REPORT 1

HARBOROUGH DISTRICT COUNCIL

URGENT REPORT TO THE CABINET MEETING OF 1 NOVEMBER 2021

PUBLIC REPORT: Y

EXEMPT REPORT: N

Report Title	**Budget Setting Principles: Budget 2022/23 and Medium-Term financial Strategy (2023/24 to 2026/27)**
KEY DECISION	No
Report Author	Clive Mason – Director: Finance, ICT & Assets
Purpose of Report	To highlight to members the budget setting process and get agreement on key principles to support the development of the Budget for 2022/23 and the Medium-Term Financial Strategy (2023/24 to 2026/27).
Reason for Decision	To support the development of the Budget and Medium-Term Financial Strategy.
Portfolio (holder)	Cllr James Hallam – Portfolio Holder for Resources
Corporate Priorities	YOUR COUNCIL: creative, proactive, and efficient CO 08 – Deliver financial sustainability for the future
Financial Implications	These principles will set the foundation for the setting of the 2022/23 budget and the MTFS. These principles are similar in nature to those applied for the 2021/22 budget (& MTFS). Further they are complementary to the Councils service transformation programme.
Risk Management Implications	These principles will help to mitigate the risk of excessive inflationary impacts within the Councils service delivery model.
Environmental Implications	There are no direct environment implications arising from this report.
Legal Implications	This report supports the Chief Financial Officer in meeting his statutory responsibilities in respect of the proper administration of the Councils financial affairs [s.151 of the Local Government Act 1972].
Equality Implications	There are no direct equality implications arising from this report.
Data Protection Implications	There are no direct data protection implications arising from this report.
Consultation	Cabinet
Background Papers	None
Appendices	**Appendix 1**: Budget Principles for the 2022/23 Budget and MTFS (2023/24 to 2026/27)

REPORT 1

Recommendation	To approve the budget principles and definitions that are summarised in **Appendix 1.**

REPORT 1

1 Introduction

1.1 Over the summer of 2020, the Council recognised it faced a considerable financial challenge, and to meet this challenge it undertook a fundamental review of all services; known as Budget Challenge 2025 (the results of this programme were reported to Cabinet in September 2021).

1.2 In February 2021, the Council approved the 2021/22 budget and Medium-Term Financial Strategy (MTFS) (2022/23 to 2024/25); the key items of the budget and MTFS are as follows, for 2021/22:

- net expenditure budget of £13.1m, increasing to £13.5m.
- budget requirement of £13.8m, reducing to £10.9m by 2024/25.
- gap of £1.9m, increasing to £2.6m by 2024/25.

1.3 To address the budge gap, over the past 12 months the Council has been undertaking a fundamental budget review (Budget Challenge 2025, BC25); this will generate savings of £9.5m over the current MTFS period. However, there are some significant, although unplanned budget pressures that are expected to impact on the Council over the MTFS period. These items are noted below and were reported to the September Cabient as part of the 2021/22 Quarter 1 Financial Performance Monitoring:

- Impact of Leisure contract extension; additional resources approved by Council in April 2021.
- Pay Award, which is expected to be above current budget estimates.

2. Strategic Budget Principles

2.1 (A) and (B) below were the Strategic Budget principles that were agreed last year; it is proposed that for budget setting 2022/23 and the MTFS that these principles are again adopted.

Strategic Budget Principles:

A. To maintain, within expected service constraints, service expenditure within the approved net expenditure envelope.

B. To ensure that over the medium term, financial sustainability can be achieved.

2.2 In respect of:

(A), this will be the “Updated Budget” that was reported to Cabinet in September as part of the Quarter 1 Financial Performance Monitoring.

(B), it is fair to acknowledge that this principle was a challenge when setting the 2021/22 budget & MTFS because the results of the BC25 programme were not then known. However, as reported to Cabinet in September, the MTFS, although updated for BC25 and the unplanned budget pressures (1.3) continues to show that financial sustainability over its duration remains a challenge without further significant service transformation. It is therefore fair to keep this principle because financial sustainability must be the Councils long-term aim.

2.3 Currently, members will recall that the MTFS covers 4 years; the budget setting year plus 3 subsequent years. To aid long-term financial planning, when members are asked to approve the 2022/23 budget & MTFS, they will see that the MTFS will be for 5-years; the budget setting year (2022/23) and 4 subsequent years (2023/24 to 2026/27) – this approach will enable the Council to take a longer-term view of its financial horizon.

3 Budget Inflation & Growth

3.1 In any budget setting process, it is necessary to set-out the inflation principles within which certain aspects of the budget will be set. Considering the financial challenge that the Council continues to face the inflation principles that will be applied for 2022/23, and over the MTFS period, will remain similarly “tight” as they were for this year. This “tighter” approach is necessary to help mitigate cost inflation and ensure that the limited financial resources available to the Council are used in the most effective way possible.

Income

3.2 **General Service Income**; it is recommended that all service income relating to fees and charges is again increased by the prevailing RPI rate for the October of the preceding year. As the October 2021 rate will not be known by the time of the Cabinet meeting; it is recommended that delegation be given to the Director; Finance, ICT and Assets to agree, in consultation with the Portfolio Holder for Finance once known. For 2021/22, the increase that was applied was 1.1%). The only exceptions to this standard application of RPI are:

- **Car Parking pay & display tariffs and permits**; these were last increased in April 2021, and it was agreed that the next increase would be applied in 2023/24 (2 years) and then on a 2-year cycle thereafter i.e. 2026/27). Any future review would reflect the prevailing commercial and political considerations at that time; however, it is fair to reflect an increase in car park income in line with the 2-year review. Therefore, a proxy will be applied which is the same as the general service income RPI increase noted above.

- **the Garden Waste service**; the charges for this service were increased for 2021/22. However, it is essential that the principle of cost-neutrality is maintained; especially to ensure that there is equitable treatment between participating and non-participating residents. To achieve “equitability”, it will be necessary for an annual review of charges to eb undertaken to ensure cost-neutrality is maintained.

Budget Principle (1)
General Service Income, to be increased by the RPI rate in the October before the year being budgeted for. The RPI rate to be agreed by the Director; Finance, ICT and Assets in consultation with the Portfolio Holder for Finance.

The only exception to the application of the RPI rate is in respect of:

i. Car Parking pay & display tariffs and payments; whereby the general service income increase noted above will be applied in 2023/24 and 2025/26.
ii. The Garden Waste service to be reviewed annually to ensure cost-neutrality between participating and non-participating residents.

Costs

3.3 **Pay Inflation**; the Council is part of the national local government pay-bargaining process. In respect of 2020/21 the current pay award was 2.75%.

3.3.1 The most recent expert advice in respect of current pay rises is showing the following:

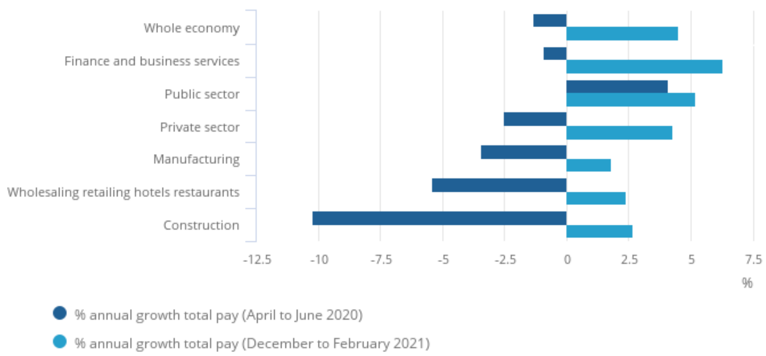
- Willis Towers Watson (advisory, insurance and risk management) indicated in December 2020 that for 2021, the average pay rise in the private sector is 2.4%.
- the Office of National Statistics in February 2021 (published May 2021) were indicating that,

  - Current average pay growth rates for all sectors are being affected upwards by a fall in the number and proportion of lower-paid jobs compared with before the coronavirus (COVID-19) pandemic; it is estimated the net impact of recent job losses is to increase the estimate of average pay by approximately 1.9% - suggesting an underlying wage growth of around 2.5% for total and regular pay.

- ○ Average pay growth for the private sector was 4.3% for total pay and 4.1% for regular pay. As per the graph below; the large increase in public sector pay growth was mainly accounted for by a strong growth in the health and social work industry (5.6%).

Figure 3: Annual percentage growth in total pay has increased in all sectors since early summer

Annual growth in Great Britain nominal average weekly earnings including bonuses by sector, seasonally adjusted, December to February 2021 compared to April to June 2020



Source: Office for National Statistics – Monthly Wages and Salaries Survey

3.3.2 In the 2020 Autumn Statement the Chancellor had indicated that he would restrict public sector pay for 2021/22 to 0%; however, following national pay-bargaining the employers have currently offered 1.75%. Following consultation with the Service Manager for Human Resources and reflecting on the current expert advice, the following are the recommended pay increases for each year of the MTFS. If however, the eventual pay-award is greater than 1.75% this will be adjusted at either the draft or final budget approval stage.

- 2022/23, it is recommended that pay inflation matches the current employers final offer for 2021/22; 1.75%,
- 2023/24 and 2024/25, increased to 2%, and
- 2025/26 and 2026/27, increasing to 2.5%.

Budget Principle (2)
Pay Inflation: to be increased 1.75% for 2022/23, increasing to 2% for the following 2 years and then increasing to 2.5% for the remaining 2 years of the MTFS.

3.4 **Pay Oncosts**; as an employer the Council is required to charge oncosts for National Insurance and Pension. In respect of:

- National Insurance this is set nationally and for budgeting purposes a standard rate of *circ 15%* is used. This reflects the current 13.8% + 1.25%

NIC Levy in respect of Social Care announced by the government in September.

- Pensions, the Council is part of the Leicestershire Local Government Pension Scheme and 2022/23 will be the second year of the triennial valuation period; the employers oncost rate is 31.4%.

It is recommended that both the National Insurance and Pension oncosts rates are applied for next year and over the MTFS period.

Budget Principle (3)
Pay Oncosts: National Insurance and Pensions Oncosts to be circ 15% and 31.4% respectively for 2022/23 and for each year of the MTFS.

3.5 **Vacancy Factor**; the Council includes a Vacancy Factor (VR) within its budget, and they are a standard means of embedding savings within the salaries budget by reflecting the time between a “Leaver” leaving and a “New Starter” starting. Currently VR the stands at £120k and was established based on an accepted “rule of thumb”. Evaluation of the VR for the previous two years has shown that, for those posts that were vacant and not occupied by temporary/interim staff, the saving for each year exceeded the VR (2020/21: 202%; 2019/20: 579%). It is therefore considered that the VR can be increased and based on previous years an increase of 50% would be fair i.e. to £180k.

Budget Principle (4)
Vacancy Factor: to increase the vacancy factor by 50% to £180k.

3.6 **General Service Inflation**; for the first-time last year, the Council set a general service inflation rate 0%. A 0% rate introduces direct cost-control within the Councils service budget; this effectively means that services will have to meet service-related contractual inflation from within their approved budgets.

3.7 However, as per the current MTFS, the only exception to the 0% general service inflation rate was the FCC contract whereby for the current contract, contractual inflation is included. This is because:

- the waste contract it is a financially significant cost to the Council. For 2021/22, this is £4.7m; 19.3% of the Councils gross expenditure; it is therefore essential that the cost of the contract remains structurally integral to the Councils overall budget including contracted inflation which prior to 2021/22 was averaging £137k per annum, and from 2022/23 will be averaging £81k per annum.
- it is an outsourced “direct-services” contract providing a key service to the Councils entire residential community.

3.8 Members should note that from 2025/26 the Council will be required to let a new environmental contract. In respect of the

a) Revenue budget, it is recommended that for the new contract:
   i) the current environment contract estimate, as at 2024/25 is inflated by the average of the inflation increases over the duration of the current FCC for each year of the MTFS.
   ii) A 5% cost escalator is added to the evaluated annual cost to reflect the potential costs associated with the government's potential changes to future waste collection.

b) Capital Programme, at this time the Council does not have its own depot from which any relet service can be based. Consequently, this could potentially pose a significant "cost risk" to the Council if a depot is not acquired in time for the contract relet. To mitigate this risk, it is recommended that within the next capital programme and estimate for depot redevelopment is included. This will also include associated revenue financing costs; Minimum Revenue Provision(MRP). The inclusion of MRP will not only recognise the revenue cost associated with financing a new depot, but it will also mitigate against the potential cost risk if the Council is not able to acquire a new depot and has to include additional within its own budget to meet any such liability of a new provider.

Budget Principle (5)
General Service Inflation to be set at 0%, except for:

i) the current FCC Contract which will be increased in line with contractual inflationary commitments.

ii) the new environmental contract from 2025/26 onwards:

- ***The annual cost to be based on the current 2024/25 environmental contract cost; inflated annually by the average inflation rate of the current contract.***
- ***An additional 5% cost escalator to reflect the potential cost of the government's changes to waste collection.***
- ***The capital programme to include an estimate for a new depot; including associated MRP costs.***

3.9 **General Service Growth**; the assumption is that there will not be any general service growth over the medium term. The only permitted growth will be:

i) that approved via the BC25 process,
ii) any subsequent transformation programme, and
iii) items approved separately by Council.

In respect of (i) and (ii), both will either have net annual revenue savings and/or a net invest-to-save over the MTFS period. Where posts are regraded that *result in a higher grade, then savings elsewhere need to be made to finance the wage growth.*

In addition,

Budget Principle (6)
General Service Growth; there will not be any general service growth, except where:

i) ***growth has been permitted via the Budget Challenge 2025 process, any subsequent transformation programme or that which has been approved separately by Council.***

ii) ***where costs must increase (i.e. due to post regrading's), savings elsewhere will be required to neutralise the additional cost.***

Non-Service Funding & Related Indices

3.10 **Non-Domestic Rates** (NDR, or Business Rates); the Council is currently part of the Leicestershire Business Rates Pool (LBRP) and up to March 2020, the total contributions to the to LBRP are £33.8m; of which £31.8m has been allocated for investment across Leicestershire. Of this, approximately:

- £8.2m (24%) relates to receipts from the Harborough area that would otherwise have been paid over to the government (this is based on the pooling arrangement since 2015/16).
- £1.6m (21%) of the District allocations has been allocated to the Harborough area for investment *(NB. £1.6m represents 7% of total contributions, but the LBRP would not exist if Leicester City and Leicestershire County Councils, as "Top-Up" authorities were not part of the LBRP)*.

3.11 Currently, the Rates Pool allocation arrangement is being reviewed and receipts from 2020/21 are yet to be distributed. At this time no estimate of future receipts will be included in the budget, MTFS or capital programme.

3.12 However, in respect of the Councils own NDR, it is recommended that the Council continues with its prudent approach of budgeting for NDR receipts at previous year's budget levels, with any increases only based on:

- known commercial developments that will deliver "certain" NDR growth within the MTFS period, and
- the governments annually set NDR multiplier (this will not be known until the provisional financial settlement is announced later in the year).

The reason for this prudent approach is so that it provides a more stable stream of funding from which the Council can deliver services sustainably over the medium-term.

Budget Principle (7)
Non-Domestic Rates:

i) ***future receipts from the Leicestershire Rates Pool will not be included in the budget, MTFS or capital programme.***
ii) ***only known commercial developments that will deliver "certain" NDR growth.***
iii) ***the NDR income stream will be inflated by the government's stipulated multiplier.***

3.13 **New Homes Bonus** (NHB); for 2021/22 the Council committed to start to remove NHB from its base budget.

3.14 It is likely that local government will see a further one-year settlement, if this is the case then the following is proposed (this replicates the NHB approach included in the current MTFS):

Budget Principle (8)
New Homes Bonus:

i) ***Any one-year allocation is allocated to earmarked reserves; 33% to Community, Economic & Infrastructure, 67% to Commercial Investment.***
ii) ***Previous legacy payments; 50% allocated to the Commercial Investment earmarked reserve and the balance to remain within the base.***

Fair Funding

3.15 Fair Funding (FF) is a government led initiative to develop a new funding formula. Its intention is to rebase local government funding to enable a more equitable distribution of centrally allocated funds; primarily via the business rates system. It is anticipated that FF will have a negative impact on the southern and midlands councils and current modelling is showing a worsening funding settlement over the medium-term. In addition, it is expected that the government will "reset" the NDR baseline; this will remove some of the "growth" currently within the Councils NDR receipts. However, because of the coronavirus pandemic the government had originally planned to delay FF until 2022/23; but now it is expected that it will be later. In anticipation of a potential negative FF impact, it is recommended to again include a prudent "negative funding adjustment", based on current MTFS amounts but increased by 15% per annum:

- 2022/23 £ 99k (£ 86k+15%)
- 2023/24 £198k
- 2024/25 £297k
- 2025/26 £396k
- 2026/27 £495k

Budget Principle (9)
Fair Funding:
To help mitigate the future impact of Fair Funding (& the NDR "reset"), to include a negative funding stream of £99k, 2022/23; £198k, 2023/24; £297k, 2024/25; £396k, 2025/26; £495k, 2026/27).

Collection Fund (Surplus)/Deficit

3.16 In January each year the Council is required to calculate its estimated share of the Collection Fund as at the forthcoming 31st March. If it is a surplus, this increases the funding available to the Council, but if it is a deficit this is an additional funding pressure.

3.17 As a consequence of Covid-19, the Council is currently modelling a Collection Fund deficit of £804k for the next 2 years; partially financed from government support of £503k per annum. However, a definitive surplus or deficit cannot be calculated until January due to the inbuilt volatility within the Collection Fund account (i.e. an individual or business's ability to pay).

Budget Principle (10)
Collection Fund (Surplus)/Deficit:
The Council will spread any forecast 31st March 2021 Collection Fund Deficit in line with legislation.

Council Tax Base

3.18 The Local Government Finance Act 1992, as amended, requires the Council to fix the Council Tax base for 2022/23 between 1 December 2021 and 31 January 2022. The calculation will be prepared in accordance with the Regulations 'Local Authorities (Calculation of Council Tax Base) Regulations 2012 (SI: 2012/2914)' which came into force on 30 November 2012, to enable local authorities to calculate the tax base for the financial year 2022/23. The Council Tax Base is defined as the number of Band D equivalent properties in a local authority's area. An authority's tax base is considered when it calculates its council tax. It is calculated by adding together the "relevant amounts" (the number of dwellings) for each valuation band then multiplying the result by the Council's estimate of its collection rate for the year (this collection rate will reflect past rates and estimated of bad debt). For 2021/22 there was an overall increase in the council tax base, although some individual parishes tax bases did decrease. However, there was a significant increase in the irrecoverable rate due to the Coronavirus Pandemic (increased from 1% to 2%); at this time it is proposed that, subject to modelling, a 2% irrecoverable rate is applied for 2022/23.

Budget Principle (11)
Council Tax Base:
Subject to modelling, an irrecoverable rate of 2% is applied when the Council Tax Base is calculated prior to budget setting.

General Budget Definitions

3.19 Having prepared the budget last year, some “definitions” of aspects of the budget is necessary to aid understanding and its operation:

1) The **Budget** is for the year that the Council Tax is set and a commitment of resource allocation. It includes the following revenue items:
    - net service expenditure,
    - capital financing (otherwise known as minimum revenue provision; MRP),
    - reserve contributions,
    - grants,
    - collection fund surplus, and
    - council tax – but for only the year that the Council Tax is being set.
2) The **Medium-Term Financial Strategy (MTFS)** shows an intention to future years resource allocations. The duration of the MTFS is for the 4-years following the Budget year.
3) The **Capital Programme** includes the gross capital expenditure and sources of finance and covers both the budget year and the duration of the MTFS.
4) The Budget, MTFS and Capital Programme are **‘organic’ plans** for spending and can flex to reflect current and future financial commitments. However, there is the statutory requirement to deliver a balanced budget. Where during the year it is established that there will be an increase in service net expenditure and/or reductions in grant, NDR or Council Tax; this “net excess budget position” (underachievement of budget) can only be financed by a higher than planned increase in the General Fund (Unallocated) reserve allocation (the opposite is true where there is a “net reduction in the budget position” i.e. overachievement of budget). Such allocations will be reported to Cabinet and Scrutiny as part of the routine quarterly financial performance monitoring process.

Appendix 1

Budget Principles for the 2022/23 Budget and MTFS (2023/24 to 2026/27)

Report Paragraph Reference	Budget Principles and Definition	
Strategic Budget Principles:		
2.1	A	To maintain, within expected service constraints, service expenditure within the approved net expenditure envelope.
2.2	B	To ensure that over the medium term, financial sustainability can be achieved.
Service and Corporate Budget Principles:		
3.2	1	**General Service Income**…. to be increased by the RPI rate in the October before the year being budgeted for. The RPI rate to be agreed by the Director; Finance, ICT and Assets in consultation with the Portfolio Holder for Finance. The only exception to the application of the RPI rate is in respect of: i. Car Parking pay & display tariffs and payments; whereby the general service income increase noted above will be applied in 2023/24 and 2025/26. ii. The Garden Waste service to be reviewed annually to ensure cost-neutrality between participating and non-participating residents.
3.3	2	**Pay Inflation**….to be increased 1.75% for 2022/23, increasing to 2% for the following 2 years and then increasing to 2.5% for the remaining 2 years of the MTFS.
3.4	3	**Pay Oncosts**….*National Insurance and Pensions Oncosts to be circa 15% and 31.4% respectively for 2022/23 and for each year of the MTFS.*
3.5	4	**Vacancy Factor**….to increase the vacancy factor by 50% to £180k.
3.8	5	**General Service Inflation**….to be set at 0%, except for: i. the current FCC Contract which will be increased in line with contractual inflationary commitments. ii. in respect of a new environmental contract from 2025/26 onwards:

		• The annual cost to be based on the current 2024/25 environmental contract cost; inflated annually by the average inflation rate of the current contract. • An additional 5% cost escalator to reflect the potential cost of the governments changes to waste collection. • The capital programme to include an estimate for a new depot; including associated MRP costs.
3.9	6	**General Service Growth**….there will not be any general service growth, except where: i. growth has been permitted via the Budget Challenge 2025 process, any subsequent transformation programme or that which has been approved separately by Council. ii. where costs must increase (i.e. due to post regrading's), savings elsewhere will be required to neutralise the additional cost.
3.12	7	**Non-Domestic Rates:** i. future receipts from the Leicestershire Rates Pool will not be included in the budget, MTFS or capital programme. ii. only known commercial developments that will deliver "certain" NDR growth. iii. the NDR income stream will be inflated by the government's stipulated multiplier.
3.14	8	**New Homes Bonus:** i. Any one-year allocation is allocated to earmarked reserves; 33% to Community, Economic & Infrastructure, 67% to Commercial Investment. **ii.** Previous legacy payments; 50% allocated to the Commercial Investment earmarked reserve and the balance to remain within the base
3.15	9	**Fair Funding**….to help mitigate the future impact of Fair Funding (& the NDR "reset"), to include a negative funding stream of £99k, 2022/23; £198k, 2023/24; £297k, 2024/25; £396k, 2025/26; £495k, 2026/27).
3.17	10	**Collection Fund (Surplus)/Deficit**….The Council will spread any forecast 31st March 2021 Collection Fund Deficit in line with legislation.
3.18	11	***Council Tax Base:*** subject to modelling, an irrecoverable rate of 2% is applied when the Council Tax Base is calculated prior to budget setting.

General Budget Definitions		
3.19	1	The **Budget** is for the year that the Council Tax is set and a commitment of resource allocation. It includes the following revenue items: • net service expenditure, • capital financing (otherwise known as minimum revenue provision; MRP), • reserve contributions, • grants, • collection fund surplus, and • council tax – but for only the year that the Council Tax is being set.
3.18	2	The **Medium-Term Financial Strategy (MTFS)** shows an intention to future years resource allocations. The duration of the MTFS is for the 4-years following the Budget year.
3.18	3	The **Capital Programme** includes the gross capital expenditure and sources of finance and covers both the budget year and duration of the MTFS.
3.18	4	The Budget, MTFS and Capital Programme are **‘organic’ plans** for spending and can flex to reflect current and future financial commitments. However, there is the statutory requirement to deliver a balanced budget. Where during the year it is established that there will be an increase in service net expenditure and/or reductions in grant, NDR or Council Tax; this “net excess budget position” (underachievement of budget) can only be financed by a higher than planned increase in the General Fund (Unallocated) reserve allocation (the opposite is true where there is a “net reduction in the budget position” i.e. overachievement of budget). Such allocations will be reported to Cabinet and Scrutiny as part of the routine quarterly financial performance monitoring process.