

**Budget Framework 2019 to 2023
Medium Term Financial Strategy Update – 2020/21 to 2023/24
26 February 2020**

**Report of Director of Corporate Services and Section 151
Officer**

PURPOSE OF REPORT

To provide an update of the Council's Medium Term Financial Strategy for 2020/21 to 2023/24.

This report is public.

RECOMMENDATIONS:

- (1) **That the Medium Term Financial Strategy (MTFS) estimates as set out in the report are noted.**

1 INTRODUCTION

- 1.1 The previous reports on this agenda consider the annual process for setting the revenue budget and capital programme. This report takes the 2020/21 revenue budget and agreed capital programme as a starting point and looks forward to the next three financial years which cover the period of this Council.
- 1.2 In proposing the revenue budget and capital programme, Cabinet has had regard to the medium term impact of decisions made and particularly the financial impact on 2021/22 to 2023/24. Local Government funding remains volatile and uncertainties with respect to the Government's Fair Funding review, the future of New Homes Bonus and local business rates retention persist. It is therefore important to regularly review future funding estimates in the context of current financial decision making.

2 STRATEGIC OVERVIEW FROM CABINET

- 2.1 In strategic terms the main challenge of budget setting is to match priorities and corporate planning objectives against what is affordable financially. The Medium Term Financial Strategy covers this challenge over a longer timeframe of four years.
- 2.2 This year we undertook a strategic review of the Council's existing priorities and services, including performance, as well as looking at options to innovate and modernise. The Council Plan and its Strategic Priorities, were updated and approved by Council on 29 January 2020 providing the following priorities and cross cutting themes:

Priorities

- A Sustainable District
- An Inclusive and Prosperous Local Economy
- Healthy and Happy Communities

- A Co-operative, Kind and Responsible Council

Cross Cutting Themes

- Climate Emergency
- Community Wealth-Building
- Community Engagement

2.3 This reports sets out the latest funding estimates covering:

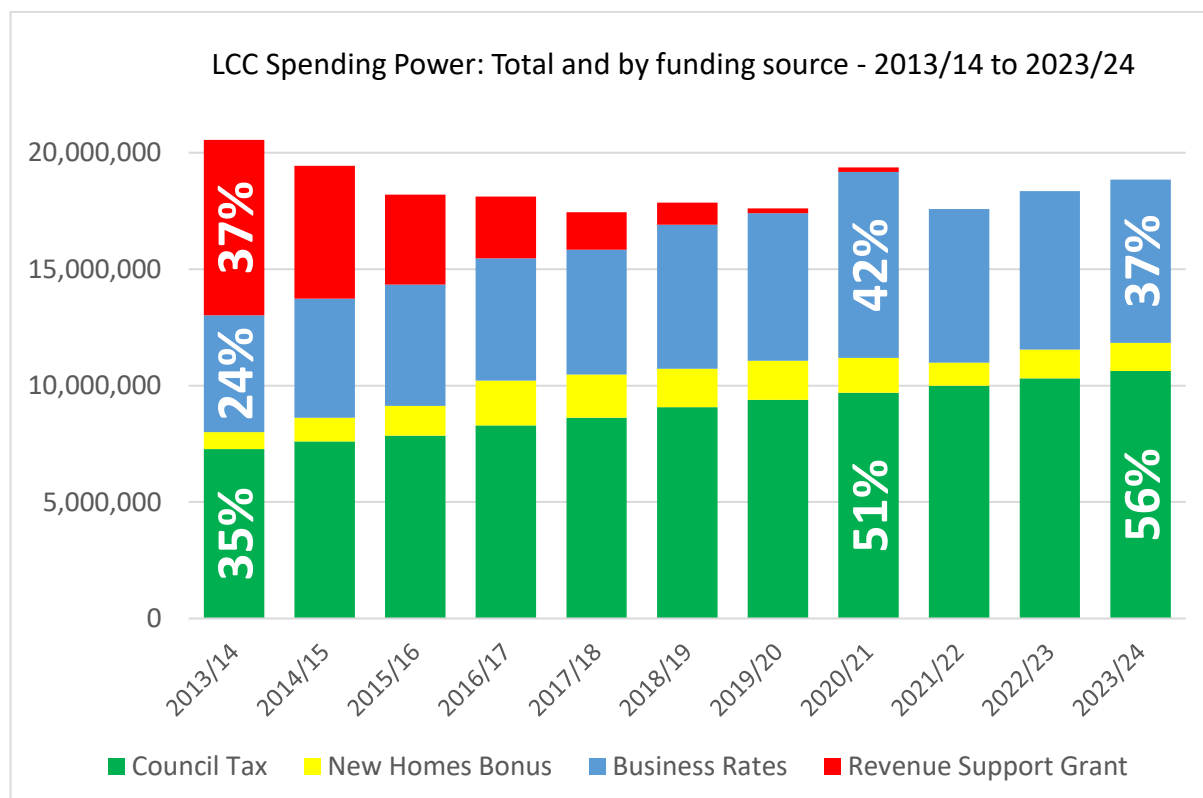
- Council Tax
- Revenue Support Grant
- New Homes Bonus
- Business Rates

It also provides an estimate of the revenue budget gap for the three years beyond the balanced 2020/21 revenue budget (set out on an earlier report on this agenda).

3. FUNDING OUTLOOK

3.1 Local Government funding has changed significantly over recent years. Significant reductions in central funding have taken place and Revenue Support Grant which accounted for more than half of Lancaster City Council's funding in 2010/11 will disappear entirely next year. As the graph below shows the Council is now almost entirely reliant on Council Tax and Business Rates to fund net expenditure and it is therefore important to provide regular estimates of these important funding streams.

3.2 The Government is expected to publish the results of its Fair Funding review over the next year and it is expected that the review will be implemented from next year, 2021/22. The estimates in this section factor in an expected reduction in funding from business rates as it is anticipated that the Government redirects Local Government resources to upper tier authorities in order to address social care pressures.



Council Tax

- 3.3 Council tax is the Council's primary source of funding. It is calculated by multiplying the taxbase, the number of eligible residential properties (expressed in band D equivalents), by the level of the district council precept which is determined each year. The table below shows council tax forecasts for the next four years.

Council Tax Forecasts and Sensitivities – 2019/20 to 2023/24

	Actual 2019/20	Budget 2020/21	Forecast 2021/22	Forecast 2022/23	Forecast 2023/24
Taxbase	41,400	41,768	42,186	42,608	43,034
Taxbase Growth	0.49%	0.89%	1.00%	1.00%	1.00%
Band D level	226.95	231.95	236.95	241.95	246.95
Band D increase	2.99%	2.20%	2.16%	2.11%	2.07%
Council Tax Income	9,395,730	9,688,194	9,996,007	10,309,007	10,627,268
<i>Above Assumptions: 1% taxbase growth from 2021/22 onwards and £5 increase in band D throughout the medium term</i>					
Scenario A: No increase in Council Tax over period of MTFP		-208,842	-421,861	-639,120	-860,682
Scenario B: Property growth at 18/19 growth levels (0.49%)		-49,792	-103,324	-160,806	-222,459
Scenario C: Increase in property growth to 1.5% per annum		48,383	100,905	157,832	219,445
Scenario D: 1% drop in council tax collection rate		-97,732	-101,661	-105,749	-109,999

- 3.4 The Council's taxbase is the number of properties in the district expressed in band D equivalents, taking account of exemptions, discounts, reliefs and council tax support. Growth in housing numbers inevitably increases the taxbase and therefore council tax income. Taxbase growth for 2020/21 is 0.72%, up from 0.49% in 2019/20. Prior to 2019/20, taxbase growth was over 1% for a number of years. Going forward growth is forecast at 1% per annum. However, scenarios B and C in the sensitivity analysis above show the impacts on the budget of slower and quicker growth in the taxbase.
- 3.5 On 29 January 2020, Council approved a £5 increase in the Band D council tax. This is the maximum allowable within the Government's referendum criteria which limits increases to 2% or £5, whichever is greater. For the purposes of forecasting, it has been assumed that the Council will increase council tax by £5, the maximum allowed, in each of the next three years. Scenario A in the sensitivity analyses shows the impact on the budget of freezing council tax over the MTFS period.
- 3.6 As the graph above shows council tax has become the most significant funding income for the Council, accounting for more than half the Council's income in 2020/21 onwards. As such decisions to freeze council tax and/or low growth in property numbers can have a significant impact on the revenue budget (as shown by scenarios A and B) and if either or both were to happen then the Council would have to look to expenditure reductions or increases to other incomes in order to balance the budget.

Business Rates

3.7 Localised business rates is now a fundamental part of the local government finance settlement and, with council tax, accounts for the majority of local government financing. There are three main elements to the system:

- **Business rates funding baseline** – this is an amount set by the Government based on assessed needs which the local authority is permitted to retain from business rates payers. It has no correlation whatsoever to the level of rates paid.
- **Business rates growth retention** – this is the share of business rates growth above a preset baseline which the Council is permitted to retain. So far the council has benefitted significantly from this source of income though it is set to be reset to zero in 2021/22.
- **Green ‘disregard’** – councils are incentivised to support renewable energy businesses and get to keep 100% of business rates which are paid by hereditaments associated with renewable energy production and Lancaster has one of the highest level of such hereditaments in England.

Business Rates Forecasts and Sensitivities – 2019/20 to 2023/24

Business Rates	Budget	Forecast	Forecast	Forecast	Forecast	Forecast
	2019/20	2019/20	2020/21	2021/22	2022/23	2023/24
Business Rates less tariff	24,924,776	26,890,116	27,483,984	28,173,832	28,880,995	29,605,908
	19,279,987	19,279,987	19,607,747	22,325,769	22,772,284	23,227,730
Rates Income	5,644,789	7,610,129	7,876,237	5,848,064	6,108,711	6,378,179
Baseline	5,644,789	5,644,789	5,740,750	5,456,363	5,565,490	5,676,800
Rates Surplus	0	1,965,340	2,135,487	391,701	543,222	701,379
Levy on growth	0	982,670	1,067,744	195,851	271,611	350,690
Income						
Baseline	5,221,430	5,644,789	5,740,750	5,456,363	5,565,490	5,676,800
Cap Comp	212,537	212,537	251,532			
Green Energy	906,729	906,729	922,143	940,586	959,398	978,586
Growth	0	982,670	1,067,744	195,851	271,611	350,690
	6,340,696	7,746,725	7,982,169	6,592,799	6,796,499	7,006,075
<i>Above Assumptions: 10% reduction in SFA from Fair Funding Review shown as reduction in baseline in 2020/21, 0.5% growth in net rates, budgeted at worst case due to power station risk.</i>						
<i>Scenario E: The power station closes down for a significant period.</i>			1,498,300	605,078	689,023	776,450
<i>Scenario F: No reduction in baseline following Fair Funding Review</i>				303,131	309,193	315,378
<i>Scenario G: 1% net rates growth every year</i>			68,368	140,517	216,604	296,792

3.8 The first two columns of the above analysis show the difference between the Council budget and actual forecasts for business rates. To date, the Council has budgeted assuming a ‘worst case’ scenario which includes no growth and an expectation that rates income will fall 7.5% below baseline at which point the Government protects the Council from further losses. The worst case scenario, which is scenario E in the above table, is based upon the significant proportion of the rates that are due from Heysham Power Station and the fact that a maintenance period would result in a significant reduction in rates income. However, in actual fact, there has been only very limited reduction in rates associated with the power station and business rates have grown at

a modest rate meaning the Council has accrued significant surpluses over and above the 'worst case'. These sit in the Business Rates reserve.

3.9 The budget from 2020/21 onwards is no longer based on 'worst case' but rather the annual estimates. Any future losses associated with power station closedown will be funded from the Business Rates reserve. This has resulted in an increase in business rates income. The Reserves Strategy, considered earlier on this agenda, covers the Business Rates Reserve which hold a sum to address the 'worst case' scenario so that this would not impact on the revenue budget in the short or medium term.

3.10 The Government has delayed its fair funding review by a year and it is now expected to implement this from 2021/22. A number of assumptions that will arise from this review have been modelled in the figures in the above table:

- A 10% reduction in Settlement Funding Assessment (SFA) to be affected through a reduced funding baseline – this is a best estimate based on a view that the Government will seek to redistribute from lower tier to upper tier authorities to reflect social care authorities. Scenario E shows the improved position if no reduction in Lancaster's SFA was to be implemented.
- Cap compensation (compensation for past Government decisions not to increase business rates by inflation) to be rolled into a revised funding baseline.
- A business rates growth reset effectively removing all growth from the system by setting the business rates baseline to equal actual rates levels. This will result in a loss to Lancaster of about £1m per year and is the single largest anticipated 'shock' to the financial resilience of the Council.

Taken together the above impacts have a substantially detrimental impact on business rates income which result in a forecast reduction of almost £1.4m. It is important therefore that the assumptions and corresponding estimates are reviewed as soon as the Government releases the results of its Fair Funding review.

3.11 In the six years since the localised business rates system was introduced, Lancaster City Council has retained over £6m in rates growth, averaging at over £1m per year. Although growth is uncertain, past experience might inspire further confidence in setting growth estimates going forward. The modelling assumes a 0.5% annual growth but Scenario G provides information on the additional receipts which would accrue if that growth was 1%.

New Homes Bonus

- 3.12 New Homes Bonus is a reward grant which is calculated from council taxbase figures. Since the implementation of New Homes Bonus in 2013/14, the Government has reduced the reward grant to cover only 4 years (down from 6) and has introduced a threshold below which no reward grant is paid. There is a risk that the Government will seek to further reduce the grant in future years which would increase the budget gap at the Council.

New Homes Bonus Forecasts and Sensitivities – 2019/20 to 2023/24

New Homes Bonus	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Annual Reward	361,030	274,251	466,299	250,000	250,000	250,000
Previous Years Grant	1,288,487	1,397,410	1,035,682	1,101,611	990,581	966,330
New Homes Bonus	1,649,517	1,671,662	1,501,981	1,351,611	1,240,581	1,216,330
<i>Above Assumptions: NHB remains in place with modest housing growth over the MTFP period</i>						
<i>Scenario H: NHB phased out over four years</i>				-500,000	-750,000	-1,000,000
<i>Scenario I: NHB scrapped & returned as SFA</i>				-1,308,282	-1,197,252	-1,173,001
<i>Scenario J: NHB is shared equally with County</i>				-506,842	-465,206	-456,112

- 3.13 Government has confirmed New Homes Bonus allocations for 2020/21 as set out in the table above. It has also set out its intention to consult on the future of the grant amidst reports that it is not satisfied with the effectiveness of the reward grant. It is unclear at this stage as to whether the Government intends to replace the grant with an alternative mechanism for recognising housing growth or will simply redirect resources via other mechanisms. The sensitivity scenarios above all reflect a view that any change is likely to be detrimental to Lancaster City Council.
- 3.14 The future of New Homes Bonus is uncertain with reports that the Government is unsatisfied that the reward grant has been effective. Looking to 2020/21 and beyond, there are a number of threats to this funding income. These uncertainties, which are modelled in the scenario analysis above, include:
- Scenario H and I: The Government scrapping or significantly reducing New Homes Bonus
 - Scenario J: The Government changing the way the reward is shared between districts and counties. The current 80/20 split in favour of districts might be deemed unfair to County Councils which appear to have more significant problems with respect to financial resilience. The scenario assumes a 50:50 split.

Additionally the Government may choose alternative mechanics to effectively reduce grant such as raising the minimum amount of housing growth which is disregarded before paying grant. A slow down in housing growth in the district would also reduce grant.

Revenue Support Grant

- 3.15 Revenue Support Grant has been increased by CPI in 2020/21. It will be rolled into the Council's business rates baseline from 2021/22.

Revenue Support Grant	2019/20	2020/21	2021/22	2022/23	2023/24
Grant	199,691	203,086	0	0	0

Funding Outlook: Conclusion

- 3.16 There remain significant uncertainties in terms of Local Government funding over the next couple of years associated with the imminent Government Fair Funding review. The main threats to funding income are related to the reset of business rates baselines and removal of accumulated rates growth both of which are anticipated and modelled (see 3.10). Additionally, uncertainty with respect to the future of New Homes Bonus (see 3.13) poses a significant threat to the Council's funding position. Whilst these uncertainties and sensitivities have been modelled into the estimates going forward, it will be important to monitor this position over the next year as the Government releases its plans.

4. THE MEDIUM TERM BUDGET GAP AND NEXT STEPS

- 4.1 Funding outlook forecasts covered in section 3 when combined with the budget expenditure estimates that have been calculated as part of the revenue budget process when taken together provide a forecast of the budget gap over the next three years. This is shown in the table below.

	2020/21	2021/22	2022/23	2023/24
Budget Gap	£0	£1.558m	£1.234m	£1.270m

- 4.2 It is important to recognise that the above figures are based on best estimates at this point in time and that these estimates will be reviewed constantly to take account of events such as Government announcements, pay settlements etc. The estimates show a 'one-off' structural gap of around £1.5m from 2021/22 onwards. A large proportion of this gap is a consequence of the anticipated funding reductions which are covered in 3.16 above.
- 4.3 Cabinet have undertaken to progress an Outcomes Based Budgeting process early in the new financial year. Further work will be undertaken on funding estimates as information becomes available from Government and a Medium Term Financial Strategy action plan will be adopted early in 2020/21.

5. CONCLUSION

- 2.1 This report provides an update on the Council's medium term financial position taking account of the latest funding estimates and the decisions made on the revenue budget and capital programme which are considered earlier on this agenda.

RELATIONSHIP TO POLICY FRAMEWORK

The budget and medium term financial estimates should represent, in financial terms, what the Council is seeking to achieve through its Policy Framework.

CONCLUSION OF IMPACT ASSESSMENT

(including Diversity, Human Rights, Community Safety, Sustainability etc)

No additional impact identified – any specific issues have been (or will be) considered as part of the relevant aspect of the policy framework or individual budget proposals, etc.

LEGAL IMPLICATIONS

No direct legal implications.

FINANCIAL IMPLICATIONS

As set out in the report.

OTHER RESOURCE IMPLICATIONS

Human Resources / Information Services / Property / Open Spaces:

No specific implications

SECTION 151 OFFICER'S COMMENTS

The Section 151 Officer has co-authored this report with the Director of Corporate Services. The report should be read alongside the other budget framework documents and provides an estimate of the future budget gap based upon decisions to be made in respect of those other reports.

MONITORING OFFICER'S COMMENTS

The Monitoring Officer has been consulted and has no further comments.

BACKGROUND PAPERS

Equality Impact Assessments for budget proposals.

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