MEDIUM TERM FINANCIAL STRATEGY AND FORECAST

2020/21 – 2023/24

“Great Place, Great Community, Great Future”

EXECUTIVE SUMMARY

1. The Medium Term Financial Strategy was last presented to Members at budget setting last year. Since then the Council has continued to be reliant on income generated by property but has also worked hard to try to reduce costs and to ensure that as much Business Rates and Council Tax are collected as possible. However, increasing demand and inflation continues to place strain on the budget. The uncertainty remains in respect of Government funding, in particular the impact of Fair Funding and Business Rates changes. It is too early to say what the priorities of the new Government will be but it is fair to assume that District Councils are likely to be quite low down the list. The general slowdown in the economy, and in particular retail, has impacted rents and the increase in the PWLB lending rate has made investment that much more challenging. In addition, there are new priorities, for example climate change, that could have resource implications and public expectation in respect of services continues to increase. All this means that there is now a new set of financial challenges, which this strategy seeks firstly to, try to quantify, and then to address.

2. It is important to remember that this report is not a blueprint for setting the budget but rather a prediction based on the facts as known now coupled with a number of assumptions. Estimates of Council Tax or pay growth are merely that – estimates – and are not to be taken as policy. Members, guided by Government, through the budget setting process in due course, will determine this.

3. Council funding beyond 2020/21 is still unknown. Although the Government has said it will defer the rollout of 75% Localisation of Business Rates and fair funding review beyond 2020/21 it is still unclear what the financial impact of these changes will be and when. The deferment of the “negative grant” in 2020/21 was to be welcomed however whether this will form part of the “fair funding “review in 2021/22 remains to be seen. On top of that, the benefit of the New Homes Bonus has been reduced significantly, and further “guidance” has been issued which seeks to make it more difficult for Councils to invest in property. Hence, in the absence of any facts this forecast has been prepared on a number of assumptions based on the advice of the Council’s professional advisors LG futures. It is meant to give an approximation as to what the future may hold and to highlight potential challenges but it should not be taken as a firm prediction.

4. The Council is under a legal duty to set a balanced budget each year and there are various statutory safeguards in place to ensure that this happens. For example if a Council tries to set an unbalanced budget the auditor is obliged to report on this and any precept levied is likely to be illegal. A better-known safeguard, as was used in Northamptonshire, is the serving of a Section 114 notice by the Sec 151 officer that has the effect of stopping all non-essential expenditure. This notice is served if there is a risk that the Council will spend beyond its financial resources and hence become insolvent.

5. This forecast is designed to highlight the challenges in delivering a balanced budget in the future so that action can be taken now. Potential reductions in funding, coupled with the Council’s ambitious capital investment programme, growth in costs and volatility in income streams do have the potential to put considerable strain on the Council’s finances. This can be seen to drive a budget

gap of £2.6m in 3 years. This may be addressed by further income generation through investment (For example £60m invested at a return of 2% would close the gap), increased charges coupled with greater efficiency and collaboration. The Council is also fortunate in that it holds significant reserves to give it time to take the actions required. However if action is not taken then eventually service reductions may be required.

6. The Council has already taken big steps on the road to self-sufficiency and dealing with the financial challenges it faces. These challenges were not of the Council's own making but imposed by Central Government and the Council has had to take on considerable risk to address them. These risks, especially the dependency on property income, has meant that the Council's finances are much more volatile than in the past and so the Council has to hold reserves to try to manage this risk at least in the short term. Whilst the Council could have chosen not to invest and therefore not expose itself to these risks, this would have resulted in significant cuts to services that would have an impact on the most vulnerable in the community.

7. It does need to be recognised that property can really only be purchased for investment or regeneration but generally not both. The property the Council has purchased as investments, such as the industrial estates, have delivered good returns and have a low level of voids. However, property purchased primarily for regeneration, such as the SQ, whilst delivering on its ability to facilitate the LRB development, has struggled in the current economic climate. If property is to be invested in to deal with, the financial challenges outlined in this document and therefore to maintain services then the focus has to be on return and security of return and regeneration a secondary objective.

8. Most District Councils have addressed the financial challenges they face through income generation from property and reducing costs. Some Councils have slimmed down their workforce and office space and used technology to become more efficient whilst others have worked in partnerships with other Councils and organisations. What is clear is that there is a limit to what an individual Council can achieve if its objective is the maintenance of services to residents. Combining Councils, be this through the creation of new unitaries or super districts or even shared management structures, can deliver substantial savings. This is really the only long-term sustainable solution for Local Government in two tier areas. However, until then Surrey Heath will need to continue to drive efficiency and increase its income mainly through further property investment.

BACKGROUND AND CONTEXT TO THE MEDIUM TERM FINANCIAL STRATEGY

Introduction

9. The Medium Term Financial Strategy (MTFS) sets out the financial challenges that the Council faces over the next four years and sets out a strategy for dealing with them. This builds on the strategy outlined in July 2016 the benefits of which are now being realised.

10. This MTFS endeavours to take account of all the various factors and influences that may impact on the Council for the next few years. These factors include economic conditions, Government spending plans, current expenditure patterns, inflation, capital plans, planned changes to service delivery, changing demand for services, the impact of new legislation, sources of income etc. However, exact information is not always available and so a number of assumptions have been made. Hence, the forecast should be seen as an indication of the Council's future financial position rather than a solid prediction.

11. The MTFS looks forward anticipating the spending pressures faced by the Council, the impact of decisions already made and those in the pipeline to give an indication of the level of future savings/income required to maintain a balanced budget. This will mean that the Council can plan for future challenges now rather than waiting for when they actually arise.

12. The Council continues to be committed to maximising the use of increasingly scarce resources, directing resources towards its priorities and generating income whilst keeping Council Tax within permitted levels.

13. Over the last couple of years, the Council continued to make significant progress in the achievement of its strategic financial priorities building on work already done. This means that the Council's underlying financial position remains strong but the Council has achieved this by accepting higher levels of risk.

14. Despite these achievements there are still significant challenges facing Council finances going forward. There is uncertainty around income from number of sources, demands continue to increase from both residents and Government and costs rise as the Council finds it difficult to recruit. Therefore, the strategy needs to remain flexible and the Council's Reserves sufficiently resilient to respond to the impact of these challenges.

15. The Council has always managed to set a balanced budget and its financial standing is sound, as has been recently confirmed by CIPFA. However, the drive for further savings/efficiencies coupled with new income streams will need to continue if the Council's financial stability and the ongoing provision of services to residents is to be maintained.

Delivering the Council's Objectives

16. Currently the Council has four main objectives as follows:
    - **We want to make Surrey Heath an even better place where people are happy to live**

- **We will support and promote our local economy so that our people can work and do business across Surrey Heath**
- **We will deliver effective and efficient services better and faster**
- **We will build and encourage communities where people can live happily and healthily.**

17. These form the basis of the Council's current Five Year Strategy and flow through to the Annual Plan. It is likely that the five-year strategy will be revised during the MTFS plan period. This may then require the MTFS to be updated to take account of the financial impact of any changes. That said if the new Five Year Strategy includes further cost implications these will only add to the financial challenge the Council faces.

Objective of the Financial Strategy

18. The objective of the financial strategy is to illustrate the financial effects of existing financial commitments over the medium term and hence to set parameters for the efficiency gains and/or income necessary to achieve a balanced budget.

NATIONAL FUNDING CONTEXT

19. The 2015 Local Government finance settlement set out Council funding up to the year 2019/20. Subsequent to that, there have been two single year settlements with a longer-term settlement promised for publication sometime in 2020. Each settlement decreased the amount of direct government funding and placed more of the burden for Local Government on Council Tax and Business Rates. Surrey Heath now gets no Government grant at all to fund general services. Indeed, in 2019/20 the Council was threatened with the payment of money to Government (Negative Grant) which, after lobbying by Districts, was then deferred 2019/20 and 2020/21. It is likely though that this will be implemented in 2021/22 as part of the Funding review of Local Government and so has been included in this forecast.

20. The Government launched a "Fair Funding Review" in 2016 with the intention of changing the way Local Government funding is distributed. This was due to be implemented in 2020/21 but has been deferred for a year. This review will probably lead to the "negative grant" being imposed albeit by another name. Also in 2020/21 there was to be a move to a 75% localisation of business rates coupled with a full rebasing of business rates but this also was deferred. At the current time, there is no information as to how these changes may impact the resources the Council receives. However, based on past experience, it is reasonable to assume that Surrey Heath's share of Local Government Funding in the form of Business Rates will continue to fall over the life of this forecast with the money being sent to other areas. Any additional money the Government may provide for Local Government is unlikely to be for Districts and even less likely directed at Surrey Heath.

21. As there is so much uncertainty over future funding the Council has engaged LG Futures to use their expertise to estimate what they think the future funding for the Council may be. The provide this advice to a large number of Councils across the

country for financial modelling purposes and hence are the “best guess” as to what the resources will be in the absence of any concrete information from Government.

22. There are therefore a number of assumptions that have been made in order to given an estimate of future resources. These are:

- The “negative grant” will be implemented as part of the changes arising out of rebasing and fair funding.
- Councils will continue to be encouraged to increase Council Tax by the maximum allowed – for Districts 2% or £5 – whichever is the higher;
- New Homes Bonus will disappear over time as an incentive to build houses;
- Even with the 75%, localisation of business rates the amount received will continue to fall over time and due to rebasing, the Council will not benefit from any growth – even if there is some.

Government Support

23. Aside from specific grants for Homelessness, Benefits administration and New Burdens, it is assumed that the Council will receive no Government funding for the life of the forecast. Indeed, due to the changes to Business Rates and fair funding more resources than are currently the case will leave the borough for distribution nationally.

Business Rates

24. Surrey Heath is responsible for billing and collecting business rates across the borough. The Valuation Office and the Government set the amount actually paid by businesses centrally. In the past all the money collected was sent straight to Government for redistribution however, in 2015, the Government introduced what was termed “Localisation of Business Rates”. This was intended to provide an incentive to Councils to grow their local economy and hence increase their business rates as they would be allowed to keep a share of any increase above a pre-determined baseline.

25. Under this system 50% of the business rates paid went to Government, 10% to County and 40% to the District. However, to ensure that individual District funding remained unchanged a “fixed tariff” was charged against the 40% allocation leaving the Council with its assessed “relative needs” or “baseline” level of funding. If the Council was able to grow its business rates then it could keep 20% (after the application of a 20% levy to fund a safety net) of any growth. If however, it loses businesses then it will bear 40% of the loss but can call on the safety net, which effectively caps its losses.

26. Surrey Heath has benefitted for the last few years from Business Rates Growth. Some of this has been due to new developments, such as Waitrose in Bagshot for example, some because of an increased collection rate, but most growth has been because the Business Rates baseline was set too low – this was an issue with the

way the system was set up in the first place and has benefitted many Districts across the country.

27. Business rates go up and down not only because businesses open and close but also due to revaluations resulting from appeals from the Valuation Office, which can go back several years. Due to the lack of development land in the borough it is difficult to deliver hard development and indeed the continuing trend to convert office premises to residential will only reduce the business rates base further.

28. The impact of office conversion is best illustrated with an example. Norwich House in Knoll Road is currently being concerted to 78 flats. In the last year of assessment it generated £139k in Business Rates of which 40% in theory comes to Surrey Heath - £55k. If we assume that, the 78 flats are all Band E for Council Tax they will generate £173k but Surrey Heath only gets 11% or £19k. In reality, Surrey Heath will not actually lose the £55k business rates since it will probably fall in to the safety net – however, any growth elsewhere in the borough say due to new building will be offset and lost.

29. The Government has said that in 2021/22 it would like to implement 75% scheme. What this means is that 75% of Business Rates will be passed on to Local Government in exchange for the removal of a number of fixed grants currently paid by Government. How this 75% will be split in two tier areas, what the tariff will be, how a safety net will work, where appeals risk sits and how baselines will be set is still being determined. Whilst giving a larger share of Business Rates to Councils enables Councils to share in any growth it also exposes them up to more income volatility, which is not the case with a direct grant. This is because national and international as well as local factors determine the success or otherwise of the economy and hence the business rates collected and therefore this in turn could affect service delivery.

30. Away from how Business Rates are shared out, the Government has also been making noises that the whole system of Business Rates charging based on buildings needs to be reformed or even abolished. How this fits in with the changes to Local Government, funding will be a question for the future.

31. Despite the fact that there is little detail to go on LG Futures has attempted to model the impact of the changes to Business Rates funding and the Fair Funding Review. This predicts that Surrey Heath's share of income will fall and is shown in the table below:

Central Government Funding				
	Provisional	Estimated	Estimated	Estimated
	2020/21	2021/22	2022/23	2023/24
Core Funding	£000	£000	£000	£000
Revenue Support Grant	0	0	0	0
Baseline Share of Business Rates	1,568	1,604	1,678	1,717
Estimated Growth in year	1,100			
Negative grant		-560	-747	-933
	2,668	1,044	931	784
Other Grants rolled in:				
Transitional Grant				
	2,668	**1,044**	**931**	**784**
Reduction in funding	**0**	**-1624**	**-113**	**-147**

32. The Council has relied on using some of its Business Rates growth to support the budget but this could be a funding pressure from 2021/22 depending on how and when the changes are implemented. In order to give the Council time to adapt to this change the Council has built up a "Business Rates Reserve" which can be used to cover this shortfall for a number of years until costs can be reduced or other income streams bought on line.

New Homes Bonus

33. Due to the success of the New Homes Bonus the Government implemented changes to the New Homes Bonus scheme in 2017 and 2019 to reduce the overall cost as follows:

- For 2018/19 the incentive was to be paid for 4 years rather than the original 6;
- From 2019/20 the incentive would be only paid for 1 year;
- The first 0.4% of the tax base increase each year will not qualify for NHB. That means that the first 154 units built in the borough do not qualify for a bonus.

34. This means that the level of New Homes Bonus is likely to decrease over time as per the table below:

Year		2019/20	2020/21	2021/22	2022/23	2023/24
		£000	£000	£000	£000	£000
Estimated payment		521	909	260	10	0

35. New Homes Bonus will therefore be of little or no direct financial incentive to provide additional housing unless the numbers are significant. I.e. An entirely new community all completed in the same year.

Council tax income

36. Councils are free to increase their Council Tax by whatever their budgeted costs demand. However if this is more than the “referendum limit” set by Government then the Council must hold a Referendum at its own expense to either ratify or reject the decision. The “Referendum Limit” has been by successive Governments to control how much Council Tax is increased annually whilst in theory leaving the decision to individual authorities.

37. The Local Government Settlement for 2018/19 allowed Districts to increase Council Tax by less than 3% or £5, whichever is the higher without a referendum. Although at the time the Government stated this would be the referendum limit going forward the provisional settlement announced in 2019 reduced this to less than 2% or £5 whichever is the higher.

38. If a Council decides, for example, to increase its Council Tax by 1% in a year, rather than the 2% permitted, there is no mechanism for this ever to be recovered in the future. Once the opportunity for an increase has passed, it is lost forever. This is why there is such a variation in the levels of Council Tax across the country as each will be a result of individual decision taken by each Council in some cases many years ago. Council Tax represents the only “certain” income available to Councils.

39. For planning purposes, it has also been assumed that the tax base will increase by 1.0% or 385 Band D properties per annum. In reality, the increase is usually higher than this. For example in the last year the tax base rose by 471 or 2.2%

40. In the future, the Government may allow Councils to increase Council Tax through the introduction of a new band or a special levy but this has been ignored for forecasting purposes.

Council Tax Forecast

Year	2020/21	2021/22	2022/23	2023/24
Tax base	38,525	38,910	39,299	39,692
Band D	£223.66	£228.66	£233.66	£238.66
Total funding	£8.617m	£8.897m	£9.183m	£9.473m

It should be noted that the figures exclude the Special Expenses charge.

It is a major element of the Financial Strategy that Council tax is increased by the maximum permitted level each year

SERVICE AND OTHER PRESSURES

Employee Costs

41. The Council has historically sought to limit the growth in salary costs by fixing in cash terms the salaries budget despite increases in wages and increments. This was achieved by greater efficiency resulting in a lower headcount. However, more recently the Council has found it increasing difficult to recruit in a number of professional areas resulting in an upward pressure on wages costs. Staff numbers have also started to rise as the Council takes on new duties and provides new services. Future reductions in headcount will only come about if the Council radically changes the way it delivers services – say through collaboration or technology – or alternatively cuts services. As a result, pay growth will be an ongoing budget and for the purposes of the forecast, an increase of 2.0% per annum has been assumed.

42. Historically pensions have been an increasing burden on the Council. Contributions have been increased for 2020/21 but no further increase in contributions is anticipated over the life of this forecast.

Inflation

43. A number of the Council's contracts are indexed in some way to inflation. It has been assumed that these increases will be in line with CPI and this has been estimated to be 2.0% pa. Any inflation over this will need to be managed through greater efficiency and/or service rationalisation.

Reduction in Surrey County Council support

44. The Council currently receives £320k revenue funding from Surrey County Council (Excluding Family Support) to support a number of services including recycling, older people's services, parks and environmental services. It has been assumed that this funding will disappear over the next 3 years but the services will be maintained at the expense of this Council.

Fees and Charges

45. The Council generates a significant income from fees and charges, of which £2m alone comes from parking charges. It has been assumed that all charges will increase by at least inflation, 2.00% pa, and this has been incorporated in to the forecast.

Property income

46. The Council holds a significant portfolio of investment property that has made a major contribution to the Council's finances.

47. In terms of the SQ it has been assumed in the projection that there will be no rental growth in the period as the new business plan has not been completed. However, given the state of the current market it is likely that rents will continue to fall thereby increasing the budget gap even further. This may be mitigated to some extent through change in use of some of the retail units and redevelopment of others. T has been assumed that the House of Fraser building will not generate a return over the life of the forecast and will continue to have to be supported by reserves.

48. In terms of rents for other properties, such as the industrial estates, it has been assumed that these will rise by 1% per annum. It has also been assumed that the current vacancies at Ashwood House and Albany Park will be filled by 2021/22.

49. In addition, the forecast assumes that no new properties are purchased over the MTFS period however, in reality this will be one of the ways that the financial gap will be addressed.

<u>Treasury Management</u>

50. The Council, as at the 30th November 2019, had £13m invested in various institutions and funds. The Council has also taken out a significant amount of borrowing to fund its investments – currently this stands at £164m – of which £109m is short-term borrowing. The model assumes that this will be at a constant rate of 2% for the life of the forecast. In reality, the short-term rate the Council will pay is likely to be less resulting in a significant saving – it is this that has been used to fund rental shortfalls. This advantage will reduce over time as loans have been forward fixed to reduce risk – £25m in 2022 and £25m in 2023 although it has been assumed the average will still be 2%. That said if rates were to rise sharply, each 1% rise would cost over £1m pa thus putting the Council under financial strain. However, on the advice of the Council's Treasury advisors the risk of rates rising sharply in the short to medium term is considered small.

<u>Capital</u>

51. The Council has an Asset Management Plan and Capital Strategy. The Capital Strategy sets the framework for capital investment and this is supported by the detailed capital programme each year. The Council is currently reviewing its estate to see whether it can take advantage of development opportunities and generate returns and/or Capital Receipts but nothing has been reflected in this forecast

52. The Council has very limited capital receipts and most significant capital funding is now either from revenue, grants or through internal and external borrowing. It has been assumed that all capital investment will be self-funded.

53. The Council has committed to two major redevelopment schemes over the past 12 months. In terms of the forecast these have been treated as follows:

Camberley Leisure Centre

54. The Council entered in to a Design, Build and Operate contract for a new Leisure Centre. On the assumption that the centre will operate in line with the financial model tendered there will be an average annual cost of between £66k and £88k. This has been included in the forecast. However due to the structure of the contract in that it takes time for membership to build up there will be a revenue requirement of £935k in 2022/23 and £900k in 2023/24. Further amounts will be required until the centre makes a surplus in 2026. These amounts have not been included in the forecast as they will be funded out of reserves – however the total demand from reserves will peak in 2025 at about £3.6m and then be repaid over the 25-year life of the contract.

55. When the decision was taken to rebuild the centre Members agreed to look at ways of generating capital receipts to reduce the build costs of the centre and hence the level of borrowing. For example, a £2.5m contribution could eliminate the annual cost and reduce the peak revenue demand from reserves to £3.2m. Also if the Council was able to fund the centre for less than the 2.85% assumed in the financial model this would reduce the annual cost and hence the peak demand from reserves.

London Road Block

56. Last year the Council awarded a contract for the redevelopment of the London Road Block. The tender was won on the assumption that the Council would recover the land value of the site and that no additional revenue or capital contribution would be required. As negotiations are ongoing, it has been assumed for the forecast that there are no revenue or capital implications arising from the LRB scheme. Where this not to be the case then this could increase (or decrease) the financial pressure on the Council.

Level of Reserves and General Fund

57. Local authorities are required, when considering their budget setting, to "*have regard to the level of reserves needed for meeting estimated future expenditure*" and to ensure that the Council has a sound financial position and is able to meet its ongoing and future requirements. It is the responsibility of the Council, together with its Section 151 Officer, to ensure a prudent approach is taken in the

administration of financial affairs and that there are sufficient reserves to meet the anticipated demands and requirements of the authority.

58. Reserves generally are kept for 3 overriding reasons:
    - As a working balance to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing – this forms part of the general reserves
    - A contingency to cushion the impact of unexpected events or emergencies
    - A means of building up funds often referred to as earmarked reserves, to meet known or anticipated requirements. An example is the ongoing maintenance of a SANG.
    - To provide resources to temporarily fund the revenue costs of capital projects due to timings of cash flows – for example the Camberley Leisure centre

59. The main reserve the Council utilises in terms of managing its overall financial position is the General Fund reserve. This reserve is used:

    - To protect the working capital of the authority i.e. to manage fluctuations in spending and to ensure there are sufficient funds to meet the ongoing commitments of the Council;

    - To support the Council through any unforeseen occurrences e.g. to support the Council's budget if there are expenditure pressures such as a loss of car parking income or very high price increases (e.g. in fuel) which are unforeseen

    - To be available to fund emergencies for example flooding etc.

60. As part of its Medium Term Financial Strategy there are also some fundamental principles which apply to how reserves are used:

    - The reserves must only be used to fund one off items of expenditure;

    - Reserves should be maintained at a sustainable level to ensure an adequate working balance is maintained;

    - As the Councils, funding becomes more volatile, a higher level of reserves needs to be maintained to manage this volatility.

61. The required level of reserves is not specified by statute, either as a cash amount or as a percentage of the Council's budget. The level set is such that the Council's financial position is maintained; having regard to the risks the authority faces, in the foreseeable future. The Section 151 Officer reports at budget setting time on the adequacy of the reserves and whether they are sufficient for the operation of the Council. Currently the Council holds approximately £37m in earmarked and non-earmarked reserves

62. In assessing the overall level of risk, some of the factors which have been considered are:

- The level of inflation on services and wages;
- The impact of the wider economy on say the housing market and council income and the demand for services;
- The continued reduction in Local Government funding across the country as part of central Government's deficit reduction programme;
- The level of volatility in a number of the Council's income streams such as property and business rates
- Legislative pressures and macro-economic policies such as new responsibilities and changing interest rates.

63. At the moment the level of reserves are considered adequate to meet most future risks within the life of this forecast and to enable the Council to take action to address issues highlighted within this forecast.

MEDIUM TERM FINANCIAL FORECAST

Introduction

64. The Medium Term Financial Forecast sets out the forecast level of resources and expenditure for the authority over the next four years as at the date of preparation. It is important to note that the figures shown in the plan are local forecasts, based upon a number of local and national assumptions and variables, the majority of which are beyond the control or influence of the Council.

65. In preparing this forecast, the Council has taken into account local and national data regarding resources levels and expenditure pressures. This allows the Council to determine the sustainability of its medium term financial position.

66. Whilst it is highly probable that the figures shown in this forecast will change, a key benefit of preparing this plan is to understand the degree to which they could change. This then can enable appropriate actions to be in place to ensure that the Council can deal with such changes.

Revenue Resources Projection

Medium Term Revenue Resources Forecast

67. Using the above individual revenue resource stream projections, the medium term revenue resource forecast is set out below. The forecast reflects an estimate in respect of Local Government funding as far as they are known.

	2021/22	**2022/23**	**2023/24**
	£000	**£000**	**£000**
Business Rates	1,604	1,678	1,717
Negative Grant	-560	-747	-933
Council Tax	8,897	9,183	9,473
Collection Fund Surplus	170	170	170
Special Expenses	190	190	195
New Homes bonus	260	10	-
	10,561	10,484	10,622

68. In terms of revenue expenditure, it has been assumed that the cost of services will stay broadly the same, subject to the areas discussed earlier in this paper. In summary the following assumptions have been made around key cost drivers and income streams used in the forecast.

Base Budget Changes

	2021/22 £000	2022/23 £000	2023/24 £000
Wages Inflation	228	461	698
contract Inflation	240	485	734
Fees and charges inflation	-134	-271	-410
Rental growth	-39	-78	-118
Arena annualised subsidy	0	0	88
Interest for capital program	0	0	0
SCC Grant reduction	110	110	100
Rental vacancy filled	-800	-800	-800
	-395	-94	292

69. Only the financial implications of approved capital schemes are included within the forecast. The potential financial impact of other schemes are considered in the Capital Section of this paper.

Revenue Expenditure Forecast

70. Using the assumptions above, the revenue expenditure projection for the authority is shown in the table below.

ANNEX B

REVENUE FUND PROJECTION 2020/21 to 2023/24

2020/21 £000 Budget	Portfolio	2021/22 £000	2022/23 £000	2023/24 £000
1,167	Business	1,167	1,167	1,167
4,888	Community	4,888	4,888	4,888
1,772	Corporate	1,772	1,772	1,772
1,881	Finance	1,881	1,881	1,881
-899	Town centre and Regeneration	-899	-899	-899
-788	Legal and Property	-788	-788	-788
2,533	Regulatory	2,533	2,533	2,533
3,787	Transformation	3,787	3,787	3,787
14,341		14,341	14,341	14,341
	Other items			
-2,106	Internal Asset charges	-2,106	-2,106	-2,106
	In year savings target			
20	Contribution to Parishes	20	20	20
-290	Investment income	-160	-160	-160
2,213	MRP funding - current	2,274	2,320	2,380
400	Tfr to reserves	0	0	0
-2,027	Reserves funding	-1,527	-1,527	-1,527
12,551		12,842	12,888	12,948
	Base budget changes			
	Wages Inflation	228	461	698
	contract Inflation	240	485	734
	Fees and charges inflation	-134	-271	-410
	Rental growth	-39	-78	-118
	Arena annualised subsidy			88
	Interest for capital program	0	0	0
	SCC Grant reduction	110	110	100
	Rental vacancy filled	-800	-800	-800
0	**Total**	(395)	(94)	292
12,551	**Total Budget to be funded**	**12,447**	**12,794**	**13,240**

Overall Position

71. Using the medium term revenue and expenditure projections, the resulting overall forecast position for the authority is shown below.

	2021/22 £000	2022/23 £000	2023/24 £000
Resources	10,561	10,484	10,622
Expenditure	-12,447	-12,794	-13,240
Net position	-1,886	-2,311	-2,618

72. The gap rises from about £1.9m to just over £2.6m over the life of the forecast driven by reductions in income from property, grants etc. and the impact of inflation. It should be noted that if the SQ income falls then the gap will be larger.

73. Whilst this can be covered by reserves and indeed the assumptions made may turn out to be better than expected steps will still need to be taken to address this funding gap be it through savings or additional income.

Other issues that may affect the forecast

74. Changes imposed by Central Government could reduce the funding available to Councils and put restrictions on Council Tax. They could also transfer extra duties to Councils, which could have a financial cost, in exchange for greater localisation of business rates.

75. Local factors, such as increasing costs, pressure on wages and demand could affect the forecast together with more macro-economic factors such as inflation, interest rates and the commercial property market also having an impact.

Impact of further Capital Expenditure on the Forecast

76. That Council has a number of plans that may require investment and hence borrowing. The revenue cost of this borrowing will depend on the interest rate as well as the length of time the loan is for. Long-term rates had fallen to 2% but in November 2019, the Government unilaterally increased borrowing rates by 1% putting the cost of 50-year money back to around 3%. It is hoped that the Government may introduce a discount for regeneration borrowing but this has not happened yet.

77. Under the prudential regulations, the Council must have sufficient revenue resources to cover the interest on the loan as well as make annual provision for debt repayment (Minimum Revenue Payment or MRP). This can add a significant pressure to the revenue budget and ultimately impact services unless it is funded by new income.

78. The table below shows the impact on the revenue budget (interest and debt repayment) of different levels of borrowing over different periods at an interest rate of 3.0%.

Revenue costs of borrowing				
	10 years	20 years	40 years	50 years
	£000	£000	£000	£000
£1m	117	67	43	39
£5m	586	336	216	195
£10m	1,172	672	532	390
£20m	2,344	1,344	1,064	780

79. If the borrowing is to fund say an income-generating asset then this revenue cost will be covered by the income the asset generates. However, for other capital expenditure the cost may have to be funded from reductions in expenditure elsewhere or new income sources.

Sensitivity

80. The projection can vary widely for a few percentage points. Taking the prudent scenario as a base point then for a number of changes in parameters the savings required for the year ended March 2024 would be:

Change in parameter for forecast period	Cumulative impact on the forecast	Amended projected savings for 2023/24
No changes – base position	0	2,618
0.5% increase in pay each year	179	2,797
0.5% rise in contract inflation each year	278	2,806
0.5% increase in fees and charges	-105	2,513
0.5% increase in variable borrowing costs in first year	2,550	5,158
Additional 100 houses for Council Tax	-72	2,546
1% rise in direct rents	-124	2,497

PROPOSED FINANCIAL STRATEGY

81. The Council's strategy has always been to seek to achieve a balanced budget with no reductions in services to the public. This has required a two pronged approach which firstly looked at increasing efficiency and thus making savings, and secondly at increasing income.

82. The strategy to date has been particularly successful. Over the last 9 years, the Council has reduced its cost base in real terms and yet continued to deliver broadly the same range of services without any impact on the public at large. Initially this was achieved through changes to staffing, greater use of technology and collaborative working with other public bodies. However as the scope for further savings reduced, the emphasis changed to one of income generation through the introduction of new chargeable services, increasing existing charges, getting better returns from assets and investing in property for growth. This income growth, particularly from property whether bought for investment or regeneration, has made a major contribution to the Council's finances and enabled it to deal so far with the financial challenges placed upon it by Central Government. However this success has been at the price of the Council taking on increased risk, as can be seen by the recent downturn in retail property, and so the challenge for the Council is not only about generating more income but also coping with the volatility that this can sometimes bring.

83. There are a number of different areas the Council should concentrate on in order to address its financial challenges going forward. These are as follows:

Business Rates and Needs based funding

84. A key area of uncertainty is the Government position on the full localisation of Business Rates and Needs Based Funding. Currently Surrey Heath gets to keep less than 4% of the Business Rates it collects and this may reduce even further over time. There is no way this could be described as "an incentive for growth" and so the Council needs to continue to lobby to ensure it gets a fair share of the economic growth it creates.

Continue to lobby the Government to give a fairer deal to Districts by fixing the baseline at the actual rates achieved and to provide within the new localisation scheme a genuine incentive for growth.

Delivery of Housing

85. The delivery of housing within the Borough is a key driver for economic growth and is in line with Government policy. An additional 1,000 houses over and above the baseline of 149 units would not only give an additional £220k in Council Tax *per year* as well as a one off new homes bonus payment of about £1.2m. Affordable Housing not only attracts a higher NHB but also reduces the cost of bed and breakfast and homelessness within the borough.

Support the delivery of significant new housing developments within the Borough.

Internal efficiency

86. Whilst a lot of work has already been done to release the easier efficiencies, there is still scope for further work to be done in areas such as shared services, combined management, better procurement, reduced customer contact and streamlined management.

Internal efficiencies, including demand management, and collaborative working, including ultimately reducing the number of Surrey Councils, be pursued to deliver further efficiencies

Additional income from charges

87. Charging for discretionary services is an accepted way of increasing resource to support other areas of the Council's activities. For example, charging for parking in parks, where in effect the user pays for the discretionary service they are using.

Introduce new charges in order to generate income to support unfunded services

Additional income from assets

88. The Council has been successful in renting space to partners in Surrey Heath House. Applying agile working to all Council staff would free up more space for rent and deliver more income. There is also potential to generate capital receipts from the development of surplus land across the borough and use this to reduce debt.

Seek to reduce the footprint occupied by Council staff so as free up space for rent. Research opportunities to develop council owned surplus land.

Reduction in provision of Discretionary Services

89. The Council provides a whole range of services that are not required by statute and therefore not funded. This includes Meals on Home and Community Buses, the theatre, parks and the museum. These services in total cost around £1m hence steps have been taken over recent years to reduce their cost. These services may need to operate based on "the user pays" or be reduced over time. Services, which are the legal responsibility SCC, may need to be handed back if SCC is unable to adequately fund them.

Work to reduce subsidy for Discretionary services and discuss with Surrey how funding for these services can be maintained

Generate Income through Investment

90. Surrey Heath has invested heavily over the past few years and this made a significant impact on its historic budget position. Whilst the retail market locally has been challenging it is worth restating that the Camberley Town Centre was never purchased as a pure investment but rather to kick start regeneration and maintain the local economy. The other asset purchases the Council made are generating good returns to support revenue services. Despite the risks investment in property can bring it is the only thing that can generate a sufficient income to bridge the financial gap the Council is forecasting in the time available. For example a 2% return on a £60m investment would close the gap entirely

91. The Council has always been open about the risks from property investment. It has sought to reduce these risks by using professional advisers, concentrating on the local market, having a mixed portfolio and looking for solid investments. However due to the lack of suitable investments within the borough the Council may have to consider investing further afield. All property has been purchased with a view to holding it for the longer term with a focus on maintaining income rather than capital growth. In order to manage income volatility it is essential that the Council maintains adequate reserves to enable it to deal with these peaks and troughs as they occur.

92. It is also important that voids are managed and that there is a focus on income generation rather than other objectives when a unit becomes vacant so as to ensure that the loans for funding the investment can continue to be serviced.

Continue to invest prudently in property to generate additional income and ensure that income from assets already owned is maximised

Looking ahead

93. It is clear that the Council will continue to find itself in an environment where the need to deliver savings and income growth is ongoing. This is due in the main to the Government taking more and more of this Council's resources, as well as the fact that rising cost and demand far outstrips the ability of Council Tax to fund them. Unless the Government is prepared to share to business rates more fairly only a strategic re-organisation of Local Government in Surrey can eventually deliver the financial cost savings required. In the meantime continued investment, development and more efficient working will be needed to plug the gap.

94. The performance of the wider economy could have a significant impact on the Council's finances in the years to come, which will need to be managed.

RISK MANAGEMENT

95. The Corporate Risk Register includes the risk of the Council being unable to deliver a balanced financial strategy over the medium term. Specific risk factors include:

    - External limitations including the Government's ongoing review of Local Government resources, planned localisation of Business Rates and Council Tax pressures including capping;

    - Reduced income from fees and charges, which the Council is dependent upon to help balance its revenue budget;

    - Budget pressures created by change in demand – decrease/increase in demand for existing services or demand for new services and increased customer expectations.

    - Risks inherent in property investment and development in terms of movement in the market, development overruns and loss of sales, rental void periods and competition. This risk, driven by the national economy particular in respect of retail, is by far the most significant risk the Council faces and could prove to be very difficult to manage.

    - Risks arising from interest rate changes. The forecast is based on an average rate of 2% and now, the council is achieving significantly below this. However if this was to change by 1% then this could potentially add £1.5m to interest rate costs. This risk has been partly reduced by taking a forward loan for £50m at a fixed rate.

    - Risks arising from the two major development projects already committed to. These may not perform in line with expectations and hence require additional financial support from the Council.

96. The Council is attempting to address these risks by placing an emphasis on value for money, efficiency planning and invest to save initiatives. The Council conducts a thorough due diligence process on all its investments and employs professional advisers to advise it on potential acquisitions to try to minimise risks.

97. It also employs professional property managers to advise on tenants and maintain income from these investments and this advice will be very important in the challenging times ahead. Whilst not investing in property would eliminate the risk, it would lead to a reduction in services to cover the loss in funding the Council has suffered.

98. The Council seeks to manage its risks, at least in the short term, by retaining an adequate level of reserves to allow time for other actions to be taken.

99. A major historical risk has been the financial stability of Surrey County Council. However, this does now appear to be reducing due to action taken at Surrey. Were Surrey CC to fail then a full reorganisation of local government within Surrey is highly likely. Any financial obligations entered in to by Surrey Heath would transfer to the new Council.

EQUALITIES

100. The strategy has been prepared as far as possible in line with the Council's approach to equalities in that it does not discriminate or support discrimination on the grounds of age, disability, gender, race, religion or belief, or sexuality. The effect on protected groups of actions required to deliver the strategy would form part of an Equalities impact assessment when those changes are considered

OVERALL CONCLUSIONS

101. This strategy and forecast give an overview of the current and future position of the Council's finances. Prospects for the Borough's finances are better than they might have been due to the focus on income generation, but the financial challenges continue to grow in the years ahead.

102. Holding the levels of reserves it does enables the Council to not only manage cyclical risks around areas such as property, but also to give it time to plan for the more strategic changes that are needed if it is to remain financially sustainable. So far, the Council's track record has been good. Savings have been achieved, income generated and most importantly services maintained, however the challenge continues. New initiatives in terms of climate change and poverty as well as increasing demand will increase costs. Hence, work will need to continue to seek more efficiencies and to generate income. This could come from new charges, commercialisation, investment and closer collaboration with other Councils even if this means giving up some control in the process.

103. Whilst the last few years have brought challenges to Councils, they have also given real opportunities to those that are prepared to take the initiative. Surrey Heath has shown historically that it can take difficult decisions. It will need to continue to be innovative, commercial and brave if it is to address the financial challenges it faces.