



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

**24th February 2020**

Mr Paul Sutton,  
Interim Chief Financial Officer,  
Eden District Council,  
Town Hall,  
Penrith,  
Cumbria.  
CA11 7QF.

Sent by e-mail to: [paul.sutton@eden.gov.uk](mailto:paul.sutton@eden.gov.uk)

Dear Paul,

### **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.

First, I would like to thank you for agreeing to meet with me to discuss the budget consultation on 4<sup>th</sup> February 2020. Having read your report and discussed it with you, I am sure that the concerns that I have expressed about financial management at Eden District Council during recent years are now being addressed.

My observations on your budget and financial management are as follows:

#### Over-Budgeting

The Council, in common with most councils, uses 'incremental budgeting' to set its budget. This is based on carrying forward budgets from year to year without necessarily recalculating what might be required and without necessarily checking that the budget figures continue to match actual expenditure and income. A recognised weakness in this approach is that budgets can diverge from reality meaning that budget figures become meaningless and budgets can either be insufficient or excessive. It appears to me that this has occurred at Eden District Council with the budget generally over-estimating required levels of expenditure and under-estimating income. During recent years, this has led to the Council making un-necessary cuts at budget time only to under-spend at the year-end thus accumulating excessive reserves.

The budget for 2019/20 and budgets for other recent years have included a provision for 'over-budgeting'. This is explained in past budget papers as follows:

*"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."*

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I have always found 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 occurring each year. In 2018/19 this was increased from £150,000 to £220,000.

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%.

In 2017/18 and 2018/19 the Council also underspent its budget but only by £0.4million in 2017/18 and £0.2million in 2018/19<sup>1</sup>. The projected under-spend in 2019/20 is £0.6million.

I am led to speculate whether the Council may have been unprepared for the relatively low level of under-spend in 2017/18. One of the reasons why this occurred is that expenditure increased by £0.9million (12%) between 2016/17 and 2017/18 especially in the Resources and Housing & Health Directorates as shown below. Expenditure in the Resources Directorate was significantly higher than in the original or revised estimates. It would be interesting to ascertain why some of these increases in expenditure occurred and why the higher level of expenditure has continued since!

	2016/17 £,000	2017/18 £,000	Variation £,000	Variation %
Commercial Services	642	750	108	+16.8%
Communities	1,055	930	125 -	- 11.8%
Eden Development	688	334	354 -	- 51.5%
Housing & Health	125	639	514	+411%
Leader	122	116	6 -	- 4.9%
Resources	2,614	3,223	609	+23.3%
Services	2,310	2,491	181	+ 7.8%
<b>Total</b>	<b>7,556</b>	<b>8,483</b>	<b>927</b>	<b>+12.3%</b>

I understand that the Council is changing its approach to budgeting to address the significant disconnect between the figures in the budgets and the figures in the accounts. This is to be welcomed. I would recommend establishing firmer budgets based either on past performance or on a zero-based approach.

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<sup>1</sup> After applying the £0.2million provision for under-spending. Without this, the underspend would have been £0.4million.

## 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 were £8.2million at 31<sup>st</sup> March 2016, £8.6million at 31<sup>st</sup> March 2017, £8.3million at 31<sup>st</sup> March 2018 and £7.6million at 31<sup>st</sup> March 2019. This represents nineteen months of Council Tax revenue. In effect, every penny of Council Tax that residents have paid from September 2017 to March 2019 remained unspent in the bank at March 2019!

The Council is now budgeting to reduce reserves to £6.5million by 31<sup>st</sup> March 2020. Further reductions in reserves are then forecast due to reductions in funding and the use of reserves to fund loans to 'Heart of Cumbria'<sup>2</sup>, leaving reserves at only £0.3million at 31<sup>st</sup> March 2024.

The Council also held a further £3.8million in useable earmarked reserves at 31<sup>st</sup> March 2016 that increased to £5.8million at 31<sup>st</sup> March 2017, £5.7million at 31<sup>st</sup> March 2018 and £5.4million at 31<sup>st</sup> March 2019. Total reserves increased from £12.0million in March 2016 to £14.4million in March 2017, £14.0million in March 2018 and £13.0million in March 2019 (representing more than two years' and eight months' Council Tax revenue).

The earmarked reserves include:

- Affordable Housing Fund - £1.7million in 2016, £1.8million in 2017, £2.0million in 2018 and £1.2million in 2019.
- Renewals Fund - £0.9million in 2016, £1.1million in 2017, £0.9million in 2018, £1.0million in 2019.
- Community Housing Fund – nil in 2016, £0.9million in 2017, £0.9million in 2018 and £0.8million in 2019.
- BRRS Reserve – nil in 2016, £0.8million in 2017, £0.8million in 2018, £0.1million in 2019.
- Homelessness Reserve - £0.5million in 2016, £0.4million in 2017, £0.1million in 2018, £0.1million in 2019.
- Capital Funding Reserve - £0.4million in 2016, £0.4million in 2017, £0.4million in 2018, £0.4million in 2019.
- Other Reserves - £0.3million in 2016, £0.4million in 2017, £0.6million in 2018, £1.8million in 2019.

The purpose of earmarked reserves is to set aside money for specific identified purposes. However, the amounts set aside in these reserves are often increasing 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 has had 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 appears to me that the Council should develop a more sophisticated approach to managing risks and that balances should be reduced to a prudent but not excessive level.

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<sup>2</sup> 'Heart of Cumbria' is an arm's length company that has been established by the Council (see below).

The Council now rightly recognises that while its current level of reserves is higher than required, it would not be appropriate to allow them to decline below the £1.5million to £2.0million range. This implies either transferring resources from earmarked reserves, finding revenue savings or reducing the planned financial commitment to 'Heart of Cumbria'.

### Refuse Collection and Recycling

The Council is currently in the process of re-tendering its refuse collection and recycling contracts. This should offer opportunities for the Council to advance its strategic objectives including those for addressing climate change, and to seek greater efficiencies. This could include introducing a food waste recycling scheme.<sup>3</sup> The service is currently outsourced so the focus of the Council's approach should be on drafting a specification to address the environmental 'reduce, re-use, recycle' approach. There may be advantages in doing this in consultation with experts in green refuse collection and recycling technology, the County Council (as waste disposal authority), neighbouring authorities (as potential partners), the current contractor and other potential contractors.

There may also be advantages in considering re-establishing an in-house service. Preparing an in-house bid could enable the Council to better understand the operational aspects of the contract, could incentivise keen competition from contractors and could even offer the Council a more cost-effective solution.

### Council Tax

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 support the proposal that the Council should increase Council Tax by £5 for a Band D property in 2019/20.

### Project Management

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' occurred in budgets again including the affordable housing innovation fund.

In 2017/18 the Council's revised capital programme was £4,585,000 while actual expenditure was only £2,401,000 (only 52% of budget). This 'slippage' occurred in budgets including housing and health and the Leader's programme.

In 2018/19 the Council's capital programme was for £6.9million but it was later revised downward to £3.2million of which only £1.7million was spent – including £1.0million to purchase equity in 'Heart of Cumbria' - (only 25% of the original budget).

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<sup>3</sup> The Welsh Government has made food waste recycling a legal requirement and it is now in place in all Welsh local authorities.

The Council's current capital programme for 2019/20 is £5.7million. Expenditure during the first three quarters of the year has been £1.2million and it is expected that expenditure at the year-end will be £1.8million. This represents expenditure of only 32% of the budget. It is expected that nine of the sixteen schemes will underspend significantly.

To illustrate my point about project management, I would like to refer to two of the Council's capital schemes; one large scheme of strategic importance and one scheme that would appear to be relatively small and straightforward.

First, the single site accommodation scheme. It has been the intention of the Council to centralise its office staff at a single site for at least six years. It has been said that this is the Council's main corporate priority. Much money and officer time has been spent on the scheme and a further £2.3million was earmarked in the capital programme for 2019/20 that has not been spent. The staff are still based where they were originally and there is doubt that the scheme will ever be completed. The Council's resources plan notes (in what may be considered an under-statement) that:

*"The main risks in this project are project overspend and overrun."*

Second, the railings between the churchyard and riverside path in Appleby. In December 2015 there was a flood that knocked down a 75metre stretch of railings. It took the Council over three years to appoint a contractor. The eventual cost of the scheme exceeded £100,000 – about £1,300 a metre. It is not clear where the original railings have gone.

Both these examples, and the significant 'slippage' in the capital programme in all recent years, suggest that there is potential for the Council to improve its project management in terms of both effectiveness and value for money.

#### Capital Programme and Prudential Borrowing

The summary capital programme shows the Council's investment in the district declining from £5.9million in 2020/21 to £1.6million in 2021/22, £0.7million in 2022/23 and £1.1million in 2023/24. Included within this are disabled facilities grants of £440,000 a year that are funded by government grants and not by the Council.

The new Council Plan identifies tackling the Climate Emergency as the Council's main priority and identifies priorities including affordable housing and economic development. The Council also has four corporate priorities that are to be sustainable; healthy, safe and secure; connected and creative. However, the capital programme does not appear to allocate any resources to these issues other than loans to 'Heart of Cumbria'. Furthermore, the Council does not appear to have carried out an appraisal or evaluation of the options available to pursue these objectives. For example, the Council does not appear to have considered the relative merits of delivering affordable housing through planning gain, supporting housing associations, providing new homes directly or providing new homes through 'Heart of Cumbria'.

The programme is supported by a combination of direct revenue / reserves (£4.6million), prudential borrowing (£2.3million), capital grants (£1.8million) and capital receipts (£0.7million).

The major schemes are for 'Heart of Cumbria' (£3.0million) and land assembly for the Town Hall site (£2.3million). The Council appears to be relying almost totally on 'Heart of Cumbria' to deliver its strategic objectives especially around housing and economic development but has decided to do this without carrying out a thorough appraisal of options and without having prepared a detailed business case for 'Heart of Cumbria' (see below).

As the capital programme is expected to 'tail off' – especially as uncommitted reserves are spent - I would suggest that the Council should consider what options exist for sustaining a larger capital programme into the future. This could include additional prudential borrowing or a more ambitious asset management policy.

The Council's balance sheet shows total assets of £62.2million and reserves of £47.5million at March 2019. This compares with £62.0million and £48.8million respectively as at March 2018; and £57.2million and £42.5million respectively as at March 2017. This is a considerable sum and I am not convinced that the Council is making best use of its resources and assets to invest for the benefit the community. For example:

- £10.0million is held as cash and short-term investments. This is a significant amount. Is this a good use of resources?
- £22.8million is held as investment property and long-term investments – an increase of £0.3million on the previous year and £1.0million on the previous year. Is this a good use of resources? This may also represent a risk (see below).
- Only £23.4million is held in Property, Plant, Equipment and Heritage Assets. 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.

### 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 annual report identifies inflation; fluctuation in income from retained business rates; central government funding; the impact of Brexit; and potential changes in pension contributions as the main financial uncertainties. The Council's budget papers also 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 would suggest that 'stress testing' be carried out around these risks.

There is increasing concern nationally about how local authorities are investing in property, seeking a financial return and the risks to which they are exposed especially if there is a downturn in property values. Of the Council's total long-term assets of £47.7million, £17.5million is held in investment property so this represents a significant exposure.

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## 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. The Council's chosen vehicle for this is 'Heart of Cumbria' (see below) but it does not appear that the Council has carried out an appraisal or evaluation of all the options available to it to deliver economic development or agreed a business case for 'Heart of Cumbria'.

## Housing

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

The Council has previously proposed to support housing through providing loans to Registered Social Landlords through the Affordable Housing Innovation Fund. However, this scheme no longer appears in the capital programme. I am not sure of the rationale for this.

Last year's budget included a 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. I assume it is now intended to deliver this through the loans that it is intended to make to 'Heart of Cumbria' but, as outlined above, it does not appear that the Council has carried out an appraisal or evaluation of this option against others that exist.

I would suggest that the Council should support this priority with significant budgets for new affordable housing, disabled facilities grants and discretionary housing payments; and should carry out an appraisal and evaluation of all options for the delivery of its housing objectives.

## Heart of Cumbria

The 'Heart of Cumbria' is a commercial arms-length vehicle that is designed to use the Council's resources to achieve the Council's objectives.

My understanding is that an initial £1million loan to 'Heart of Cumbria' 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 subsequently decided that this would be equity rather than a loan. It was also agreed that the Council would not expect to receive a return if the company failed to make a profit.

I understand that this initial investment was followed by loans of £0.6million in 2018/19 and £1.7million in 2019/20. 'Heart of Cumbria' has therefore already received £3.3million from the Council and it expects to receive a further £3.0million between 2020/21 and 2024/25. This totals £6.3million and is a significant amount of public money.

However, 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

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.

For example, one of the aims of 'Heart of Cumbria', is to provide the Council with increased revenue income. In February 2018, the Council approved a business case for the Company to purchase and let 86 affordable dwellings. The financial projections included in the business case showed interest income realised of £50,000 and increasing from 2019/20.

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 '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.

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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 understand that such a report does not exist.

It appears to me that the arrangements with 'Heart of Cumbria' present financial risks to the Council, but it is not clear to me 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?).

There appears to be a lack of transparency, a lack of accountability, a lack of clarity about objectives and a lack of performance monitoring. Despite the significant investment, very little appears to have been achieved in the three years since 'Heart of Cumbria' first received funding.

The Council's intention to review the 'Heart of Cumbria' is therefore to be welcomed. I would suggest that the Council should consider the ways in which 'Heart of Cumbria' could best contribute to the Council's strategic objectives, ways of 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

The Council has received favourable local government finance settlements in recent years. However, the government is currently carrying out a 'Fair Funding Review' that may redistribute resources away from district councils. It is important that the Council engages fully with the Fair Funding Review as appropriate.

#### Conclusion

I am pleased that the Council is now addressing weaknesses in financial management that have been apparent in the past.

I think that the Council should 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.
- A thorough appraisal and evaluation of all the options available to the Council to deliver its key corporate objectives including housing and economic development.
- Providing greater clarity and transparency about the objectives and activities of 'Heart of Cumbria' through preparing a detailed business case.
- 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.
- Considering whether to balance the budget through transferring resources from earmarked reserves to the general fund, revenue savings (possibly including savings from re-tendering the refuse collection and recycling contract) or reducing the planned financial commitment to 'Heart of Cumbria'.

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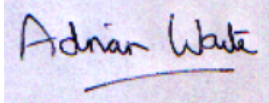
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- Adopting a more robust approach to risk management and stress testing.
- Increasing Council Tax by £5 for a Band D property in 2020/21.

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,

A handwritten signature in blue ink that reads "Adrian Waite". The signature is written in a cursive style and is underlined with a single horizontal stroke.

**Adrian Waite**  
**Managing Director**

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