APPENDIX F

Budget report 2018/19 - LOCAL GOVERNMENT ACT 2003 ROBUSTNESS OF ESTIMATES, ADEQUACY OF RESERVES AND THE MANAGEMENT OF RISK

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1. BACKGROUND

1.1 Section 25 of the Local Government Act 2003 requires Chief Financial Officers to report to their authorities about the robustness of estimates and the adequacy of reserves when determining their budget and level of council tax. Authorities are required to consider their Chief Financial Officer's report when setting the level of council tax.

1.2 Section 26 of the Local Government Act 2003 gives the Secretary of State power to set a minimum level of reserves for which an authority must provide in setting its budget. The minimum would apply to "controlled reserves", as defined in regulations. The intention in defining controlled reserves would be to exclude reserves that are not under the authority's control when setting its call on council tax, for example the balance on the Housing Revenue Account and schools balances. There may also be a case for excluding other types of reserve. Regulations to define controlled reserves would only be made in conjunction with regulations setting a minimum.

1.3 It was made clear throughout the Parliamentary consideration of these provisions that section 26 would only be used where there were grounds for serious concern about an authority. The Minister said in the Commons standing committee debate on 30 January 2003: "The provisions are a fall back against the circumstances in which an authority does not act prudently, disregards the advice of its Chief Finance Officer and is heading for serious financial difficulty. Only in such circumstances do we envisage any need for intervention." There is no intention to make permanent or blanket provision for minimum reserves under these provisions.

1.4 If the need to apply a minimum to an authority were identified, the minimum would be set after considering the advice of the CFO to the authority and any views expressed by the external auditor. The authority would be consulted on the level to be set.

1.5 Any minimum set under section 26 applies to the allowance to be made for reserves in the budget. There is nothing to prevent the reserves being used during the year even if as a result they fell below the minimum. However, if in preparing the following year's budget it was forecast that the current year's reserves would fall below the minimum the CFO would need to report to the authority under section 27.

2. REPORT OF THE CHIEF FINANCIAL OFFICER

2.1 The Chief Financial Officer for the London Borough of Havering has provided the following assurance:

The London Borough of Havering prides itself on its record of creating balanced budgets, delivering challenging savings programmes and carefully managing its finances within each financial year. It is this track record which has helped to build the foundations for setting a robust budget in 2018/19. This effort will need to intensify during 2018/19 to secure financial balance over the period of the MTFS from 2019/20 through to 2022/23.

Recent Government announcements reinforce the direction of travel to fiscal devolution in local government through business rates retention and relaxing constraints on the ability to raise council tax locally. However, the announcements also serve to prolong the funding pressures, risks and uncertainties within which Havering, like many local authorities, is required to set its 2018/19 budget and Medium Term Financial Strategy.

The Government has recently confirmed that it now intends to move towards 75% business rate retention from 2020/21, with the London Business Rate Pilot being one of eleven pilots to operate for up to two years from 2018/19. Whilst it is anticipated that Havering may benefit from between £0.9m and £2.5m per annum of business rate growth retention as a result of the Pilot, this will not be confirmed until mid-way through the 2019/20 financial year and so cannot be prudently relied upon in setting the base budget in 2018/19.

The delayed consultation on Fair Funding has now been issued for local authorities to respond by 12 March 2018 with an intention to implement in 2020/21. In the meantime, the failure of the funding formula to acknowledge the significant financial pressures associated with rapid population growth and its impact upon social care services and housing and homelessness, results in continued significant financial pressures for the Council in delivering its statutory services in the forthcoming years.

No further transition grant is proposed in the draft settlement to alleviate the deeper and faster funding cuts experienced by Havering and other authorities with a higher relative level of council tax which resulted from the introduction of 'core spending power' calculations in 2016. Consequently, levels of Council Tax and budget savings required to balance the budget are likely to be higher than would otherwise be the case for a given level of service, had the anomalies in the funding formula been resolved earlier through the Fair Funding Review as originally intended.

The long awaited Green Paper to address the funding pressures within Adult Social Care has been further delayed until the Summer 2018. This prolongs the risks around the lack of a sustainable funding solution for social care, with reliance upon fixed term Improved Better Care Fund to contain demographic and market pressures and represents a key financial risk for Havering.

Further, despite the national growth in demand upon Children's social care and homelessness services, the Government has not indicated any substantial response to addressing the associated funding requirements of local government.

Within this context, it is essential that Havering makes substantial progress through 2018 to develop its future long term operating model, its policies and its 2019/20 financial strategy to achieve financial balance and secure its financial future over the period to 2022/23 and beyond.

2018/19 Budget

Substantial savings have been made in recent years (£56.6m) over the period 2014/15 to 2017/18). The challenge in preparing the budget for 2018/19 and the MTFS has been to identify proposals which minimise the impact of budget reductions upon delivering the Council's priority services, mitigating further Council Tax increases for residents in the context that Havering has the 4th highest council tax in London in 2017/18, whilst creating a foundation upon which the New Council Administration can build from May 2018 for the 2019/20 MTFS and beyond.

I have assessed the proposals contained in this report for 2018/19 as robust, with a sufficient safety net for savings that are ultimately non-deliverable.

The budget reinforces the need for on-going robust financial management, strict budgetary control and the on-going focus of the Administration and Senior Leadership Team (SLT) to deliver agreed savings plans, service mitigation and recovery plans, with effective processes in place to monitor and report progress throughout the financial year.

In assessing the robustness of estimates, I have drawn upon the advice of Chief Officers within the SLT to give their assurance that the proposals presented for 2018/19 can be delivered within the available resources envelope and to agreed timescales.

In January 2017, Cabinet approved the establishment of a Business Risk Reserve (BRR) with effect from 1 April 2017. The forecast balance on the Business Reserve at 31 March 2018 is £6.872m of which £1.010m is committed leaving £5.862m available. In addition, an amount of £0.700m in respect of one off Under-indexing compensation grant will be received in 2018/19 and will be added to the BRR. The Business Risk Reserve will provide a safety net against the risk of non-delivery of savings and/or over optimism with funding assumptions within 2018/19 but must not be relied upon to meet recurrent operational spending. The Reserve will be supplemented by any underspending on the Corporate Risk Budget and Corporate Contingency Budget at final outturn. At period 9, the underspend on the Corporate Risk Budget after meeting projected overspending in service directorates is forecast to be £2.618m and £2m on the Corporate Contingency Budget.

For 2018/19, the available Corporate Risk Budget of £3.098m is available to support the management of budgetary pressures that may arise within the year. This is much reduced compared to previous years, but is in line with estimates provided in 2017/18 budget setting. It will become more difficult for the Council to respond to financial pressures in services in the future in the way that it has historically.

The Corporate Contingency budget for 2018/19 will reduce from £2m to £1m as planned in the 2017/18 financial strategy. The contingency budget does not provide specific funding for any unforeseeable, extraordinary items of major expenditure, for example, the implications of flooding. If such an event were to occur, it would need to be funding from the existing general reserves and balances, if the general contingency were exhausted.

No call has been made upon the contingency budget during 2017/18 to date and is forecast not to be required at month 9 reporting. In view of this fact and the other risk budgets and reserves available, £1m is considered adequate for the risks that this budget it is expected to cover in 2018/19.

The projected levels of earmarked reserves as referred to in section 3 and 4 below have been established to meet planned projects or budgetary pressures and are considered adequate at this time. The sums earmarked for these purposes were agreed as part of the annual approval of accounts process and the use and application of those reserves are reviewed quarterly as part of the budget monitoring process. Within these reserves, the Transformation Reserve stands at £9.423m, of which £7.792m is committed for projects and initiatives which aim to reduce the ongoing operational expenditure of the Council or generate future income streams.

The General Fund Balance stood at £11.766m at 31 March 2017 and it is recommended that it be retained at this level as a minimum going forward.

Against such a challenging financial background, it will therefore be crucial that reserves, both general and earmarked, continue to be managed in the medium term in a way that gives due regard to the need to set a legally balanced budget.

All of the above comments are made in the context of a planning assumption that the Council will agree to a Council Tax increase of 3.5% including an Adult Social Care precept of 2% in 2018/19.

<u>Medium Term Financial Strategy</u>

The future financial position for Havering is very challenging. Whilst the proposal contained within this report will achieve a balanced budget in 2018/19, a gap of £23.227m is forecast over the following two years to 2020/21, with a total of £30.025m by 2022/23.

Much good work has been undertaken during 2017/18 to develop and launch ambitious housing and regeneration projects through significant capital *investment that aims to deliver much needed housing supply, together with long term income streams to the Council. It is critical that these projects are proactively and robustly managed to deliver the financial returns set out in the approved business cases, thereby contributing to longer term financial sustainability of the Council after meeting the capital financing costs associated with the capital investment.*

During 2018/19, the Council will need to consider its future operating model, challenging its overall spending plans and service priorities in order to develop more transformational savings proposals and income generation plans so that the financial strategy remains fit for purpose over the medium to long term. The SLT is currently developing proposals to present to the new Council Administration for consideration as soon as possible after the local elections in May 2018. It is essential that these plans are considered promptly and progressed at pace in order to enable implementation in sufficient time to address the forecast budget gap in 2019/20 and beyond.

Given the Government's agenda for fiscal devolution, it is further recommended that the Council gives early consideration to determine and maintain its Council Tax Strategy for the duration of the MTFS for 2019/20 through to 2022/23 in order to provide more stability and certainty in financial planning.

Debbie Middleton BA(Hons), CPFA
Chief Finance Officer (Section 151)

3 ROBUSTNESS OF ESTIMATES, RESERVES AND BALANCES

3.1 The budget has been prepared using a five year Financial Strategy agreed by Cabinet in October 2017 as its starting point. This Strategy has been developed through:

- The revenue and capital budget strategy statements, which are included as part of this report;
- The forecast position as set out in the Cabinet reports in October and December 2017 and January and February 2018 and the proposals set out in those reports;
- The outcome and forecast impact on the Council of the provisional Local Government Financial settlement as reported to Cabinet in January 2018;
- A variety of announcements concerning the new government funding regime;
- The Chancellor's Autumn Budget Statement 2017.

3.2 As the development of the budget for 2018/19 has progressed, the position has been the subject to review and challenge with Heads of Service, SLT, the Leader of the Council, Cabinet Members and the Lead Member for Financial Management, ICT(client) and Transformation. Due consideration has been given to the over-arching strategy above along with the delivery of corporate priorities in undertaking these reviews and this is reflected in the detailed budget proposals.

Budget proposals have been developed within the context of current and future service plans. Furthermore:

a) the Council has reviewed its pressures alongside those identified by the LGA and London Councils to provide a cross check/challenge;
b) In respect of savings, the proposals have been risk assessed against an agreed set of criteria which will ultimately inform in-year monitoring;
c) A review of legislation takes place on an ongoing basis as part of the budget development process to assess possible implications;
d) Financial modelling related to the new funding system and its impact on Havering's budget has been under periodic review and refinement, especially in light of the Autumn Budget Statement and the Provisional Local Government Financial Settlement announcements.

3.3 At a more detailed level, budgets have been built having due regard to:

- Staffing changes incorporating proposed restructures;
- Inflation;
- Contractual commitments;
- Existing budgets;
- The proposals for budget adjustments and savings;
- The impact of changes to specific grants.

3.4 The budget includes a contingency that will provide a reasonable level for unforeseen issues that could arise during the year. This has had due regard to a risk assessment. Further information on the basis of this is set out later in this statement.

3.5 A review of the 2017/18 significant budget variances has taken place to assess any impact on the 2018/19 budget outside of the proposals in order to:

(a) Ensure action plans are in place where a possible adverse variance could occur;
(b) Ensure use of any possible additional favourable variance is considered in the context of the overall strategy;
(c) Inform the risk assessment of contingency and reserves.

3.6 The proposed budget provides a foundation from which to develop the financial strategy over the period to 2022/23 and work will continue during 2018/19.

4. THE ADEQUACY OF ESTIMATES, RESERVES AND BALANCES

4.1 As set out in section 1, local authorities are required to maintain adequate balances to deal with unforeseen demands upon financial resources. It is the responsibility of each authority to set its level of reserves based on local conditions, but taking into account national factors. Although a view can be sought from the external auditors it is not their responsibility to prescribe or recommend the appropriate level. In setting the level, the Authority should take into consideration the advice of their Chief Finance Officer (CFO), taking into account all local relevant circumstances.

4.2 The General Fund Balance stood at £11.766m at 31 March 2017. An annual review of the balance has taken place as part of the budget setting process. The risk assessment is attached at Annex 1 and the CFO's advice is that the minimum level of the General Fund Balance should remain at its current level of £11.766m which represents *7.4%* of the Council's net 2018/19 budget including levies.

4.3 After taking account of the most recent projection in the current year and more significantly the outcome of the Local Government Financial Settlement, it is anticipated that the Council's general reserves will remain at £11.766m as at 31 March 2018.

4.4 Members will be aware that the working balances provide protection against unforeseen events that could impact on the authority. Reserves must be used carefully and can be used only once. As reflected in the revenue budget strategy, the Council will not utilise General Fund Balances to subsidise its budget or suppress council tax increases. Further it will not use any specified or earmarked reserves to subsidise its budget or to suppress council tax increases on an on-going basis as this is neither financially sustainable nor prudent. It may, in exceptional circumstances, utilise appropriate specified or earmarked reserves to bridge short term forecast budget shortfalls to facilitate delivery and implementation of projects and service initiatives that will generate additional income or reduce on-going expenditure to achieve a balanced budget. Approval of decisions to utilise reserves in this manner will require the approval of a robust business case including implementation plan to be approved by Cabinet.

4.5 The Council maintains a number of earmarked funds for specific purposes and their use is planned and approved for these purposes. Often they are used to comply with accounting policies, manage arrangements across financial years, or to fund known future commitments. The most significant are the following which have the projected forecast balances at the 31st of March 2018:

(a) Insurance Reserve (6.446m), which is part of the Insurance Self-Funding Arrangement to meet future liabilities incurred but not yet claimed.
(b) Corporate Transformation Reserve to support corporate transformation (£9.423m, of which £7.792m is committed)) – these funds are earmarked for the various transformation programmes across the Council.
(c) Business Risk Reserve (£6.872m of which £1.010m is committed for potential Adult Social Care pressures) which provides a safety net against unforeseen service pressures, under delivery of agreed savings and/or over optimism of funding streams.

The sums established within earmarked reserves were agreed by SLT as at 1st April 2017 and were fully allocated to projects or liabilities. The balances will be reviewed again as at 31 March 2018.

4.6 Other reserves continue to be expended/ planned in accordance with their specific approved purpose. A review has taken place of these as part of the budget finalisation.

4.7 The working balances of the HRA are also subject to a risk assessment; this will be included in the report to Cabinet on the HRA budget for 2018/19.

5. OPPORTUNITY COST OF RESERVES

5.1 Holding general reserves to meet unexpected events or emergencies is a necessary requirement. However, there are opportunity costs and benefits of holding cash balances, which can be measured in different ways, depending on what these resources were alternatively to be used for. For example, holding cash gives a financial benefit in contrast to using the cash to fund capital expenditure. The financial benefit would be the difference between the investment return and the total borrowing cost. At the current time due to low interest rates, these are in fact broadly neutral. However, a cost of around 4% will be incurred in respect of a requirement make revenue provision to repay debt.

5.2 On this basis, for every £1m of cash held, the purely financial benefit could be deemed to be £0.040m per annum or approximately £0.400m per year for balances of £10 million. This is dependent on prevailing money market conditions, which in the current economic climate can fluctuate significantly. Using the balances to repay debt earlier would not achieve a matching saving given the costs around early redemption and the similarity in short-term lending rates and long-term borrowing rates. For information, £1.1m equates very approximately to 1% on the level of Band D Council Tax.

5.3 If, however, this is considered in the context of using these balances to fund one off expenditure, then the opportunity cost is the improvements that would accrue from that expenditure. This might for example be improvements in services, increased performance or some other measure and would be assessed via a business case. Such items have been considered by officers during the course of developing the MTFS, but these have not generally been included within the final proposals or the detailed budget given the broad financial constraints within which Havering is operating.

5.4 Should these items be included within the budget, they would obviously provide a basis for additional and/or improve services; with the need to appreciate that reserves exist for various reasons, and once expended, either have to be replenished, or the funding terminated. This is the opportunity that is being potentially foregone by holding general reserves. However this is only relevant to the extent that such proposals align to Council's priorities and Medium Term Financial Strategy.

5.5 It is important that in considering the level of working balances that the issue of the opportunity costs and benefits of such an approach is also considered and that Members weigh up the potential benefits against the risks. The other important factor in making this judgement is to consider is that balances can as indicated only be spent once, and can realistically only be used to support one off expenditure, or to allow time for management action to be implemented to address ongoing expenditure requirements.

5.6 As stated above, the use of significant levels of balances to fund ongoing spending or reductions in Council Tax can pose material financial risks, especially given that the Council's ability to generate funds to replenish reserves through Council Tax is severely restricted by the Council Tax capping regime. Hence the level of reserves held overall requires a balance to be struck between the opportunity cost of holding balances against the unknown risks facing the Council and the need to safeguard the provision of local services if such risk were to crystalize.

6. REVIEW OF RESERVES AND CONTINGENCY

6.1 The assessment of the sums required for reserves and contingency purposes is reviewed regularly, taking into account the various risks facing the Council, the level of risk, the actions taken to mitigate risk, and the financial assessment of the risk. The review include consideration of the Corporate Risk Register, with the objective of ensuring that all such risks having a potential financial impact are covered in the reserves and contingency assessment.

6.2 The outcome of this review is set out in Annex 1 to this Appendix. This shows each risk and the detail associated with it, and includes a cross-reference to the Corporate Risk Register. Each risk is evaluated and a financial assessment is made of the potential costs arising and the degree of likelihood, which in turn drives the sum for which provision is being made.

6.3 The Corporate Risk Register is kept under review by the Senior Leadership Team, so any changes are then reflected when the reserves and contingency assessment is updated.

ANNEX 1

RISK ASSESSMENT FOR GENERAL BALANCE / CONTINGENCY 2018/19
REVIEWED AT 20 JANUARY 2018

Risk (incl. Corporate Risk Register item)	Risk Owner	Risk Description	Assessment of Risk (counter measures in place)	Contingency		General Balance	
				Value of Assess-ment £m	Value Having Regard to Risk £m	Value of Assess-ment £m	Value Having Regard to Risk £m
Failure to Balance the annual budget and the MTFS (CR4) : Medium Term Financial Strategy	S151 SLT	MTFS: The financial settlement 2016/17 to 2019/20 resulted in significant reduction in RSG and the review of the RSG formulae via the Fair Funding Review will now not take effect until 2020/21 due to delays in the consultation. Further, the delay in the Green Paper on Adult Social Care adds to the uncertain financial position post 2019/20 due to lack of sustainable funding streams. In the absence of clarity of the Government's position, the potential loss of iBCF of £5.619m is factored into the 2020/21 base budget, albeit that it is probable that Government will either develop sustainable funding solutions or extend BCF beyond 2019/20, nothing is certain. The Base Budget gap in 19/20 is £10.341m with a further £12.886m in 20/21, a total of £23.227m which is roughly double the current GF balance. The cumulative gap over the period to 2022/23 is £30.066m exist in the MTFS over 2019/20 to 2022/23. Therefore the development of further robust and deliverable savings plans are critical to financial sustainability over the medium term. During 2018/19, LBH needs to plan for the worst case scenario over the next two years should it arise by identifying and delivering savings to balance over the medium term. The uncommitted Corporate Risk Budget of £3.098m Minimum GF remains available to meet new unavoidable service pressures that may arise. General Fund balances should go no lower	Medium to High			23.227	11.613

		than their current level of £11.766m					
Failure to Balance the annual budget and the MTFS (CR4) : 18/19 budget	S151 SLT	The 2018/19 base budget assumes that Service Directors deliver all approved savings plans, mitigation plans and manage expenditure within the approved 2018/19 budget. The forecast outturn for 2017/18 shows underlying financial pressures of £2.280m within directorates for which mitigation plans are being pursued and these must be controlled effectively in 2018/19. The Corporate Risk Budget of £3.098m exists in 2018/19 to meet new unavoidable service pressures that may arise. The uncommitted Business Risk Reserve of £6.562m is available to underpin pressures which may arise from delays or ultimate non delivery of directorate savings and mitigation plans. In addition a general contingency of £1m is provided to meet significant and unanticipated financial risks.	Medium to High	1.200	1.000		
Failure to Balance the annual budget and the MTFS (CR4) : Education Support Grant (ESG)	Director of Children’s Services	The ESG ceased from September 2017 and for 2018/19 a sum of approximately £0.590m has been included in the Central Schools Services Block. This leaves a shortfall against the cost of providing LA statutory services in spite of the savings made centrally and a contribution from LA maintained schools to meet the cost of central services relating only to that sector. The forecast shortfall in funding in 2018/19 is £0.835m (Service cost after 2017/18 savings is £1.746m less DSG central services block for LA central duties (£0.589m) and Contribution from schools (£0.322m)..This is planned to be met in full from the Schools Traded Services Reserve, whilst longer term solutions to deliver the services within available resources are developed.	Medium	0.835	NIL		
Assessment having regard to risk likelihood – Minimum required			**Overall Medium /High Risk**	2.035	1.000	23.227	11.613