203.pdf

Flexible Use of Capital Receipts

In March 2016 the government produced Statutory Guidance on the Flexible Use of Capital Receipts. Proper accounting practices mean that capital receipts can only be used to support capital expenditure. However, the purpose of the guidance is to give flexibility as to the use of capital. In summary, the guidance allows councils to use capital receipts from the disposal of property, plant and equipment assets received in the period 1 April 2016 to 31 March 2019 to fund revenue spending which is forecast to generate ongoing savings to an authorities or several authorities, and / or to another public sector bodies net service expenditure.

The guidance itself gives examples of the type of expenditure that can be funded from this source although it is not exhaustive. This includes sharing back office services, funding the cost of service reconfiguration where this leads to revenue savings and driving a digital approach to the delivery of more efficient services. A fuller list is provided in the guidance.

This provides an opportunity for the council to invest in some significant projects during this period to embed efficiencies for future years. Previously the council has utilised this funding to support a range of digital initiatives including a significant service transformation for the revenues and benefits service which has generated ongoing revenue savings. As part of its strategy for addressing the future funding gap, the council is considering a major transformation programme. This will include a significant level of investment to enable efficiencies to be realised. Once the detailed planning of this project is completed, it is anticipated that the use of capital receipts will be directed to support this transformation programme.

Developing Areas

The detail for addressing the annual budget gaps will be set out in the council's annual budget strategy report. However, there are 2 significant ongoing activities which will have a major impact on the future finances of the council but are not yet sufficiently developed to be fully incorporated into the MTFS.

Firstly, as previously mentioned, the development of the Otterpool Park Garden Town, within which the council has a significant landholding, offers the potential for an important for a long term financial contribution to the finances of the council. The nature this will take is yet to be developed and can vary between a short term capital receipts to the benefits of a longer term holding. As this is developed this will come to play more significantly into the financial projections of the council. It is, however, anticipated that this will involve a significant level of borrowing in order to secure a financial return to the council but also to meet its social objectives of a quality investment. This will be fully reflected as the long term detailed plan is developed.

Secondly, the council is looking at developing a future operating model. This will not only change how the council delivers services and interacts with its residents, but also offers the opportunity to generate significant efficiency savings. Work is currently being undertaken to identify the proposed plan and benefits prior to looking for a final decision in early 2018.

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 governments 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 Shepway 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.