| POLICY AND RESOURCES COMMITTEE | 21 July 2020 |
| --- | --- |
| Is the final decision on the recommendations in this report to be made at this meeting? | No |

# Financial impact of Covid-19 and development of the Medium Term Financial Strategy 2021/22-2025/26

| | |
| --- | --- |
| **Final Decision-Maker** | Council |
| **Lead Head of Service** | Director of Finance and Business Improvement |
| **Lead Officer and Report Author** | Director of Finance and Business Improvement |
| **Classification** | Public |
| **Wards affected** | All |


**Executive Summary**

Covid-19 has had a major impact on the Council's financial position. This report sets out an updated assessment of the impact of Covid-19 and the implications for the Medium Term Financial Strategy (MTFS). It describes the measures that are proposed to address the impact of Covid-19 in the current financial year and the approach that it is proposed to take in developing an updated MTFS, covering the period 2021/22 to 2025/26, which will take into account the changed environment.


**This report makes the following recommendations to this Committee:**

1. That the impact of Covid-19 on the Council's financial position in 2020/21 is noted.
2. That the proposed deployment of reserves and other budget variations to accommodate the projected impact, as set out in paragraph 3.36, are agreed.
3. That the approach outlined to development of an updated Medium Term Financial Strategy for 2021/22 – 2025/26 and a budget for 2021/22 is noted.
4. That the assumptions described in this report for planning purposes and to establish the remit for future budget development are noted.
5. That the principles for transformation initiatives set out at paragraph 5.11 are agreed as the basis for meeting the budget remit.

| **Timetable** | |
| --- | --- |
| ***Meeting*** | ***Date*** |
| Policy and Resources Committee | 21 July 2020 |
| Policy and Resources Committee | 25 November 2020 |
| Council | 9 December 2020 |
| All Service Committees | January 2021 |

| | |
|---|---|
| Policy and Resources Committee | 10 February 2021 |
| Council | 24 February 2021 |

# Financial impact of Covid-19 and development of the Medium Term Financial Strategy 2021/22-2025/26

## 1. CROSS-CUTTING ISSUES AND IMPLICATIONS

| Issue | Implications | Sign-off |
|---|---|---|
| **Impact on Corporate Priorities** | The Medium Term Financial Strategy and the budget are a re-statement in financial terms of the priorities set out in the strategic plan. They reflect the Council's decisions on the allocation of resources to all objectives of the strategic plan. | Section 151 Officer & Finance Team |
| **Cross Cutting Objectives** | The MTFS supports the cross-cutting objectives in the same way that it supports the Council's other strategic priorities. | Section 151 Officer & Finance Team |
| **Risk Management** | This has been addressed in section 5 of the report. | Section 151 Officer & Finance Team |
| **Financial** | The budget strategy and the MTFS impact upon all activities of the Council. The future availability of resources to address specific issues is planned through this process. It is important that the committee gives consideration to the strategic financial consequences of the recommendations in this report. | Section 151 Officer & Finance Team |
| **Staffing** | The process of developing the budget strategy will identify the level of resources available for staffing over the medium term. | Section 151 Officer & Finance Team |
| **Legal** | Under Section 151 of the Local Government Act 1972 (LGA 1972) the Section 151 Officer has statutory duties in relation to the financial administration and stewardship of the authority, including securing effective arrangements for treasury management. The S151 Officer also has a personal duty under Section 114(3) of the Local Government Finance Act 1988 to report to the Council if it appears that the set budget will be exceeded. Key considerations for the Council include the need for adequate reserves, the S151 officer's guidance on the financial prudence of options before members and ensuring that there are reasonable grounds for making decisions. The Medium Term Financial Strategy demonstrates | Team Leader (Corporate Governance), MKLS |

| | | |
|---|---|---|
| | the Council's commitment to fulfilling its duties under the Act.<br>The Council has a statutory obligation to set a balanced budget and development of the MTFS and the strategic revenue projection in the ways set out in this report supports achievement of a balanced budget. | |
| **Privacy and Data Protection** | Privacy and Data Protection is considered as part of the development of new budget proposals. There are no specific implications arising from this report. | Section 151 Officer & Finance Team |
| **Equalities** | The MFTS report scopes the possible impact of the Council's future financial position on service delivery. When a policy, service or function is developed, changed or reviewed, an evidence based equalities impact assessment will be undertaken. Should an impact be identified appropriate mitigations will be identified. | Equalities and Corporate Policy Officer |
| **Public Health** | The resources to achieve the Council's objectives are allocated through the development of the Medium Term Financial Strategy. | Public Health Officer |
| **Crime and Disorder** | The resources to achieve the Council's objectives are allocated through the development of the Medium Term Financial Strategy. | Section 151 Officer & Finance Team |
| **Procurement** | The resources to achieve the Council's objectives are allocated through the development of the Medium Term Financial Strategy. | Section 151 Officer & Finance Team |

## 2. INTRODUCTION AND BACKGROUND

2.1 The Council's financial position has been drastically altered by the Covid-19 pandemic. The Council set a balanced budget for 2020/21 at its meeting on 26th February 2020 on the basis of the information available at the time and the assumptions set out in the budget report. Since then, the position for 2020/21 and future years has changed completely. The Council has incurred substantial additional costs in combatting the pandemic and all the Council's main sources of income have been adversely affected. This report sets out a current assessment of the impact of Covid-19 on the Council's finances in **Section 3**.

2.2 As well as addressing the position for the current financial year, this report sets out the implications for future years in **Section 4**. The way in which the Council describes how it will deliver its strategic plan in financial terms is through its Medium Term Financial Strategy (MTFS). The existing MTFS, covering the period 2020/21 to 2024/25, reflects the Strategic Plan 2019 – 2045, which was adopted by the Council in December 2018. As explained by the Chief Executive in her report to this Committee on 24th June, Covid-19 will lead to a reappraisal of how the ambitions set out in the Strategic Plan can be achieved and the timescales.

2.3 Even if there is a rapid recovery from the pandemic, the financial impact will be felt for some time. The Council will have to draw on its reserves to fund the current financial year's deficit. This poses the question of how quickly reserves can be rebuilt and the right level at which to maintain them in the future. Income and expenditure projections for future years also need to be reassessed in the light of the latest assumptions about the pattern of recovery.

2.4 Reassessing the future financial position challenges the Council to consider how it will adapt to the changed environment. A number of areas for investigation are described and principles set out for developing savings proposals in **Section 5**. These will be pursued over the next four months, prior to an updated MTFS being submitted for Council's approval in December 2020.

2.5 Given the Council's central role in the community, members will wish to consider how it can contribute to the recovery from Covid-19, in the same way as it has contributed to the immediate response. Although the financial position of the Council has been impaired by the pandemic, it is appropriate to seek out creative and affordable ways in which it can play its part.

2.6 All these factors need to be taken into account in updating the MTFS, whilst keeping in mind the key objective of ensuring a balanced budget. Specifically, the MTFS must set out how Council can agree a level of council tax for 2021/22 at its meeting on 24 February 2021 that will enable this. This report is the first step towards achieving that objective.

## 3. CURRENT FINANCIAL POSITION

### Revenue Budget

3.1 The Council's financial position prior to the onset of Covid-19 was sound. Unallocated reserves as at 31 March 2020 amounted to £8.819 million, well in excess of the agreed minimum level of £2 million. An overall summary of the financial position as at 31 March 2020 is set out in the Narrative Report that accompanies the 2019/20 Statement of Accounts and is included as Appendix A.

3.2 Since the end of March, the position has been drastically altered by the pandemic. The table below sets out the current projected revenue spending position for 2020/21, as compared with the original budget.

3.3 Local authorities have been required to report to MHCLG each month on the impact of additional expenditure pressures and reductions in income. The figures set out below reflect the projections set out in the return submitted to MHCLG on Friday 19 June. Any significant changes of which we have subsequently become aware will be reported verbally at this meeting.

**<u>Table 1: 2020/21 revenue budget and latest projections</u>**

| | Service | Original budget | Add'l spend | Income red'n | Total Covid impact | Revised proj'n |
|---|---|---|---|---|---|---|
| | | £000 | £000 | £000 | £000 | £000 |
| CHE | Communities & Housing | 3,512 | 321 | 101 | 422 | 3,934 |
| CHE | Environment & Public Realm | 4,994 | 60 | 289 | 349 | 5,343 |
| ERL | Heritage, Culture & Leisure | 627 | 721 | 555 | 1,276 | 1,903 |
| ERL | Economic Development | 312 | 20 | 28 | 48 | 360 |
| SPI | Planning Services | 945 | 15 | 781 | 796 | 1,741 |
| SPI | Parking & Transportation | -2,271 | 55 | 1,055 | 1,110 | -1,161 |
| P & R | Property & Investment | 1,031 | 0 | 1,547 | 1,547 | 2,578 |
| P & R | Corporate and Shared Services | 9,785 | 132 | 10 | 142 | 9,927 |
| | **Total** | **18,935** | **1,324** | **4,366** | **5,690** | **24,625** |
| | | *100.0%* | *+7.0%* | *+23.1%* | *+30.1%* | *130.1%* |

Details by service area are set out below.

*Communities and Housing*

3.4 During the pandemic, the Housing Service received and assisted new clients who were not previously known to them. The Accommodation Team was able to create capacity within the Council's owned temporary accommodation stock, which enabled MBC to avoid procurement of large scale usage of hotel and Bed and Breakfast accommodation which has been the case elsewhere in the UK. During the crisis, the Outreach and Accommodation Teams continued to provide a front-line service and provided accommodation to over 40 people, of whom 17 remained in temporary housing last month. These clients are being assisted back into settled accommodation or reconnected with their areas of origin where that is not Maidstone. This is expected to give rise to additional costs as set out in the table above.

*Environment & Public Realm*

3.5 Street cleaning, grounds maintenance and waste collection services remained fully operational throughout the pandemic. The street cleansing, grounds maintenance and commercial waste teams have assisted Biffa by providing staff and vehicles, which it is considered will enable the Council to resist any claim for additional costs as well as ensuring all services have remained fully operational. The closure of the Household Waste Recycling Centre (HWRC) resulted in an increase in new garden waste customers.

However, a net loss of income is projected from other services provided by Environment & Public Realm, including commercial waste and grounds maintenance.

3.6 The Bereavement service has remained fully operational throughout despite increased demand and cremator breakdowns. The team worked shifts, sometimes starting at 4am and working until midnight to carry out cremations during the busiest weeks. The additional costs are reflected in the table above.

*Heritage, Culture & Leisure*

3.7 The Leisure Centre and the Hazlitt Theatre have closed as a result of the pandemic. Whilst these facilities are operated by third party suppliers, there is a potential liability on the Council's behalf to help mitigate losses suffered by the contractors, as well as a loss of income that would normally be generated from these facilities. An estimate of the liability is included within the table above.

*Economic Development*

3.8 Lockmeadow Market is included within the Economic Development budget. The Market was closed in April and May, re-opening on Saturday 13 June. The estimated loss of income is shown within the above figures.

*Planning Services*

3.9 During the pandemic the planning service has continued to operate largely by staff working from home. However, the volume of planning applications and therefore fee income has reduced. The likely future volume of planning applications remains unclear. It is assumed in the figures above that there will be an income reduction of 33% for the year as a whole.

*Parking & Transportation*

3.10 On-street and off-street parking income from pay and display machines fell steeply at the beginning of lockdown, with income only 7% of the previous year's level in April. Although it was not possible to collect cash from the machines, the new pay units helped to an extent by allowing contactless payments as well as the normal RingGo payment options. These payments represented 62 % of all payments in April and May. Car park income is now slowly recovering.

3.11 Civil Parking Enforcement patrols have continued, with a focus on maintaining traffic flow and highway safety rather than the issue of penalty charge notices.

*Property & Investment*

3.12 The impact from Covid-19 has been significant in terms of rental income, with most tenants experiencing financial difficulties. Grant funding has however helped many of our smaller commercial tenants to continue operating. There has been a rise in rent arrears, but repayment plans are being made where appropriate with tenants. In a limited number of cases we have agreed a lease extension in exchange for a rent holiday. As of the time of writing, the only major tenant whose status has changed is The Restaurant Group (TRG), owner of Frankie and Benny's, Lockmeadow. TRG is entering a creditors voluntary administration, under which it will close 125 sites. The Maidstone site will remain open, but as part of the CVA the rent receivable will be reduced for the next two years. Otherwise, we have not lost any commercial tenants. Lettings do not appear to have been impacted and we continue to complete on new leases and have good interest in vacant commercial premises.

*Corporate & Shared Services*

3.13 The cost of providing a Community Hub during the pandemic has been accounted for under Corporate & Shared Services. The Community Hub comprised a contact centre where people could seek support, a physical distribution hub, a befriending service and a dedicated part of the MBC web-site to provide information for people needing support and a place where volunteers could offer support. The Community Hub provided free phone and web based contact channels, the team developed processes for managing contact with residents and the provision of support, sourced and procured food and household essentials and linked in with parish councils, community services, voluntary groups, KCC, health providers and volunteers.

*Council Tax and Business rates*

3.14 As well as service budgets being affected by additional expenditure and loss of income, the Council's income from Council Tax and Business Rates has suffered as a result of Covid-19.

3.15 As of the end of May, the Council faced a reduction in Council Tax receipts of 5% as compared with the same point in time last year. With the increase in unemployment and the general uncertainty about economic prospects, it is likely that many households are struggling to pay. Given the importance of cash flow to enable the Council to continue delivering services, we are emphasising to Council Tax payers the importance of keeping up to date with their payments. If they are unable to pay the full amount of Council Tax, for example through redundancy, they may apply for Council Tax support, which reduces their Council Tax by 80%. The existing shortfall in Council Tax receipts is assumed to continue being experienced for the rest of the year, although it is obviously hoped that the position will recover. This gives a projected shortfall for Maidstone's share of Council Tax of £948,000.

3.16 As at the end of May, the Council faced a reduction Business Rates receipts of 7% for those businesses still liable to pay rates (leisure, retail and hospitality businesses are entitled to 100% relief, which is funded by central government). As with Council Tax, we are encouraging businesses to pay. The projected shortfall for Maidstone's share of Business Rates is £1.925 million.

3.17 The shortfall in Council Tax and Business Rates is accounted for in 2020/21 through the Council's Collection Fund, rather than the General Fund. However, as the General Fund will ultimately have to bear the cost of the shortfall, these deficits are included for the purposes of this report within the overall deficit that the Council must address.

*Overall Position*

3.18 The overall deficit for 2020/21, in the absence of any mitigating action, is currently projected to be as follows.

**Table 2: Projected deficit for 2020/21 before mitigations**

| | £000 |
|---|---|
| Service overspend as per table 1 | 5,690 |
| Projected shortfall on Council Tax income (Maidstone share) | 948 |
| Projected shortfall on Business Rates income (Maidstone share) | 1,925 |
| **Total projected deficit** | **8,563** |

So far, we have received £1,777,000 in central government grant to offset this.

3.19 The government announced a further package of support on 2nd July, comprising:

- £500 million additional unringfenced grant to cover cost pressures;
- a commitment to cover 75% of lost income from sales, fees and charges (excluding commercial income) above a threshold adverse variance of 5%;
- phasing over three years of Collection Fund deficit repayments.

3.20 An announcement about the £500 million to cover cost pressures is expected imminently and the details will be reported verbally at this meeting if available. Early indications are that the distribution will be based on a formula intended to prioritise spending according to local authority needs. If the needs assessment replicates the assessment of needs that is built into the 2020/21 local authority finance settlement, this would mean approximately £100,000 for Maidstone Borough Council.

3.21 The most significant of the three items in the package for Maidstone Borough Council is the commitment to cover 75% of lost income, excluding commercial income, over a 5% threshold. Taken at face value, this could reduce our service overspend by around £1.5 million on the basis of the latest MHCLG return. It is expected that lost income will be reimbursed in arrears, based on periodic returns to central government of actual income lost.

3.22 The third element listed above, the phasing of Collection Fund deficit repayments, is designed to mitigate the impact of the loss of Council Tax and Business Rates revenue on the General Fund next year. Normally any loss would have to be made good through an additional charge to the Council's General Fund in 2021/22. By spreading the loss over three years, it should be easier for Councils to meet the legal requirement to set a balanced General Fund budget next year. However, the total amount of the loss will not change and there is no cash contribution from the government to mitigate it. The only potential concession from the government is that it has committed to reconsider the apportionment of the loss between central and local government in the next Spending Review.

3.23 The Chancellor's Summer Statement on Wednesday 8th July included no further assistance for local government. However, it was confirmed that the government will set out further details on its spending plans at the next Budget and Spending Review. No date has been set for the Budget and Spending Review, but they are expected to take place in the autumn.

3.24 Future spending plans may reflect the aspirations of the government's forthcoming Devolution White Paper. Indications are that the White Paper will encourage the formation of further unitary authorities with elected mayors. It is therefore possible that there will be financial incentives for local government to reorganise along these lines.

**Capital Programme**

3.25 The capital programme plays a vital part in delivering the Council's strategic plan, since long term investment plays an essential role in realising our ambitions for the borough. The cost of the capital programme is spread over the lifetime of investments, so does not have such an immediate impact on the revenue budget position. However, there are revenue consequences to the capital programme. Maidstone Borough Council borrowed to fund its capital programme for the first time in 2019/20. The cost of borrowing is factored into the 2020/21 budget, along with a Minimum Revenue Provision which spreads the cost of loan repayments over the lifetime of an asset. The budgeted total revenue costs of the capital programme in 2020/21 amounted to £1.870 million.

3.26 The existing capital programme was approved by Council at its budget meeting on 26th February 2020. Major schemes include the following:

- Completion of Brunswick Street and Union Street developments
- Granada House extension
- Further mixed housing and regeneration schemes
- Purchase of housing for temporary accommodation
- Flood Action Plan
- Mote Park Improvements
- Further investment at Lockmeadow Leisure Complex
- Commercial Property Investments
- Kent Medical Campus Innovation Centre
- Mall Bus Station Improvements
- Biodiversity and Climate Change.

3.27 The capital programme for 2020/21 has been reviewed in the light of the Covid-19 pandemic. The majority of projects in the current programme are either already under way, are required for health and safety reasons, or must be carried out to meet contractual commitments. However, it is proposed that a number of projects are deferred to 2021/22, which will have the effect of reducing the in-year revenue costs of capital expenditure.

3.28 The capital programme is reviewed every year. In carrying out the annual review, prior to presentation of revenue and capital budget proposals to Council in February 2021, consideration will be given as to how the capital programme can support the process of recovery from Covid-19, eg by investing in projects that have a positive effect on employment and economic regeneration.

3.29 In recent years, a number of local authorities have used the capital programme as an opportunity to acquire commercial property to general rental income. Government ministers have made a number of critical statements about this practice, which they see as detracting from core local authority activities. The Covid-19 pandemic has also demonstrated the riskiness of the practice. The government is currently consulting on revising the terms of PWLB lending to ensure that local authorities continue to invest in housing, infrastructure, and public services. Any review of the Maidstone Borough Council capital programme will therefore need to take into account that it will be unlikely to secure funding for purely commercial investments in future: the primary purpose of capital investment must be to meet the Council's strategic priorities.

**Reserves**

3.30 The Council maintains reserves as a safety net to allow for unforeseen circumstances. There is no statutory definition of the minimum level of reserves: the amount required is a matter of judgement. However, the Council has a longstanding policy whereby £2 million is the agreed minimum General Fund balance. This is equivalent to around 5% of Council turnover (income from Council Tax, Business Rates, Sales, Fees and Charges and Commercial Rent), which is an accepted benchmark when setting reserves levels.

3.31 In addition to uncommitted General Fund balances, the Council holds reserves that are earmarked for specific purposes. The most substantial of these in the past was earmarked New Homes Bonus funding for capital expenditure. However, this was fully utilised as at 31 March 2020, given that it has been deployed to fund the capital programme.

3.32 Council agreed last year to set aside the £1.589 million which would have been required in order to fund negative Revenue Support Grant as a contingency for future funding pressures. This is treated as an earmarked reserve.

3.33 Full details of reserves held are set out below:

**Table 3: General Fund balances as at 31 March 2020**

| | 31.3.19<br>£000 | 31.3.20<br>£000 |
|---|---|---|
| **Earmarked Reserves** | | |
| Local Plan Review | 200 | 309 |

| | | |
|---|---|---|
| Neighbourhood Plans funding carried forward | 64 | 75 |
| Planning Appeals Contingency | 300 | 286 |
| Accumulated Surplus on Trading Accounts | 31 | 32 |
| Civil Parking Enforcement | 419 | 164 |
| Future Capital Expenditure | 431 | 431 |
| Future Funding Pressures | 0 | 1,589 |
| Housing Prevention & Temporary Accommodation | 700 | 681 |
| Unspent Business Rates Growth (Pool and Pilot) | 3,682 | 3,887 |
| Occupational Health & Safety Contingency | 0 | 31 |
| Lockmeadow Complex – income smoothing | 0 | 335 |
| **Sub-total Earmarked Reserves** | **5,828** | **7,820** |
| Unallocated Balances | 9,228 | 8,819 |
| **Total General Fund balances** | **15,056** | **16,638** |

3.34 In developing the Medium Term Financial Strategy, Members will wish to consider the appropriate future level of reserves. Whilst this is projected to remain above the existing specified minimum level of £2 million as at 31 March 2021, it could be argued that the increased level of risk highlighted by the Covid-19 pandemic justifies increasing the minimum.

3.35 The appropriate level of reserves is a matter of judgement. However, to further guide Members' thinking, the current corporate risk register is included at Appendix B, together with a very approximate financial quantification of the risks. By allocating probabilities to these risks, it is possible to come up with a notional desired reserves level. It is accepted that many of the judgements involved are debatable, but this exercise gives an idea of the order of magnitude of reserves that may be appropriate. The table shows a financial evaluation of the risks of £3.5 million. Allowing for risks not captured on the table and to allow some flexibility, it is suggested that £4 million may now be an appropriate safe minimum reserves level. A key objective of the MTFS will therefore need to be to ensure that reserves remain above this level.

**Mitigating actions**

3.36 In order to mitigate the deficit set out in Table 2 above, the following management actions have been taken.

- CLT authorisation of any new recruitment
- Review of all new discretionary spend on goods and services
- Review of all new procurements in excess of £25,000
- Review of capital programme (as described in paragraph 3.27 above).

These measures are estimated to generate a saving of approximately £500,000.

**Summary**

3.37 The effect of these mitigating actions on the projected deficit and on unallocated reserves is shown below.

**Table 4: Projected deployment of unallocated reserves**

| | £000 | £000 |
|---|---|---|
| Unallocated reserves as at 1 April 2020 | | 8,810 |
| Total projected deficit | 8,563 | |
| Government grant already received - tranches 1 and 2 | -1,777 | |
| Estimated grant – tranche 3 | -1,600 | |
| Mitigating actions | -500 | |
| Net projected drawing on reserves | 4,686 | -4,686 |
| **Projected unallocated reserves as at 31 March 2021** | | **4,124** |

It should be noted that this is a preliminary estimate at a relatively early point in the financial year. There are a whole range of factors that could affect this both adversely (eg the risk of a resurgence of Covid-19) and favourably (eg further government grant).

3.38 It can be seen that the projected position above shows reserves in excess of the existing minimum agreed level of £2 million, but only just above the 'safe' minimum reserves level of £4 million proposed in paragraph 3.35. The Council is therefore in a position of considerable vulnerability, and any further shocks, such as a resurgence of the pandemic, could lead to reserves falling below a safe level.

## 4. FUTURE FINANCIAL POSITION

4.1 The Council's future financial position will be considered by looking firstly at the local authority funding context. Next, potential scenarios for the national economy, bearing in mind the pace of recovery from Covid-19, will be considered. Assumptions are then made about the key variables for the Council's budget, in order to arrive at a set of strategic revenue projections which can be used as a starting point when updating the MTFS.

**Local authority funding**

4.2 For the past five years, local authority funding has been subject to a national settlement, originally announced in 2016. 2019/20 was due to be the final year of a four year settlement. In the event, the key elements of the four year settlement were rolled forward to 2020/21, owing to Brexit, and are now set to be rolled forward for a further year to 2021/22, owing to Covid-19. The extended four-year settlement has provided a degree of certainty about the Council's funding position, even though the amount of central government support for local government has fallen steadily. The effect in Maidstone has been that the percentage of revenue raised locally has increased from 82.3% in 2014/15 to 92.7% in 2020/21.

4.3 It should be noted that the four year funding settlement has given no Revenue Support Grant (RSG) to Maidstone Borough Council since 2017/18. It was originally envisaged that the funding settlement would incorporate a clawback of £1.6 million from the Council in the form of negative RSG in 2019/20. Under pressure from local authorities like Maidstone and our parliamentary representatives, the government withdrew the proposal to levy negative RSG. However, the threat of negative RSG, or a measure with a similar effect has not entirely disappeared. Without an overall increase in funding available to local government, it is not clear how the local government financial settlement will be balanced in future years without the 'lost' negative RSG being recouped in some form.

4.4 There are a number of variables to be determined in the future local government funding regime to be introduced in 2022/23, including:

- the Council Tax referendum limit
- review of relative needs and resources (previously referred to as the Fair Funding Review)
- proportion of business rates retained by local government (currently 50%)
- the Business Rates Baseline (which dictates the amount of business rates that individual local authorities may retain locally)
- future of specific grants, eg New Homes Bonus.

The existing MTFS has taken a cautious view of the likely outcome for Maidstone, for a number of reasons.

- Within the overall local government landscape, pressures on upper tier authorities which are responsible for delivering social care have had a higher profile than those faced by lower tier authorities like Maidstone. This is likely to affect the outcomes of the Fair Funding Review.

- Maidstone has benefited disproportionately from business rates growth since the introduction of the current funding regime. Much of this benefit risks disappearing if the business rates baseline is reset.

- In any equalisation of business rates income between local authorities, Maidstone risks losing out because of its relative prosperity. This was illustrated by the fact that Maidstone Borough Council was due to pay a larger amount of negative RSG than any other district in England. Even though 'negative RSG' as a measure may not be employed, there remains a risk that we will be penalised in any equalisation process.

4.5 Covid-19 may lead to the government reconsidering its plans for future local authority funding. For example, emergency measures introduced as a result of Covid-19 to provide business rates relief may be retained. Whilst this in itself would have no direct financial impact for local authorities, as these measures are fully funded by central government, the reliefs challenge the underlying direction of government policy towards greater devolution of business rates income to local authorities. If there is significantly less business rates income available, there would be less merit in allocating a notionally higher percentage of the income to local authorities.

4.6 At this stage it is not known when we will have clarity about the funding position for 2021/22 or about the way that the new funding regime due to be introduced in 2022/23 will impact the Council. Given the usual pattern whereby the local government finance settlement is announced just before Christmas, we may not have any definitive figures for 2021/22 until late December.

**Scenario Planning**

4.7 At this stage, the pace and scale of recovery from the Covid-19 pandemic is extremely difficult to predict. It is therefore proposed that, as in previous years, we model a number of different scenarios when developing the Medium Term Financial Strategy, as follows:

*Scenario 1 – Favourable (OBR reference case)*

Lockdown impacts sharply on output in 2020 Q2, but rebounds in the second half of the year, with a strong return to growth in 2021.

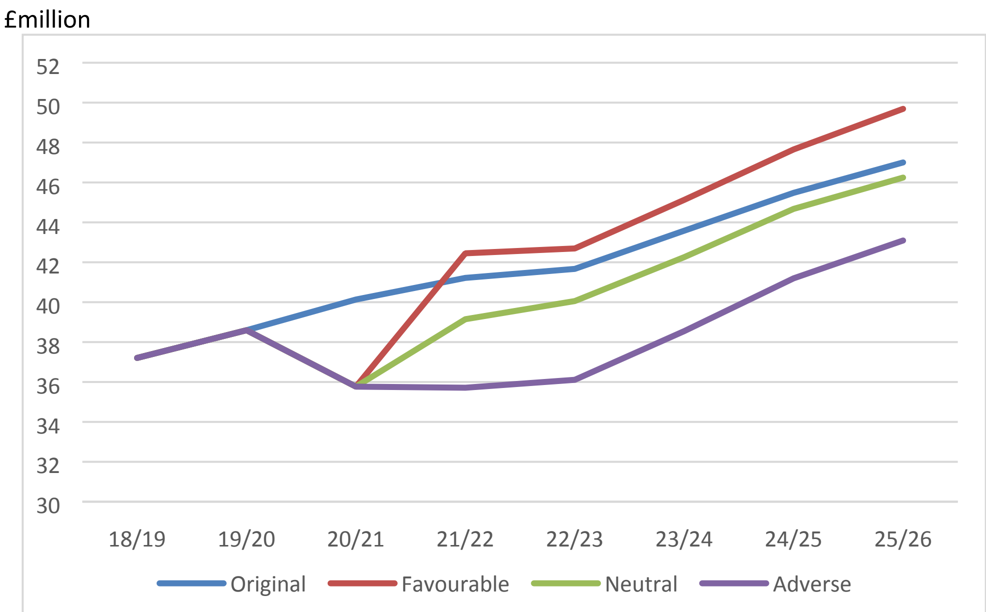
*Scenario 2: Neutral (Recovery, relapse, growth)*

The economy is slower to rebound, due to (some combination of) a reimposition of restrictions to contain a second infection wave, weaker than expected market responses to the loosening of restrictions (i.e. savings hoarding, poor investor confidence), or continued lockdown in supplier/ customer markets.

*Scenario 3: Adverse (Great Depression)*

'L shaped ' recession, similar to that experienced after 1929: permanent loss of output, with combination of persistently weak demand, over capacity and high unemployment.

These scenarios have been translated into the following income profiles for the Council, with the original MTFS assumptions also shown for comparison:



4.8 Specific assumptions underlying each of the scenarios are set out below.

**Strategic Revenue Projection**

*Council Tax*

4.9 Council Tax is by far the Council's biggest single source of income. It is a product of the tax base and the level of tax set by Council. The tax base is a value derived from the number of chargeable residential properties within the borough and their band, which is based on valuation ranges, adjusted by all discounts and exemptions.

4.10 The tax base has increased steadily in recent years, reflecting the number of new housing developments in the borough. See table below:

**Table 5: Number of Dwellings in Maidstone**

| | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|
| Number of dwellings | 67,721 | 68,519 | 69,633 | 70,843 | 71,917 |
| % increase compared with previous year | 0.81% | 1.18% | 1.63% | 1.74% | 1.52% |

**Note:** Number of dwellings is reported each year based on the position shown on the valuation list in September.

4.11 Given the impact of Covid-19 on housebuilding and the general economy, it has been assumed for the purposes of the neutral scenario that growth will slow to 0.5% in 2021/22, but will then revert to 1.5% in 2022/23 and subsequent years.

4.12 As has been seen, Council Tax collection has been 5% lower in the current financial year than last year. Some of this reduction may foreshadow a more long-lasting decline in Council Tax revenues, with reductions in household earnings leading to a higher number of CTRS claimants. It has therefore been assumed in the neutral scenario that the Council Tax base will be 3% lower as a result in 2021/22. Taking into account the projected increase of 0.5% in the number of dwellings, this would result in a reduction in the Council Tax base of 2.5%

4.13 The level of council tax increase for 2021/22 is a decision that will be made by Council based on a recommendation from Policy and Resources Committee. In practice, the Council's ability to increase the level of council tax is limited by the need to hold a referendum for increases over a government set limit. In 2020/21, the limit was the greater of 2% or £5.00. The Council approved the maximum possible increase. The rationale for this approach was that:

- pressures on the Council's budget mean that even a marginal difference in Council Tax income is of value;
- the referendum limit might revert to a lower level in later years;

- because the starting point for calculating the referendum limit in any given year is the previous year's Council Tax, agreeing a lower increase reduces the Council's room for manoeuvre in later years.

4.14 The referendum limit of 2% was intended broadly to reflect the rate of inflation. Although the government target for inflation remains at 2%, current projections are that inflation will not increase to this level for some time to come. On the other hand, cost pressures for local councils may make it difficult for central government to justify reducing the referendum limit. Accordingly, the current MTFS projections assume that Council Tax increases will be at the referendum limit, and that this limit will be 2%.

*Retained business rates*

4.15 Under the current business rates regime, local government in aggregate retains 50% of business rates income. However, most of the 50% share collected locally is lost to Maidstone, because it is redistributed to other authorities through a system of tariffs and top-ups.

**Table 6: Baseline Business Rates Income 2020/21**

| | £000 | % |
|---|---|---|
| Baseline Business Rates income | 56,496 | 100 |
| Government share | -28,248 | -50 |
| Kent County Council / Kent Fire & Rescue Authority | -5,649 | -10 |
| Government tariff | -19,339 | -34 |
| Baseline Business Rates income retained by MBC | 3,260 | -6 |

4.16 To the extent that business rates income exceeds the baseline, this growth element is retained locally, subject to a levy payable to central government by tariff authorities like Maidstone. The Council has been able to minimise the levy payable on business rates growth through its membership of the Kent Business Rates Pool. This is because the levy payable by some pool members (district councils) is offset against the top-up received by the major preceptors (Kent County Council and Kent Fire and Rescue).

4.17 The Council includes the non-pool element of business rates growth as part of its base budget. Maidstone Council's 30% share of the growth arising from membership of the pool is allocated to a reserve which is used for specific projects that form part of the Council's economic development strategy. A further 30% represents a Growth Fund, spent in consultation with Kent County Council. This has been used to support the Maidstone East development. Another 30% goes directly to Kent County Council; the residual 10% is held back to compensate pool members whose business rates income falls below the baseline and would otherwise have benefited from the government's safety net.

4.18 A further element of growth was retained locally for one year only in 2018/19 as a result of Maidstone's participation in the Kent & Medway 100% Business Rates Retention pilot. Kent & Medway local authorities were successful in bidding for pilot status, which meant that 100% of business rates growth, rather than 50%, was retained locally. Unfortunately, a bid for pilot status in 2019/20 was unsuccessful and there were no further pilots in 2020/21.

4.19 Unspent Business Rates pool and pilot proceeds are included within earmarked reserves as at 31 March 2020 (see table 3 above). This reserve includes both amounts that have subsequently been spent, or are contractually committed to be spent, and uncommitted amounts.

4.20 The Government has announced a further deferral of its commitment to introducing 75% business rates retention, and its review of relative needs and resources (previously referred to as the Fair Funding Review). Linked to this, the planned revaluation exercise which had been scheduled for 2021 has also been deferred. It is likely that the planned resetting of business rates baselines against which growth is measured will also be deferred.

4.21 This presents significant uncertainty in the budget estimates as they currently stand, particularly in relation to business rates, which are subject to the following variables:

- Retention: due to the deferral of the planned reforms, the 50% retention scheme will continue to operate, with Maidstone retaining 40% of business rates collected. However, as shown in table 6 above, the government applies a tariff to this which reduces the actual amount retained down to the Council's baseline funding level (i.e. its assumed spending requirement). The level at which this is set is likely to be announced in the Autumn.

- Growth: Under the current 50% retention scheme, the Council is able to retain the first 50% of growth generated against its business rates baseline, which was set in 2013. Due to the significant impact of the Covid-19 pandemic on the local and national economies, in addition to Brexit, it is likely that growth will be affected. However, the unprecedented nature of this situation makes this difficult to predict.

- Appeals and VOA announcements: these have always presented a source of volatility in estimating business rates income, with recent examples including blanket rulings on ATMs and GP surgeries. There is limited information available to enable the level of appeals and likelihood of success to be estimated. The planned revaluation is likely to give rise to further challenges over the coming years.

- Recovery: as stated above, the Covid 19 pandemic and containment measures have caused significant financial stress to many local businesses, and it is likely that some businesses may struggle to pay their business rates bills as a consequence. The true impact of this is yet to be seen.

- Reliefs: the government announced significant levels of relief to support businesses in the retail, hospitality, leisure and nursery sectors as part of its support package to businesses impacted by Covid 19. The effect of this is that a significant proportion of the Council's business rates income is currently paid through government grant, rather than by ratepayers. It is currently unclear as to whether or not this subsidy will continue.

- Pooling: consideration will need to be given to the merits of continuing with such an arrangement in 2021/22, in light of the increased risks for all pool members.

- Future reforms: the delay to the planned reforms calls into question the future of business rates retention which presents an additional layer of uncertainty in the forecasts.

4.22 The Strategic Revenue Projection reflects the following assumptions in relation to retained business rates:

- The Local Government Finance Settlement for 2021/22 will be a roll forward of the current year's settlement, given the deferral of the planned reforms.

- In the neutral scenario, business rates growth retained by the Council will be lower than it has been in previous years.

*Revenue support grant*

4.23 As has already been mentioned, the Council no longer receives Revenue Support Grant.

*Local income from sales, fees, charges and commercial rent*

4.24 Other income is an increasingly important source of funding for the Council. We have a policy that guides officers and councillors to set the appropriate level of fees and charges based on demand, affordability and external factors. The policy is not influenced directly by the MTFS with the exception that charges should be maximised within the limits of the policy.

4.25 These sources of income have been badly affected by Covid-19. The projections assume a gradual recovery, with the previously projected level of income being attained again in 2024/25 in the neutral scenario.

**Revenue Projections**

4.26 Strategic revenue projections, based on the assumptions set out above, are summarised in table 7 below for the 'neutral' scenario. More detailed projections are included in Appendix C.

4.27 In light of the many uncertainties around future funding, it is important to note that projections like these can only represent a 'best estimate' of what will happen. These projections will be updated as more information becomes available, prior to a final version of the projections being included in the updated Medium Term Financial Strategy.

**Table 7: Strategic Revenue Projections 2021/22-2025/26**

| | 20/21 | 20/21 | 21/22 | 22/23 | 23/24 | 24/25 | 25/26 |
|---|---|---|---|---|---|---|---|
| | Orig budget | Latest projn | Forecast | | | | |
| | £m | £m | £m | £m | £m | £m | £m |
| Council Tax | 16.8 | 15.9 | 16.7 | 17.3 | 17.9 | 18.6 | 19.2 |
| Business Rates | 4.5 | 2.6 | 3.9 | 3.4 | 3.6 | 3.8 | 4.1 |
| Other Income | 21.7 | 17.3 | 18.6 | 19.4 | 20.8 | 22.3 | 22.9 |
| Total Funding Available | 43.0 | 35.8 | 39.2 | 40.1 | 42.3 | 44.7 | 46.2 |
| Predicted Expenditure[1] | 43.0 | 44.3 | 43.4 | 41.0 | 42.1 | 44.2 | 46.1 |
| Budget Gap | 0.0 | -8.5 | -4.2 | -0.9 | 0.2 | 0.5 | 0.1 |
| Existing Planned Savings | | | 0.9 | 0.6 | 0.2 | 0.0 | 0.0 |
| Contribution to Reserves | | | 0.0 | 0.0 | 0.4 | 0.5 | 0.1 |
| Savings Required | | | -3.3 | -0.3 | 0.0 | 0.0 | 0.0 |

[1] Predicted Expenditure assumes that Existing Planned Savings and Savings Required arising in the preceding year have been delivered and are built into the budget.

4.28 The above table shows that, based on the 'neutral' scenario, income will recover from the levels projected in 2020/21, and one-off additional expenditure will reduce. However, there will not be a full recovery, with income remaining below the levels previously projected. In the absence of any mitigating action, this would lead to a deficit, smaller than the £8.5 million projected in the current year, but still very significant.

4.29 The savings required in 21/22 of £3.3 million, as set out in the table above, amount to nearly 10% of total income. This scale of saving, which is more challenging than the Council has faced for the past ten years, demands a radical reassessment of how it operates, if we are to maintain service delivery standards and achieve our strategic priorities.

## 5. UPDATING THE MEDIUM TERM FINANCIAL STRATEGY

5.1 The MTFS must balance the very severe financial pressures set out in the previous section with the requirement to deliver the Strategic Plan. The Council's Strategic Plan 2019 - 2045 was adopted by the Council in December 2018. It sets four key priorities, as follows:

- Embracing Growth and Enabling Infrastructure
- Homes and Communities
- A Thriving Place
- Safe, Clean and Green.

'Embracing growth and enabling infrastructure recognises' the Council's role in leading and shaping the borough as it grows. This means taking an active role in policy and master planning for key sites in the borough, and where appropriate, investing directly ourselves.

‘Homes and communities’ expresses the objective of making Maidstone a place where people love to live and can afford to live. This means providing a range of different types of housing, including affordable housing, and meeting our statutory obligations to address homelessness and rough sleeping.

‘A thriving place’ is a borough that is open for business, attractive for visitors and an enjoyable and prosperous place to live for our residents. We will work to regenerate the County town and rural service centres and will continue to grow our leisure and cultural offer.

A ‘safe, clean and green’ place is one where the environment is protected and enhanced, where parks, green spaces, streets and public areas are looked after, well-managed and respected, and where people are and feel safe.

5.2 Covid-19 compels a reappraisal of how these ambitions can be achieved and the timescales. Neverthless, it is proposed to update the MTFS on the basis that the underlying principles continue to apply. The challenge in updating the MTFS is therefore to realise the Council’s ambitions within the financial constraints defined above.

5.3 In previous years, where projections have indicated a significant budget gap, the approach taken has been to seek a blend of revenue savings and additional income, including reduction in discretionary services which are not strategic priorities and reconfiguring statutory services which are not strategic priorities. Although individual initiatives may have been modest in scale, in aggregate they have been sufficient to meet the budget remit.

5.4 Unfortunately, this approach will not deliver the scale of savings / additional income required to meet the budget gap that we now face. A much more radical and ambitious approach is therefore required.

5.5 In order to generate savings or additional income on the scale required, without having a catastrophic impact on individual front-line services, it is proposed that a suite of organisation-wide transformation measures are taken. Only organisation-wide initiatives are likely to deliver the necessary scale.

5.6 The pandemic has illustrated the potential from one type of organisational transformation, namely a significant reduction in office accommodation. The expiry of the lease on Maidstone House in 2023 puts the Council in a strong position to exploit this opportunity.

5.7 The cost of occupying Maidstone House is around £1 million per annum, so this alone will not be sufficient to close the budget gap identified above. Other areas proposed for investigation include:

- Better use of technology
- External grant funding
- Income generation
- Overhead costs of delivering the capital programme
- Overhead costs of project delivery

- Service commissioning
- Shared service arrangements
- Staff reward packages
- Structure of democratic representation
- Synergies between service areas.

The overall approach will be that nothing is excluded from consideration, including proposals made in the past but rejected at the time.

5.8 Together with office accommodation, these areas for further investigation will be fully tested in a number of task and finish groups over the next two months. The objective will be to develop viable proposals, consistent with the certain key principles which are set out below. It is likely to be an iterative process, given the scale of the budget gap.

5.9 The financial impact of initiatives based on these principles is unlikely to be sufficient to close the budget gap within twelve months. In evaluating such initiatives, consideration will therefore need to be given as to how to fund their implementation over the necessary timescales. For example, savings from new office accommodation will not be deliverable before 2023. In the meantime it may be necessary to deploy earmarked reserves, including resources hitherto earmarked for other purposes, such as New Homes Bonus and uncommitted Business Rates Growth proceeds.

5.10 It is essential to retain a focus on the strategic priorities, as the local community recovers from the pandemic. Even if revenue resources are constrained, the Council still has the potential to use the capital programme, which impacts the revenue budget over a longer period of time, to deliver many of the priorities. This could for example mean a stronger focus on regeneration projects, which create local employment, and this will be reflected in the annual review of the capital programme due to be undertaken this Autumn.

5.11 The principles set out below are proposed in order to guide the development and implementation of the necessary transformation measures.

**PRINCIPLES FOR TRANSFORMATION INITIATIVES**

**Scope of transformation**

- Nothing is excluded from consideration, including measures previously considered and rejected
- The transformation measures will reflect strategic priorities and will include an assessment of their impact on strategic priorities.

**Achieving the necessary financial impact**

- The scale of the measures must be sufficient to deliver the budget remit
- Individual measures within the overall programme must contribute significantly to the budget remit
- The measures must be capable of realising significant savings or additional income within the first three years of the MTFS period

- One-off costs of delivering any measures must be recouped over the same period.

**Designing the transformation measures**

- Appropriate professional and technical advice will be taken at all stages of the process
- Consultation will be carried out with residents, councillors and staff as part of the budget process.

**Managing the process**

- Clear responsibility will be assigned for delivery of each measure
- Appropriate levels of resource will be assigned to individual projects.

5.12 Following these principles, it is proposed that plans for transformation initiatives are therefore developed, which will support an updated Medium Term Financial Strategy to be considered by this Committee in November 2020 and by Council in December 2020.

5.13 The importance of this work cannot be under-estimated, given the scale of the budget challenge faced by the Council. The work will therefore be given a suitably high priority and will be addressed as a matter of urgency.

## 6. AVAILABLE OPTIONS

### 6.1 Current Financial Position

Option 1 – Do Nothing

Option 2 – Adopt the mitigations set out in paragraph 3.36 and deploy reserves to accommodate the residual impact of Covid-19.

### 6.2 Updating the Medium Term Financial Strategy

Option 1 – Do Nothing

Option 2 – Adopt the principles set out in paragraph 5.11 as a means of meeting the budget remit defined by the Strategic Revenue Projection.

## 7. PREFERRED OPTION AND REASONS FOR RECOMMENDATIONS

### 7.1 Current Financial Position

The preferred option is Option 2, adopt the mitigations set out in paragraph 3.36 and deploy reserves to accommodate the residual impact of Covid-19. Failing to take these steps would mean that the Council had no plan for addressing the financial impact of Covid-19.

### 7.2 Updating the Medium Term Financial Strategy

The preferred option is Option 2, adopt the principles set out in paragraph 5.11. The scale of savings required means that alternative approaches are unlikely to deliver the necessary sums without a degradation of the Council's service offering.

## 8. RISK

8.1 The preceding paragraphs have indicated at several points the unprecedented risks and uncertainty surrounding the Council's financial position. The report has set out proposals for maintaining a suitable level of reserves to address this uncertainty.

8.2 The Council already has an established framework for addressing risks in a structured way and ensuring that appropriate mitigations are developed, through the corporate risk register. Reference has already been made to the corporate risk register and details are set out in Appendix B.

8.3 In addition, a report on financial risks is reviewed by the Audit, Governance and Standards Committee at each meeting. This seeks to capture all known budget risks and to present them in a readily comprehensible way.

## 9. CONSULTATION RESULTS AND PREVIOUS COMMITTEE FEEDBACK

9.1 Consultation with all relevant stakeholders is an important part of the process of developing the MTFS. A public budget consultation will take place this Autumn, then individual Service Committees will be consulted on the details of the MTFS proposals as they affect the respective Committee portfolios. Specific consultation will take place on individual transformation initiatives as appropriate.

## 10. NEXT STEPS: COMMUNICATION AND IMPLEMENTATION OF THE DECISION

10.1 An outline timetable for developing the Medium Term Financial Strategy and budget for 2021/22 is set out below.

| ***Date*** | ***Meeting*** | ***Action*** |
|---|---|---|
| 21 July 2020 | Policy and Resources Committee | Agree approach to development of updated MTFS and key assumptions |
| August – October | | Update MTFS and SRP ; develop savings proposals |
| 25 November 2020 | Policy and Resources Committee | Agree updated MTFS for submission to Council |
| 9 December 2020 | Council | Approve updated MTFS |
| October – December | | Develop detailed budget proposals for 2021/22 |
| January 2021 | All Service Committees | Consider 20/21 budget proposals |

| | | |
|---|---|---|
| 10 February 2021 | Policy and Resources Committee | Agree 20/21 budget proposals for recommendation to Council |
| 24 February 2021 | Council | Approve 20/21 budget |

## 11. REPORT APPENDICES

The following documents are to be published with this report and form part of the report:

- Appendix A: Narrative Report – Review of 2019/20 Financial Year
- Appendix B: Corporate Risk Register
- Appendix C: Strategic Revenue Projections – 2021/22 – 2025/26:
  - Adverse
  - Neutral
  - Favourable

## 12. BACKGROUND PAPERS

None.