APPENDIX 2

STATEMENT OF THE SECTION 151 OFFICER UNDER THE REQUIREMENTS OF SECTION 25 OF THE LOCAL GOVERNMENT ACT 2003

ROBUSTNESS OF BUDGET ESTIMATES AND ADEQUACY OF RESERVES 2018/2019

1. INTRODUCTION

The Local Government Act 2003 Section 25 includes a specific duty on the Chief Finance Officer (Section 151 Officer) to make a report to the authority when it is considering its annual budget and council tax levels. The report must deal with the robustness of the estimates and the adequacy of the reserves included within the budget. (For the purpose of the Act 'reserves' includes 'general fund balances'.) The Act requires the Council to have regard to the report in making its decisions at the Council's budget and council tax setting meeting in respect of 2018/19.

In making this report I have considered the risks arising from it, outlined below, and the Council's mitigating actions in arriving at my conclusions which, in summary are:

- Supplies and services and staffing budgets are sufficient to maintain services as planned.
- Budgeting assumptions for treasury management activity reflect the impact of sustained low interest rates.
- The approach to budgeting for income is prudent.
- The approach taken to using the New Homes Bonus to support the base revenue budget is prudent and allows the Council more time to make measured decisions regarding future service provision.
- The proposal to increase council tax is required to ensure the viability of this Council in future years without having to make significant cuts to front-line services.
- The medium term financial planning assumptions, including future cuts in government support, are prudent and the continued development and revision of the budget strategy for closing the projected budget gap is providing a planned and measured approach to meeting future financial challenges.
- The approach to financing maintenance is acceptable. Looking ahead, the need to model and prioritise future investment aspirations will become critical if the Council is to meet some of the targets within the Medium Term Financial Strategy (MTFS).
- The level of reserves, including General Balances, is satisfactory.

2. ROBUSTNESS OF ESTIMATES

Budget estimates are assessments of spending and income made at a point in time, based on service needs and known expenditure patterns. The statement about the robustness of estimates cannot give a guaranteed assurance about the budget, but gives members reasonable assurances that the budget has been based on the best available information and assumptions.

In order to meet the requirement of assessing the robustness of estimates the Section 151 Officer will consider and rely upon the key processes that have been put in place:

- the issuing of clear guidance to Service Managers on preparing budgets through the annual budget strategy report;
- peer review by GO Shared Services finance staff involved in preparing the standstill base-budget, i.e. the existing budget plus contractual inflation;
- the use of in-year budget monitoring to re-align budgets in line with projected changes for 2018/2019;
- a medium term planning process that highlights priority services;
- a review of the corporate risk register;
- a service review by the Cabinet, Executive Management Team and Service Managers of detailed budget and proposed savings and their achievability; and
- GO Shared Services finance staff providing advice throughout the process on robustness, including vacancy factors, increments, current demand, and income levels.

Notwithstanding these arrangements that are designed to test the budget throughout its various stages of development, considerable reliance is placed on Service Managers having proper arrangements in place to identify issues, project demand data, to consider value for money and efficiency and record key risks within their operational risk register.

The table below identifies assumptions made during the budget process and comments upon the risks and decisions taken when preparing the budget.

Budget Assumption	Financial Standing and Management
1. The treatment of demand led pressures.	Service Managers will be expected to manage changes within their budgets by re-prioritising or by taking steps to reduce expenditure where income streams decrease significantly. Where this is not possible it will be necessary to use the working balance or earmarked reserves on the understanding that they may need to be restored in future years. The full rollout of Universal Credit (UC) began in Cheltenham on 6th December 2017. It is estimated that up to 1,800 tenants will move to UC within the next 3 years, placing considerable pressure on rent arrears. CBH is conducting a proactive campaign to provide support and information to all tenants affected by these changes. The impact on arrears will be closely monitored and the budget proposals reflect an increasing provision for bad debts.

Budget Assumption	Financial Standing and Management
2. The treatment of inflation and interest rates.	The following assumptions have been made in the preparation of the Medium Term Financial Strategy in respect of inflationary pressures: • Pay awards are modelled at 2% per annum from 2018/19. • Employer's Superannuation contributions – agreed until 2020 through the latest triennial valuation and through agreement to pay the required secondary sum payments to the Local Government Pension Scheme (LGPS) as an up-front payment for the next 2 years future liability (i.e. pay some of the liability up front which impacts on cash flow but does not represent an additional budgetary commitment). Future uncertainty in the economy / fund performance may increase pension fund deficits although budgeting assumptions follow actuarial advice. Current modelling and results suggest the current strategy will ensure the Council is in a positive cash-flow position by 2018/19, resulting in an improved funding level. • Contract inflation has been allowed for at the appropriate contractual rate • In line with previous practice, general inflation has not been provided for unless the relevant professional officer has indicated that there are inflationary pressures. Whilst this creates natural efficiency savings it could lead to insufficient budget to maintain service levels. In-year increases will need to be managed. • The Council provides a number of demand led services e.g. green waste collection, car parking, building control charges, etc. The estimates for 2018/19 have been prepared on the advice of officers who have taken a professional view on income levels, based on their opinion about the local economic conditions. Income from fees and charges will generally have been increased where legislation permits although a more targeted approach to demand led services have been appraised by Service Managers. • On 8th July 2015 the Chancellor announced that rents in social housing would be reduced by 1% a year for four years. This resulted in an estimated loss of rental income of £6.7m in the period to 31st March 2020. The proposals agreed in 2016/17 recommended a balanced approach to cost savings and planned use of reserves. The Government has now confirmed that from April 2020 rent policy will revert back to the previous guidelines of allowing annual increases of up to CPI + 1% per annum. • Despite historic significant investment returns, the treasury management budgets are based on sustained low interest rates. The budget proposes a diversification into pooled funds which will expose the Council to investments within property, bonds and equities. These funds have the advantage of providing wide diversification of investment risk, coupled with the services of professional fund managers in return for a fee. These funds offer enhanced returns over the longer term, but are more volatile in the short-term but will allow the authority to diversify into asset classes other than cash. • The Council adheres to the CIPFA Code of Practice for Treasury Management 2011 and updates its policy and strategy statements annually. The Investment Strategy is reviewed annually to ensure security of public money. Following the banking crisis, our treasury advisors continue to advise the Council and Treasury Management Panel on policy. Risks around inflation and interest rate variations have been built into my assessment of the budget. In-year increases will need to be managed but may need to be funded from General Balances and subsequently be built into base budget in future years. The recommended minimum HRA revenue reserve to cover contingencies is £1.5m. The three year projections forecast a reserve balance of £3.605m at 31st March 2021 which is deemed sufficient to cover the impact of the changes in Housing and Welfare Policy over the medium term.

Budget Assumption	Financial Standing and Management
3. Estimates of the level and timing of capital receipts.	Property services need to ensure our land and property asset portfolio is fit for purpose, secures increased income generation, maximises capital receipts and stimulates growth and investment in the Borough. In December 2016, Full Council agreed that a minimum of 50% of all future asset disposal proceeds be ring-fenced to enhancing the Council's land and asset portfolio. In that same report, Full Council endorsed an aim to generate a minimum 5% yield on future investment in property to help towards achieving a sustainable MTFS. No major General Fund capital receipts are anticipated that would affect the planned capital expenditure in 2018/2019. A strategic review of our property portfolio has been undertaken to support the development of the investment property portfolio and to ensure that the council's assets make the maximum contribution possible to support the MTFS. Housing stock sales through Right to Buy (RTB) are estimated to be at 30 per annum to March 2022 then reducing to 20 per annum thereafter. These receipts will be ring-fenced towards the supply of new housing.
4. The treatment of efficiency savings/ productivity gains.	The majority of savings proposals for 2018/2019 are already in progress and no identified slippage has been identified. This should not undermine our ability to keep expenditure within budget in 2018/19 although provision is made for slippage within working balances.
5. Government support.	The following assumptions have been made in the preparation of the Medium Term Financial projections in respect of Government support: • The estimates for 2018/19 are based on the final financial settlement notified by the Ministry of Housing, Communities and Local Government (MHCLG) on 7th February 2018. Whilst the Valuation Office Agency (VOA) error led to Cheltenham receiving an increased Tariff of £454k from that proposed in the provisional settlement, this has been partly offset by an increase of £383k in Section 31 grant to compensate us for limits to the increase in the NNDR multiplier. • The medium term financial projections reflect the significant reductions in Revenue Support Grant (RSG) as it is top-sliced to fund the growth in the New Homes Bonus (NHB). • The budget requires £1.754m of New Homes Bonus (NHB) to support the revenue budget in 2017/18. The fact that this source of funding is being top-sliced from the RSG, means that the Council has little alternative but to regard this money as an important part of its income stream and is therefore assumed to be base funding across the period of the MTFS. • The budget for 2018/19 includes assumptions for business rates based on estimates of collection rates, bad debts, appeals, reliefs (mandatory and discretionary) and assumed 50% share under the 2018/19 100% Business Rates Retention pilot for Gloucestershire. The medium term financial projections make no provision for the impact of future changes in the mechanism for operating local business rates retention but this budget uses a reserve to help mitigate the risk of any future fluctuations from previous years' one-off deficits. Despite the uncertainty over future government funding, I am comfortable that the Council has been sufficiently prudent in budgeting for reductions in government support, including dealing with the uncertainty of business rates and NHB receipts.

Budget Assumption	Financial Standing and Management
6. Proposed level of council tax.	When setting the level of council tax, members should always consider the medium term outlook to ensure that a sustainable budget position is maintained Members also need to acknowledge that the Localism Act 2011 contains requirements for local authorities to hold a referendum where council tax is proposed above a specific increase (the greater of up to 3% or £5 in 2018/19). Council tax is the main source of locally-raised income for this authority and has previously been referred to by MHCLG as 'an important source of funding which is used to meet the difference between the amount a local authority wishes to spend and the amount it receives from other sources such as government grants. When calculating the core grant settlement, the Government assumes that all Shire Districts will increase their Council Tax by the threshold amount for 2018/19. The indicative grant levels for the period 2019/20 also assumes that all local authorities will increase their Council Tax levels up to the threshold each year. There has been an important shift in the Government's principles, most noticeably, the shift away from freezing council tax to using council tax to generate additional funding. Given that this budget relies on the use of reserves to generate a balanced budget in 2018/19, I am of the opinion that council tax cannot be frozen as it would carry significant risks in future years. I therefore support a council tax increase of 2.99% as this will avoid the requirement for a referendum (cost c. £50k) for council tax increases over the government cap.
7. Medium Term Financial Strategy (MTFS) – the strategy for closing the projected funding gap.	Sound financial management requires that the Section 151 Officer and Councillors have full regard to affordability when making recommendations about the local authority's future revenue and capital programme. The 2018/19 budget includes medium term financial projections of the projected funding gap and indicates broadly how the Council may close the projected funding gap over the period 2018/19 to 2021/22. The Medium Term Financial Strategy (reported to Cabinet 12th December 2017) outlines the strategy for closing the funding gap and includes savings and income targets rather than necessarily specific worked up projections of cost savings. The Council has traditionally provided 'one off' funding for investment in systems or staff costs i.e. additional short-term resource, redundancy / pension costs funded from savings or earmarked reserves. The Council's approach to modelling and monitoring the MTFS and planning for meeting future funding gaps outlined in the budget strategy demonstrates robust and effective planning for closing the funding gap and is effectively scrutinised. The Council is developing a more commercial approach to service provision with the aim of becoming self-financing and less dependent of Central Government funding. This approach will help refocus on delivering a sustainable MTFS. It is anticipated that the move to a greater share of business rates is a step in the right direction for Cheltenham, although we are already aware that a system of tariffs and top-ups will remain which effectively distributes funding across the Local Government sector. Developing strategies for business and economic growth which will generate revenue for the council to offset the reductions in government funding streams will be a key strand of the development of the MTFS.
8. The authority's capacity to manage in-year budget pressures.	The authority has proven its ability to manage in-year budget pressures with no recorded overspends in recent years. Improvements to our Devolved Budgetary Control scheme have improved our management of cash limited budgets.

Budget Assumption	Financial Standing and Management
9. The strength of the financial information and reporting arrangements.	The Council has strong internal and external reporting standards. Quarterly management reports are made to the Cabinet. These procedures have allowed firm management of any projected overspends in the past. These reports have been enhanced with detailed financial commentary and clear direction with regards to in-year virements which aids transparency and full scrutiny.
10. The authority's virement and end of year procedures in relation to budget under/overspends at authority and departmental level.	The Council's virement and carry forward rules are clear. The Council is operating management disciplines to ensure management and policy actions are considered in relation to overspending budgets. Generally virement is considered at a corporate level against corporate priorities, including the contribution towards the optimal level of general fund reserves. The Council's Devolved Budgetary Control scheme gives managers flexibility to manage budget variations within their services. Service overspends may be clawed back from future budgets.
11. The adequacy of the authority's insurance arrangements to cover major unforeseen risks.	The Council's insurance arrangements are considered adequate. The Council does self-insure on small claims and has reserves to meet any excesses relating to claims. No uninsured risks have been identified.
12. The approach to financing the maintenance programme.	The Council has £600k built into the base revenue budget to fund the annual maintenance budget of the property portfolio. The maintenance schedule of planned commitments has been established for 2018/19 and will be reviewed by the Asset Management Working Group on an annual basis.

Given consideration of the above factors and the detailed scrutiny of the budgets that has been undertaken this year I can give positive assurance on the robustness of the budget estimates.

3. ADEQUACY OF RESERVES AND BALANCES

The requirement for financial reserves is acknowledged in statute. Sections 32 and 43 of the Local Government Finance Act 1992 require billing authorities in England and Wales to have regard to the level of reserves needed for meeting estimated future expenditure when calculating the budget requirement.

Within the statutory and regulatory framework it is the responsibility of the Section 151 Officer to advise the authority on its level of reserves that should be held and to ensure that there are clear protocols for their establishment and use. Councillors, on the advice of the Section 151 Officer, should make their own judgements on such matters taking into account local circumstances. The adequacy of reserves can only be assessed at a local level and requires a considerable degree of professional judgement. The assessment needs to be made in the context of the authority's MTFS, its wider financial management, and associated risks over the lifetime of the plan. The Secretary of State has reserved powers to set a minimum level of reserves to be held by councils if required.

Reserves should not be held without a clear purpose. Should it be considered that the level (or proposed levels of reserves) is inadequate then a report must be made to Council outlining how this has arisen and what action should be taken to prevent a reoccurrence in subsequent years.

As part of the annual budget setting process and in reviewing the MTFS, the Council needs to consider the establishment and maintenance of reserves. These can be held for three main purposes:

- a working balance to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing – this forms part of general reserves;
- a contingency to cushion the impact of unexpected events or emergencies – this also forms part of general reserves;
- a means of building up funds (earmarked reserves) to meet known or predicted requirements.

GENERAL (WORKING) BALANCES – CALCULATION OF OPTIMUM LEVEL

There are two approaches for deciding the optimum level of working balance. One approach is to apply a percentage range to the Net Budget Requirement, currently assessed as between 5% and 10% or a level between £0.721m and £1.443m. The alternative is a level based upon a risk assessment of the budget. In 2018/19 the Section 151 Officer has used a risk based approach to assess the appropriate level of general balances.

The framework for assessing the risks surrounding the budget needs to consider the following:

- Inflationary pressures.
- Pension Fund changes.
- Planned savings measures.
- Interest rate variations.
- Volume variations on demand-led services such as planning fees, land charges.
- New services/initiatives including waste and recycling.
- The risk of litigation.
- Emergency planning.
- Financial guarantees.
- Grant income.
- Future budget projections.

	Area of Risk	Explanation
1.	Inflationary Pressures	Historically the cost of pay awards has caused major variations to budget estimates. The National Employers have offered a 2% pay award per annum for the two years up to 2019/20. A further provision of £42,500 (0.50%) is recommended within the working balance to offset the risk of the offer not being accepted. Inflationary risks on other costs are a factor elsewhere. The Ubico contract is driven by fuel and pay increases and a provision of 1% on the 2018/19 General Fund contract value suggests a figure of £77,000 should be kept as a provision within the working balance.
2.	Pension Fund Changes	The 2016 triennial review has brought a degree of certainty to future pension costs for 2018-2020. These will not impact adversely on the Council in the next 24 months so no specific provision is required at this point. The Chief Finance Officer has recently agreed to pay the required secondary sum payments to the Local Government Pension Scheme

	Area of Risk	Explanation
		(LGPS) as an up-front payment for the next 2 years future liability (i.e. pay some of the liability up front which impacts on cash flow but does not represent an additional budgetary commitment). This will realise a base budget saving of £275,000 by 2019/20 as the Council will benefit from a greater assumed investment return.
3.	Planned savings measures	The Savings Strategy identifies £3.586m of savings targets to be delivered across 2018/19 to 2021/22. Slippage can occur and the Red Amber Green (RAG) system for identifying those work streams at risk of slippage within the Savings Strategy. Currently the strategy notes £100,000 of work streams considered 'amber' or 'red' for 2018/19 in terms of delivery and so these are accommodated within the working balance. The Council's base budget includes an annual target of £375k to recognise staff vacancy management which has been allocated out to cost centre managers which has ensured more transparency and ownership of the target. However, a smaller workforce coupled with reducing opportunities in a depressed public sector could impact on this budget principle and therefore a 10% allowance, equivalent to £37,500 for this is included within the working balance.
4.	Interest rate variations	The current very low level of investment rates suggest that there is little down-side risk at present and no specific provision is recommended for 2018/19. However, the budget proposals determine that the Council will diversify some of its cash balances away from fixed term deposits towards pooled property funds and multi-asset funds such as equities and bonds.
5.	Volume variations demand led	During the economic downturn the Council was vulnerable to drops in key income streams, e.g. planning fees, car parking income, etc. The budget projections reflect current levels of income however the risks associated with volatility should be better reflected particularly given recent fluctuations in planning, car parking and building control income. As such a 2% provision amounting to £236,000 to reflect the volatility is recognised in the working balance.
6.	New services/ initiatives	In October 2017, a new waste and recycling scheme was introduced across the Borough. The roll-out has seen increases of around 25% of kerbside recycling collections. This exceeds the projections made as part of the project / financial parameters. The Council has been advised that considerable fluctuations occur in recycling / waste habits during the first few months of any significant change to the service. It is therefore prudent not to make longer term assumptions until patterns have been embedded. It is important to effectively analyse whether the levels will be sustained, and where the recyclate now being collected is coming from (landfill waste or other recycling facilities). To this end a financial provision should be made to ensure collections are maintained to the expected standard during this interim period. As such a provision amounting to £200,000 to reflect the volatility is recognised in the working balance.
7.	Risk of litigation contingency	The level of risk associated with litigation is considered to be reducing over time however risk does still remain and as such a provision of £200,000 is retained. The council holds a separate earmarked reserve for planning appeals which is also available if required.
8.	Emergency planning	Whilst the government will step in to assist in the event of a major disaster there are thresholds at which assistance is given. This threshold is 0.2% of the net budget. Financial support is then given at 85% of costs above this level. Provision of £1m would cost this Council £170,000; the cash flow impact would need to be handled from invested cash balances.
9.	Financial guarantees/ contingent liabilities	Run-off of the old Municipal Mutual Insurance claims has begun but no provision is required at this stage.

	Area of Risk	Explanation
10.	Grant income	No new grant streams are anticipated in the 2018/2019 budget. No risks have been identified around existing grant flows that require specific provision in the working balance.
11.	Business rates retention	As part of the pooling arrangement, the Council could be required to contribute to large scale revaluations such as occurred with Virgin Media via Tewkesbury Borough Council. Provision for such occurrences should therefore be included within the working balance and as such £150,000 is estimated. The council holds a separate earmarked reserve for Business Rates Retention which is also available if required.
12.	The Cheltenham Trust	A contingency provision of £150,000 be held in general balances for the Trust to draw down; this will provide for short-term losses incurred by the Trust as they go through re-organisation and transformation. The Cabinet have requested that the Trust look at their business operations, including those services that are currently protected, to ensure it is fit for purpose and commercially focussed.
13.	Cheltenham Transport Plan	In February 2014, Council approved an allocation of £50,000 towards a mitigation fund for the Cheltenham Transport Plan. This allocation is now held within the working balance.

The assumptions above total £1,313,000 suggesting that we strive to maintain a working balance around this figure during 2018/19. The Council should aim to not allow the working balance to fall below this figure. The current working balance is £1,408,591.

EARMARKED RESERVES

In order to assess the adequacy of earmarked reserves when setting the budget, the Chief Finance Officer should take account of the strategic, operational and financial risks facing the authority. Accepting that there are still some areas of uncertainty, the level of reserves appears adequate at this point in time and no other changes are currently recommended.

Whilst the majority of these reserves are held for specific purposes, there are three reserves which are available to help meet the cost of any changes as the Council meets the challenges of future funding reductions; these are:

	Balance projected at 31st March 2018 £
Budget Strategy (Support) Reserve	1,151,848
New Initiatives Reserve (Transformation)	595,914
Pension and Restructuring Reserve	200,000
	1,947,762

In determining the budget strategy in October 2015, the Section 151 Officer recommended the creation of a specific earmarked reserve: a ‘budget strategy (support) reserve’, to provide greater resilience. This reserve secures the Council against short-term challenges which we know we will encounter in the coming years such as the one-off drop in business rates income due to redevelopment, and the delay in securing a revenue stream from the North Place development. Given the late impact of the pay offer on the Ubico contract fee and the reported Valuation Office errors on the finance settlement, the budget proposals rely on a significant drawdown of this reserve in 2018/19, which will need to be replenished.

I have reviewed the revenue reserves and propose the transfers as identified in Appendix 6. I also consider that the financial reserves and working balance as proposed in these papers are adequate to fund spending plans for 2018/2019 and give a firm basis for the years 2019-2022. However, given the significant cuts proposed by Central Government in the future, I recommend that any future underspends or fortuitous windfalls are earmarked for transfer to either general balances or the budget strategy (support) reserve.

4. OVERALL CONCLUSION

There is a legal requirement under the Local Government Act 1992, section 32 and 43 to set a balanced budget. The budget proposals includes budgets for expenditure and income and uses reserves to fund one off expenditure, fund future expenditure or phase in the impact of increased expenditure per the MTFS without drawing on the General Reserve.

I am, therefore, satisfied that the proposed budget is balanced and meets the legal requirement to set a balanced budget.

My overall view is that the budget is a sound response to continuing challenging financial circumstances, which maintains services, maximises efficiencies and responds to anticipated future financial challenges.

In line with statutory duties, Members are asked to consider the advice provided in this report, based upon my assessment of the robustness of the overall budget and estimates in the medium term financial projections.

PAUL JONES
Chief Finance Officer (Section 151 Officer)