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**Adrian Waite (Independent Consultancy Services) Limited**

**9th January 2018**

Mr. Clive Howey,
Director of Finance,
Eden District Council,
Town Hall,
Penrith,
Cumbria.
CA11 7QF.

Sent by e-mail.

Dear Mr. Howey,

**Budget Consultation**

I write in response to your budget consultation in my capacity as a resident of the Eden District and as Managing Director of 'AWICS Limited' a management consultancy company that is based in the district.

My answers to the questions that you ask in your consultation are as follows:

1. Please provide your comments on the draft budget.

Revenue Reserves

I have always been surprised at the high level of general fund reserves that are maintained by the Council. I obviously understand that it is prudent to maintain an adequate level of reserves but there is a difference between an adequate and prudent level and an excessive level. The annual accounts show that reserves increased from £8.2million at 31st March 2016 to £8.6million at 31st March 2017. This represents 23 months of Council Tax revenue. In effect, every penny of Council Tax that residents have paid from May 2015 to March 2017 remained unspent in the bank!

The Council is planning to increase reserves to £8.7million by 31st March 2021. However, the actual increase may be even larger due to 'over budgeting' (see below).

The usual reason for a Council to hold reserves is to guard against unforeseen overspending. However, I would hope that the Council's budget monitoring processes would be sufficiently good to avoid an overspend of up to £8.7million on a £7.3million budget! Another reason would be to ensure that the Council has sufficient cash, but cash balances appear to be more than sufficient at £2.7million backed by other current assets of £10.6million (see below).

Furthermore, the Council also held a further £3.8million in useable earmarked reserves at 31st March 2016 that increased to £5.8million at 31st March 2017 so the total reserves actually stood at £14.4million at 31st March 2017 (representing three years' Council Tax revenue).

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This included the following:

- Affordable Housing Fund - £1.7million in 2016, £1.8million in 2017.
- Renewals Fund - £0.9million in 2016, £1.1million in 2017.
- Community Housing Fund – nil in 2016, £0.9million in 2017.
- BRRS Reserve – nil in 2016, £0.8million in 2017.
- Homelessness Reserve - £0.5million in 2016, £0.4million in 2017.
- Capital Funding Reserve - £0.4million in 2016, £0.4million in 2017.
- Other Reserves - £0.3million in 2016, £0.4million in 2017.

The amounts set aside in these reserves are increasing rather than being spent. It also appears to me that these reserves may be general reserves rather than sums set aside to meet specific liabilities.

It appears to me that the Council may have a policy of managing risk by having large reserves. Accumulating reserves on this scale by failing to use the resources that are available to the Council may be a sign of poor financial management rather than a sign of good financial management.

It also appears to me that an opportunity exists to bring forward capital or non-recurring schemes to improve the infrastructure of the district and / or to 'invest to save' that may be being missed in the draft budget as it is currently being presented.

The view was expressed in the budget reports for 2015/16 and 2017/18 that reserves should be maintained at between £1.5million and £2.0million – equivalent to about a quarter of the annual spend. In this year's budget papers there is a reference to 'a normal minimum of £1.5million'. I would suggest that the Council budget to reduce its reserves to that level.

Council Tax

In view of the need for the Council to maintain important services in the district I am surprised that the Council is proposing to freeze Council Tax in 2018/19. Inflation is currently running at just over 3% and in the local government finance settlement for 2018/19, announced in December 2017, government announced that local authorities could increase Council Tax by up to 3% without having to hold a local referendum (in the case of Eden District Council this could be even more because of the 5% flexibility).

The government currently controls the level of Council Tax that councils can charge by limiting annual increases rather than by setting any sort of cap. This means that a decision not to increase Council Tax in one year depresses the capacity of the Council to raise Council Tax permanently. For this reason, it is often considered unwise for Councils not to increase Council Tax by the maximum permitted by government.

I would therefore suggest that the Council should increase Council Tax by at least 3% in 2018/19; but only if the Council can demonstrate that it has a robust plan to spend these resources in a way that would benefit the people of the district.

Interest on Balances

The Council's Resources Plan states that:

*"Latest advice from the Council's advisers indicates that the Base Rate will remain at its current rate of 0.25% for the period of the Medium Term Financial Plan."*

However, the base rate has already been increased to 0.5%. I therefore assume that the draft budget does not take account of this increase in interest rates.

The 2018/19 budget report states that:

*"Interest returns will be 0.6% in 2018-2019 and 0.5% thereafter. This may be over prudent."*

This is the same wording that was included in the 2017/18 budget report, suggesting that the Council has not reconsidered the prospects for interest rates during the last twelve months. Most forecasts of interest rates now show them increasing during 2018/19 and subsequent years. If these forecasts are correct, it is likely that the budget for interest on balances will prove to have been significantly under-estimated.

Over-Budgeting

The proposed budget for 2018/19 and budgets for all recent years have included provision of £150,000 a year for 'over-budgeting'. If I understand what is meant by 'over-budgeting' correctly I find this rather disturbing. My understanding of the situation is that, because some of the Council's budgets are excessive they are likely to be underspent (accountants sometimes call this 'budget slack') and so the Council has decided to count on an underspending of £150,000 occurring each year.

In 2015/16 the Council underspent on its budget by £1.5million on a net expenditure of £7.5million – a 20% under-spend. In 2016/17 the Council underspent on its budget again, this time by £2.2million on a net expenditure of £8.8million – a 25% under-spend. It is generally considered to be evidence of good financial management if there is an under-spend of less than 2%.

As Eden District Council usually reports a significant under-spend on its revenue budget, this leads me to suspect that the Council may be over-cautious in the preparation of its estimates with the result that its budgets contain significant 'budget slack'.

The budget report for 2017/18 seemed to admit that this was the case and states (for example) that:

*"Based on previous years, there is a tendency for a degree of underspend. This is a function of having a large number of budgets, some of which are not always fully used due to circumstances. Such a provision has been included in the last few years. The proposed level of £150,000 was used for 2015-2016."*

This does not appear to me to represent good practice. There are two reasons for this: Firstly, if managers have budgets that are excessive there is little incentive for them to exercise effective budgetary control; and secondly, if the estimated 'underspend' does not materialise the Council will 'overspend'. Most accountants would say that it would be good practice to identify the excessive budgets and reduce them to a reasonable level rather than indulging in 'over budgeting'. I wonder if this approach to budgeting is linked with the apparent policy of managing risk by having high levels of reserves!

The Chartered Institute of Public Finance & Accountancy, in its workbook for students of Management accounting considers 'budget slack' as a problem and defines it as follows:

*"Carrying forward past inefficiencies to future periods within the budget is one reason for the existence of budgetary slack. Budgetary slack refers to areas of the budget where the value of the budget is more than is really required for delivery of the budget."*

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I would suggest that the Council consider changing its approach to this matter.

Central Services

It has appeared to me for some time that the Council is tending to reduce budgets for direct services and increase budgets for central services. This appears to be happening in the draft budget for 2018/19 as shown below:

| | 2016/17 Actual £,000 | 2017/18 Estimate £,000 | 2018/19 Estimate £,000 |
|---|---|---|---|
| Leader's Portfolio | 122 | 147 | 153 |
| Resources Portfolio | 1,603 | 2,161 | 2,228 |
| Central Services | 1,725 | 2,308 | 2,381 |
| Variation | | +33.8% | +38.0% |
| Services Portfolio | 2,312 | 2,570 | 2,315 |
| Commercial Services Portfolio | 647 | 864 | 840 |
| Eden Development Portfolio | 688 | 342 | 511 |
| Housing & Health Portfolio | 1,151 | 1,248 | 1,022 |
| Communities Portfolio | 1,050 | 1,077 | 841 |
| Direct Services | 5,848 | 6,101 | 5,529 |
| Variation | | +4.3% | -9.4% |

In 2017/18 the Council budgeted for an increase of 4.3% in direct services and an increase of 33.8% in central services compared with 2016/17; and in 2018/19 it is budgeting for a reduction of 9.4% in direct services and an increase of 38.0% in central services compared with 2016/17. I would suggest that the Council considers focusing its resources more on delivering front line services.

Capital Programme and Prudential Borrowing

The summary capital programme shows the Council's investment in the district declining from £3.9million in 2017/18 to £0.7million in 2018/19 and to £250,000 in the following years. Included within this are mandatory renovation grants of £500,000 in 2018/19 and £250,000 a year in subsequent years that are funded by the Better Care Fund and not by the Council. There are also capital growth proposals of £310,000 in 2018/19.

In the press release that accompanied the budget consultation, the Leader of the Council stated that:

*"We can also look at how we can use our assets to support economic development and create extra income to keep Council Tax low."*

However, the budget proposals do not appear to be very ambitious in this regard. After 2018/19 the Council is proposing to spend none of its own resources on a capital programme! It is hard to see how this approach can adequately support the Council's corporate priorities that are:

- Decent Homes for All
- Strong Economy, Rich Environment
- Thriving Communities
- Quality Council.

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For example, one of the Council's strategic actions is to support housing that is affordable to buy, rent, self-build, and live in and bring empty homes back into use. It is difficult to see how this objective if no resources are allocated to it in the capital programme.

I would suggest that the Council should consider what options exist for sustaining a larger capital programme into the future. When I was Finance Director at Copeland Borough Council we resourced a capital programme that peaked at £19.6million a year.

The Council's balance sheet shows total assets of £57.2million and reserves of £42.5million as at 31st March 2017. This is a considerable sum and I am not convinced of the evidence that the Council is making best use of its resources and assets to invest for the benefit the community. For example:

- £8.7million is held as cash and short-term investments. This is £1million less than at the end of the previous year, but is still a significant amount. Is this a good use of resources?
- £21.8million is held as investment property and long-term investments. This is an increase on the previous year. Is this a good use of resources?
- Only £21.2million is held in Property, Plant, Equipment and Heritage Assets. This is slightly less than the previous year. Should the Council be investing more in infrastructure for the benefit of the community rather than in cash investments?

If the Council was a housing association, it would be required to 'sweat its assets'. Perhaps the Council should act more like a housing association and use its considerable assets to improve the infrastructure of the district including for housing and economic development.

The draft budget does not propose to make any use of the prudential borrowing powers that the Council has enjoyed under the 2003 Local Government Act ever since 2004/05. Instead the report states (using identical wording to that used in last year's budget report) that:

*"For planning purposes, it is assumed that no borrowing will be undertaken beyond that currently in place, as the Council currently has sufficient capital resources to fund the current Capital Programme. When these resources are fully exhausted, a detailed business case will have to be undertaken to identify if borrowing can be justified within the framework of the Prudential Code."*

This appears to me to be a circular argument: If the capital programme is based on what can be afforded without borrowing it follows that borrowing will not be required to fund it. However, the Council has identified important objectives not least in economic development and housing that require capital resources to be committed. I therefore feel that the Council may be missing an opportunity by not even considering the use of its borrowing powers. The use of identical wording in budget reports each year suggests that the prudential borrowing strategy has not been reviewed for 2018/19.

Despite the budget papers stating that the Council has no capacity to borrow, I note the report on the front page of the 'Cumberland & Westmorland Herald' of 6th January 2018 headed 'Council to borrow £2.2million for Town Hall re-vamp' that states that:

*"Eden Council wants to borrow more than £2million to make Penrith Town Hall 'fit for purpose' for the delivery of public services and business growth opportunities at its Mansion House offices. Chief Executive, Robin Hooper, has outlined a vision which involves the building of an extension at the Town Hall to be paid for by a £2.2million loan from the Public Works Loans Board that would be added to the 2018/19 capital programme."*

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I find it surprising that such a significant proposal that conflicts with the Council's established policy on Treasury Management and Prudential Borrowing that is confirmed in the budget documents should be made after the Council has already received and approved the draft budget documents. However, I also find this proposal interesting because it shows that the Council is prepared to countenance borrowing to fund office accommodation whereas down the years it has consistently set its face against borrowing to fund affordable housing!

I would therefore suggest that the Council should review its borrowing policy annually to ensure that it considers its finances and its capital programme in a comprehensive way. Indeed, it is my understanding that The Chartered Institute of Public Finance and Accountancy's code of practice on treasury management and the Prudential Code require local authorities to determine a treasury management strategy statement and set prudential indicators, on an annual basis. All local authorities with which I am familiar do this.

As outlined above, I think there is potential to increase the size of the capital programme by using reserves to fund revenue contributions to capital outlay and headroom in the general fund to fund prudential borrowing.

In 2015/16 the Council's revised capital programme was £1,593,000 while actual expenditure was only £778,000 (only 49% of budget). This was due to significant 'slippage' in budgets including housing renovation grants and the affordable housing innovation fund both of which have been identified as being of strategic importance.

In 2016/17 the Council's revised capital programme was £1,150,000 while actual expenditure was only £717,000 (only 62% of budget). This 'slippage' was slightly less than in the previous year but was still significant. It occurred in budgets again including the affordable housing innovation fund.

There may therefore be a need to consider how the Council can improve its project management arrangements.

Risk Management

Any budget or financial plan represents merely one possible financial outcome for the year or financial period under consideration – even though it is the outcome that is considered most likely and for which plans are made. However, the budget and financial plan are underpinned by data and assumptions and there is a risk that in practice events may differ from those that have been assumed. The Council's budget papers identify several uncertainties that affect the budget. There is therefore a need to identify key variables and to subject them to rigorous sensitivity analysis and 'stress testing'.

'Stress testing' involves considering what combination of risks would 'break' the budget or financial plan if they were to occur and considering how to manage the possibility of such a combination of risks occurring.

I think that inflation is a risk to local authorities moving forward. The Office for Budgetary Responsibility revised its inflation forecasts upward in November 2017 and many commentators consider that inflation will exceed these forecasts. I therefore trust that the Council has included increased inflation as a risk in its risk assessment and has appropriate arrangements in place to manage this risk.

Economic Development

I think that the Council has correctly identified economic development as a major priority. While the district enjoys low levels of unemployment, much of the employment that is available is part-time, seasonal, low wage and / or insecure. There is a need to build an environment in which more secure high-value businesses will develop.

Housing

I think that the Council has correctly identified affordable housing as a major priority.

The Council's proposals to support housing are to be welcomed, especially the:
- Commitment to provide loans to a Registered Social Landlord through the Affordable Housing Innovation Fund of £1million that will be realised by 31 March 2018.
- Proposal to establish a £6million fund for new affordable homes, to support community-led housing projects and housing provided through the Heart of Cumbria Limited (the Council's commercial arm). This could be financed by existing Council resources, as the investment will provide higher income returns than is currently available through banks. Income generated will be used to support housing services.

I would suggest that the Council should support this priority with significant budgets for new affordable housing, disabled facilities grants and discretionary housing payments.

Heart of Cumbria

The creation of the 'Heart of Cumbia' as a commercial arms-length vehicle that is designed to use the Council's resources to achieve the Council's objectives is to be welcomed. I also note that the Council's capital programme for 2017/18 includes provision for a loan of £1million to the Heart of Cumbria that I understand has already been made to the company.

My understanding is that a £1million loan was approved by full Council in January 2017 on the basis that £500,000 would be available to fund affordable homes and £500,000 would be available to fund commercial investments and that the Council would expect a return on its investment of 3%. It was also agreed that the Council would not expect to receive a return if the company failed to make a profit.

However, the evidence from reports in the media is that there appears to be some confusion regarding the purpose and priorities of 'Heart of Cumbria'. As shareholder, the Council has instructed the directors to:
- Provide affordable housing
- Seek economic growth and higher paid jobs
- Seek a 3% return on any Council investment

I understand it has also been agreed that 'Heart of Cumbria' should consider:
- Buying and managing housing for people in need, for people who are key workers and market housing
- Buying and managing commercial and / or residential property generating an income above the threshold of 3%
- Development schemes involving non-Council owned land
- Development schemes involving the Council land
- Renewable energy schemes

I understand that it has been agreed that the work to be undertaken by 'Heart of Cumbria' will include:

- Purchase and management of affordable and key worker housing
- Purchase and management of commercial and residential property investment
- Advice and consultancy from initial feasibility, guidance on planning applications and regulations, legal guidance to a full project management of the total build
- Representation and securing planning permissions
- Total site/project management from tendering through build to final 'sign off', this service will also ensure appropriate contracting, on-going liaison and project management according to the agreed build schedule

However, there is a potential conflict between these objectives. For example, if resources are allocated to economic development they cannot be allocated to housing; while investment in market housing is likely to achieve a higher rate of return than investment in social housing. It is not clear to me what conditions the Council has attached to the loan that it has provided to 'Heart of Cumbria' that will govern how the company should invest the money.

The overall targets of 'Heart of Cumbria' appear to me to be rather vague. They are to achieve:

- Additional income from cash investments for the Council of up to £200,000 a year within five years as a minimum assuming the Council's financial support is forthcoming.
- To facilitate additional new higher paid jobs and employment development.
- To own at least 50 affordable dwellings.

I understand that 'Heart of Cumbria' is considering buying some affordable homes from a developer that have already been offered to local housing associations that have declined to buy them. I am not sure why 'Heart of Cumbria' see them as a good commercial prospect in the circumstances.

The 'Heart of Cumbria' business plan states that the company intends to:

*"Invest in affordable dwellings and also to work with the Council through use of Section 106 monies or other funds with the Council and developers to own the dwellings which would then be managed and rented out by it."*

My understanding is that 'Heart of Cumbria' would have to register with the Homes & Communities Agency as a registered provider if it wished to own and manage social housing. However, I am not aware that the Council has considered the implications of this for 'Heart of Cumbria' (for example a registered provider must be a not-for-profit company) or for the Council.

I would have thought that the Council would have prepared a business case for the establishment of 'Heart of Cumbria' before establishing the company and certainly before providing the company with any public funds. This would have identified the objectives that the Council is trying to achieve and demonstrated that creating 'Heart of Cumbria' would not only be able to achieve those objectives but would be the best way to achieve those objectives. However, I have not been able to identify the existence of such a report.

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It appears to me that the arrangements with 'Heart of Cumbria' probably present financial risks to the Council, but it is not clear to me from the budget papers whether these risks have been assessed and how they have been accounted for in the risk strategy (for example the risk that 'Heart of Cumbria' may not achieve a rate of return of 3% on its investments) or the finances (for example in the provision for doubtful debts -  what is the probability that the loans to 'Heart of Cumbria' will not be repaid?).

I would suggest that the Council should consider introducing greater clarity and transparency regarding the role of 'Heart of Cumbria' and its financial arrangements; and should consider any implications for the Council's approach to risk management.

Fair Funding Review

At the same time as announcing the financial settlement for 2018/19, Sajid Javid, the Secretary of State for Communities & Local Government, published a consultation paper on what he described as a fairer funding system for local government. This Fair Funding Review could significantly impact on the future financial assumptions.He said that:

*"I am today publishing a formal consultation on a review of relative needs and resources. I aim to implement a new system based on its findings in 2020/21. One particular issue that has caused concerns for some councils is the so-called negative Revenue Support Grant.*

*"I do recognise the strength of feeling in local government around this issue. So I can confirm that my department will be looking at fair and affordable options for dealing with negative Revenue Support Grant and we will formally consult on proposals in the spring."*

The Council has received favourable local government finance settlements in recent years, but it is important that the Council engages fully with the Fair Funding Review when appropriate.

2. Are you in favour of a £300,000 fund for Town and Parish Councils in the 2018/19 budget?

Yes, although I would suggest that it should operate on the basis that the Fund should cover 50% of the costs of any scheme for which it is used with Town and Parish Councils providing the other 50% of the funding from their own resources. This would help to ensure that the scheme resulted in additional services being provided.

3. Are you in favour of establishing a £6million fund for housing?

My understanding of this proposal is that the Council would establish a £6million fund for new affordable homes, to support community-led housing projects and housing provided through 'Heart of Cumbria'. The Council considers that this could be financed by existing Council resources, as the investment will provide higher income returns than is currently available through banks. The Council intends that income generated will be used to support housing services.

As outlined above I am in favour of the Councl using its resources to support the development of affordable housing through grants and / or loans and through 'Heart of Cumbria' and / or directly. However, I cannot identify provision for this within the Council's draft budget papers.

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Conclusion

In the Council’s press release, the Leader of the Council is quoted as saying that:

*“This is a budget proposal for jobs, for housing and for growth, to improve the quality of life for residents and businesses.”*

However, it appears to me that the Council has not taken every opportunity that it could have done to pursue these objectives as I have outlined above.

I think that the Council is being insufficiently ambitious in this budget and that there appears to be scope to improve financial management. I would suggest that the Council consider:

- A more significant capital programme to address especially the economic development and housing objectives that it has identified, funded through surplus reserves, prudential borrowing and more effective asset management; and perhaps delivered through ‘Heart of Cumbria’.
- Providing greater clarity and transparency about the objectives and activities of ‘Heart of Cumbria’.
- Improvements to the project management of the capital programme.
- Approving revenue budgets that do not contain ‘budget slack’, that aim to reduce reserves to an appropriate level and that focus resources on direct services.
- Increasing Council Tax by 3% in 2018/19.

I hope that you find these observations useful. If you have any questions about any of the issues that I have raised I would be pleased to hear from you.

Yours sincerely,

Adrian Waite

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**Managing Director**

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