

HAMPSHIRE COUNTY COUNCIL

Decision Report

Decision Maker:	Cabinet
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Date:	18 February 2016
Title:	Revenue Budget and Precept 2016/17
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Report From:	Director of Corporate Resources

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1. Executive Summary

- 1.1. The purpose of this report is to set out the County Council's proposals for the revenue budget and precept for 2016/17.
- 1.2. The County Council's early action in tackling its forecast budget deficit over the 2010 Comprehensive Spending Review (CSR) period and providing funding in anticipation of tougher times to come placed it in a very strong financial position and has given the time and capacity to develop and implement the next phase of savings of £98m by 2017/18 through the Transformation to 2017 (Tt2017) Programme.
- 1.3. In line with the financial strategy that the County Council operates, which works on the basis of a two-year cycle of delivering Departmental savings to close the anticipated budget gap, no Departmental savings targets have been built into the 2016/17 budget. It has previously been agreed that any early achievement of savings proposals during 2016/17, as part of the Tt2017 Programme, may be retained by departments to use for cost of change purposes.
- 1.4. The provisional Local Government Finance Settlement was announced on 17 December 2015 and covered the four years up to and including 2019/20. The impact of the settlement on the County Council is significant as reductions in Revenue Support Grant (RSG) have not been made consistently across all authorities. The total reduction in RSG for 2016/17 is £48m, compared to a forecast position of £19m. By 2019/20 the County Council will no longer receive any RSG.

- 1.5. The reason for this significant unexpected shift in funding is that the Government has made RSG allocations using calculations that are based on local authorities' 'Core Funding' which is made up of:
 - Settlement Funding Assessment (mainly Business rates and RSG)
 - Council Tax income
- 1.6. Core Funding is the major component of core spending power, a new measure introduced by the Government which also includes the new Better Care Fund (BCF) and New Homes Bonus (NHB).
- 1.7. The Government have implemented a clear shift in council tax policy and have assumed that local authorities will put up their council tax by the maximum they are allowed each year in the period to 2020. For Hampshire County Council this will be 3.99% per annum, which includes an extra 2% flexibility to pay for the increasing costs of adults' social care. The report recommends that the County Council increases council tax by this level in 2016/17, in line with these broad assumptions which will generate additional funding of more than £20m to offset the majority of the greater than anticipated grant reduction in 2016/17 and builds the assumption into the Medium Term Financial Strategy (MTFS).
- 1.8. The 2016/17 budget will be balanced without the need for additional savings targets, using additional one off income from council tax collection and business rates retention together with a draw from the Grant Equalisation Reserve (GER) in line with the agreed MTFS approved in October 2015, albeit that this draw will in effect see this reserve almost fully utilised.
- 1.9. Financial performance in the current year remains strong, with the main pressure, as in previous years, being around the increasing demand for adults' and children's social care. Both Departments have action plans in place to contain this pressure in the current year but as in previous years further funding has been set aside within contingencies to manage this potential risk in 2016/17.
- 1.10. During January individual Executive Members have been considering their revenue budget proposals with the Leader and Cabinet and this report consolidates these proposals together with other items that make up the total revenue budget for the County Council in order to recommend a budget, precept and council tax to the meeting of full County Council on 18 February 2016.
- 1.11. This report also considers a number of items that are linked to capital investment, in particular supporting feasibility studies and bids for Government or Local Enterprise Partnership (LEP) funding, although at this stage there is very limited scope to add additional schemes to the overall Capital Programme.
- 1.12. It should be noted that the figures in this report in respect of government grant levels and figures notified to the County Council by District Council's are provisional at this stage and will be subject to change. Revised figures will therefore be presented to full County Council and this report seeks delegated authority for the Director of Corporate Resources in consultation with the Leader and Chief Executive to make these changes as appropriate.
- 1.13. Looking ahead, the provisional figures for 2017/18, 2018/19 and 2019/20 which are set out in the settlement result in an increase in the County Council's revenue gap that must be bridged in each of these years. In 2017/18 the bottom line

impact is that a further £15m is required, on top of the savings to be delivered from Tt2017 Programme to deliver a balanced budget, and the revised gap in 2018/19 is £70m rising by a further £70m in 2019/20 to a cumulative figure of £140m assuming council tax is put up each year in line with Government expectations.

- 1.14. It is imperative during the next 14 months that the County Council is not distracted from delivering the Tt2017 Programme, irrespective of the financial outlook in the years beyond 2017/18. Any failure to deliver recurring sustainable savings for 2017/18 will only serve to worsen the position. It is therefore intended to review reserves and complete a further “housekeeping” exercise, in order that additional one off resources can be found by April 2017 to meet the remaining predicted gap of £15m.
- 1.15. The implications of these unexpected and significant changes are explored in Appendix 7 as part of the Director of Corporate Resources report and will be considered and incorporated into an update of the MTFs which will be prepared for consideration in the summer.

2. Background

- 2.1. Members will be fully aware that the County Council has been responding to reductions in government grant since the first reductions were applied in 2010/11 and then as part of the Comprehensive Spending Review (CSR) 2010.
- 2.2. It was thought at that stage that the period of austerity would last until the end of that CSR period (2014/15) and consequently the County Council planned and implemented four years worth of savings in two years; totalling £100m. By 2013, it was clear that the period of austerity would extend beyond this, at least to 2017/18, and work was therefore started on Transforming the Council to 2015 (Tt2015), to deliver a further £102.5m of savings by April 2015.
- 2.3. Subsequently a further programme of activity was developed to take the County Council through to 2017/18 and the Transforming the Council to 2017 (Tt2017) Programme will deliver the next tranche of savings required which total an additional £98m. In line with the financial strategy that the County Council operates, which works on the basis of a two-year cycle of delivering Departmental savings to close the anticipated budget gap, no Departmental savings targets have been built into the 2016/17 budget. Any early achievement of savings proposals during 2016/17 as part of the Tt2017 Programme may be retained by departments to use for cost of change purposes.
- 2.4. Following the General Election in May 2015, it was announced that Government Departments had been asked to draw up plans to tackle real terms reductions of 25% and 40% over the next four years. However, it was always recognised that the distribution of these reductions between government departments and consequently different tiers of local government would not be uniform.
- 2.5. The provisional Local Government Finance Settlement was announced on 17 December, which provided figures for local authorities for the next four financial years. The settlement included an unexpected major revision to the methodology for distributing Revenue Support Grant (RSG), which has had a major impact on Shire Counties and Shire Districts. Significant changes to

methodology like this are usually consulted on by the Government over the summer ahead of the settlement announcement, but no such warning was given this year.

- 2.6. The impact of the change in methodology is that the County Council has had a reduction in grant of £48m in 2016/17, which is equivalent to a 37.4% cut compared to an adjusted 2015/16 base level of grant. This is £29m higher than anticipated in the Medium Term Financial Strategy (MTFS).
- 2.7. More detail about the provisional local government finance settlement is set out in Section 5 of this report and the County Council has responded to the Government's consultation, making it clear that this will have a significant impact on the County Council's ability to meet the predicted budget deficit over the next four years, particularly in the face of rising social care costs in respect of growing demand and the impact of the National Living Wage (NLW) on the private social care sector. The detailed consultation response is attached as Appendix 1.
- 2.8. The final grant settlement for 2016/17 is not due out until this report has been dispatched, however based on the figures we have been given the additional reduction of £29m in Government grant announced in December, offset by an assumed increase in council tax of 3.99% and collection fund surpluses still means that there is an anticipated budget gap for 2016/17 of around £55m that needs to be addressed.
- 2.9. The County Council had always planned to meet the deficit in 2016/17 by drawing on the Grant Equalisation Reserve (GER) in line with the MTFS and fortunately, sufficient funding will be available within the reserve to meet the predicted gap of £55m outlined above. However, the implications on the MTFS are significant both in terms of the impact on 2017/18 and the Tt2017 Programme and on the financial outlook to 2019/20, further details of which are included in Section 5 of this report.
- 2.10. In December last year Cabinet received a budget update report that set provisional cash limit guidelines for Departments, taking into account inflation and base changes. This report confirms the cash limits that will be applied to Departments next year and the individual reports approved by Executive Members during January all show that the proposed budgets are within the cash limit guidelines that have been set.

3. Third Quarter Budget Monitoring

- 3.1. The cash limited budget for 2015/16 included savings to be delivered during the year of £102.5m, developed as part of the Tt2015 Programme which was formally closed in March 2015.
- 3.2. A key focus has remained strong financial management during the year to ensure that all Departments stay within their cash limits, that no new revenue pressures are created and that they deliver the savings programmes that have been approved. Enhanced financial resilience monitoring has continued through monthly reports to the Corporate Management Team (CMT) and periodic reports to Cabinet.

- 3.3. The third quarter monitoring position remains largely unchanged from the half year position and reflects the strong financial management grip across the County Council. Most Departments are expecting underspends resulting from early delivery of savings during the year.
- 3.4. Adults' and Children's Services are both expected to be at a break even position by year end through pro-active management of the services together with the use of Departmental reserves and agreed corporate support. All departments and their staff deserve credit for the quality of their financial stewardship in the face of these pressures and changes.
- 3.5. The next section outlines the expected outturn position for the current year in more detail.

4. Revised Budget 2015/16

- 4.1. During the current financial year there have been a number of changes to the original budget that need to be taken into account, some of which have already been reported to Cabinet. In addition, it is also timely to review some of the high-level numbers contained within the revenue budget in order to assess the likely impact on the outturn position for the end of this year.
- 4.2. Appendix 2 provides a summary of the original budget that was set for 2015/16 together with adjustments that have been made during the year. The proposed Revised Budget for 2015/16 is then set out for information. The variance between the adjusted and revised budget gives an indication of any one off resources that may be available at the end of the year that could be used to provide additional contributions to the GER or to fund new priorities.
- 4.3. The paragraphs below explain the main adjustments that have been made to the budget during the year:

Adjusted Budget 2015/16

- 4.4. **Departmental Spending** – Departmental spending has increased by £28.7m, the reasons for this are highlighted in the table below:

	£M
Changes to Revenue Contributions to Capital Outlay (RCCO)	17.3
Change in Dedicated Schools Grant (DSG)	1.0
New grant for Independent Living Fund	3.6
New grant for Children's Social Care Innovation	3.0
Reduction in Public Health Grant	(3.0)
Use of cost of change reserves	3.5
Use of Public Health reserve	1.3
Other Net Changes	2.0
Total	<u>28.7</u>

- 4.5. The paragraphs below outline changes to the other items that make up the overall revenue account.
- 4.6. **Capital Financing Costs** – The decrease is due to changes in the capital charges to Hampshire Transport Management for assets that have been purchased which have an impact as it is a Trading Unit.
- 4.7. **Revenue Contributions to Capital Outlay (RCCO)** – The decrease in RCCO reflects changes made to the capital programme and financing during the year but this is entirely offset by other funding changes in budgets or to earmarked reserves so that there is no bottom line impact in 2015/16. The decrease is mainly due to the realignment of the Capital Programme approved in December which saw a number of maintenance programmes that are strictly revenue in nature moved out of the capital programme but this is offset by an increase in service budgets.
- 4.8. **Contingencies** – The reduction in contingencies is the result of transfers made to Departmental budgets during the year.
- 4.9. **DSG and Specific Grants** – The increase in DSG reflects amendments that have been made to the final grant during the year. The increase in specific grants is mainly due to the receipt of a number of new grants including the Independent Living Fund Grant (£3.6m), the Children’s Social Care Innovation Grant (£3m) and some changes in known grants; most notably a £3m reduction in the Public Health Grant and £1.2m of additional New Homes Bonus (NHB).
- 4.10. All of these changes have had no overall impact on the bottom line of the revenue account as they mainly represent transfers between different areas of the budget or represent matching additions of expenditure and income as is the case with additional specific grants.

Revised Budget 2015/16

- 4.11. The fourth column of figures shown in Appendix 2 outlines the proposals for the revised revenue budget for the County Council for 2015/16. At this stage the revised budget for Departments matches the adjusted cash limits that they have been given for the year and therefore no variances are shown for the end of the year. As part of the monitoring updates presented periodically to Cabinet it is anticipated that there will be under spends in departmental budgets by the end of the year. However, in line with current policy all of these underspends can be transferred to departmental earmarked reserves to be used to fund the cost of change in future years and therefore would still have no impact on the bottom-line position of the revenue account.
- 4.12. The forecast position for the majority of services is break even against the revised cash limits reflecting the fact that most Departments are managing their bottom line positions to contain spending pressures or are using any surplus to meet the cost of change in the year instead of drawing from reserves.
- 4.13. **Interest on Balances** – The County Council adopts a prudent approach to estimating for interest on balances given the number of different variables involved. For 2015/16 the budget was increased by £1.5m (to £7.2m) to take account of levels of investment returns and to reflect a change in the investment strategy to look at higher yielding medium term investments. Current forecasts

anticipate that performance in the year will exceed this figure and an additional return of £0.3m is therefore assumed in the revised budget.

- 4.14. As part of change in the investment strategy it was recognised that investments yielding higher returns will contribute additional income to the County Council, although some come with the risk that they may suffer falls in the principal instead. As a consequence, the 2015/16 Investment Strategy recommended that returns from a pooled property fund be used to create a reserve in the County Council's accounts as protection against the irrecoverable fall in value of any investments. It is recommended that a further £0.5m is added to this reserve to further protect the County Council's funds. This is prudent given the additional risk that is being taken in targeting investments with higher returns.
- 4.15. **Capital Financing Costs** – As in previous years, the estimates for this heading are prepared on the basis of taking out new planned borrowing during the year. However, since the County Council has sufficient cash reserves there is no need to actually take out this long term borrowing at this stage, particularly since this would attract a high 'cost of carry' when comparing short term to longer term interest rate levels.
- 4.16. Cabinet approved a change in Minimum Revenue Provision (MRP) policy in December 2015 and as a result of this the amount which must be set aside for repaying external loans and meeting other credit liabilities will be reduced in 2015/16. Whilst this reduction will continue, the saving will diminish over time until the future costs of MRP are eventually higher than current levels from 2033 onwards.
- 4.17. The estimates for 2015/16 have therefore been revised taking these changes into account and show a saving of £9m in the overall capital financing costs for the year.
- 4.18. **Contingencies** – The key items within this budget relate to risk contingencies set aside to reflect the major change and savings programmes that were being embarked on during the year, allowance for waste disposal inflation and disposal costs, together with some other centrally held contingencies in respect of pay and price increases.
- 4.19. In considering the revised estimates position, it is timely to review these contingencies in light of the current financial position highlighted in monitoring reports. At this stage of the year, it is considered prudent to release contingency items in respect of pay and price inflation that have not been used, together with other sums set aside for income risk and the general risk contingency. In total, these items amount to £4.8m which can be declared as savings against the revised budget.
- 4.20. It is important to note that whilst these do represent significant available resources, they must be set in the context of the size and complexity of the County Council's gross budget and the efficiency and change programme that has been implemented in recent years. Contingency sums are set aside for a variety of purposes and it is only now at this late stage in the year that these resources can be deployed for other purposes with greater certainty.

- 4.21. Taking this £4.8m, together with the £9.3m available from capital financing and interest on balances gives a grand total of £14.1m that can be used on a one-off basis.
- 4.22. In addition, the opportunity has been taken to review the level of general fund balances and given the level of contingency sums set aside in the budget the planned contribution is not required in 2015/16. Without this contribution the level of balances remains slightly in excess of 2.5% of the budget requirement which is the broadly recommended level. This £0.9m is a one off and can be added to the £14.1m.
- 4.23. It is proposed that this total of £15.0m is used to fund a number of capital related priorities, described in more detail in the next section, which total £12.5m, that £0.5m is added to the Investment Risk Reserve as explained in paragraph 4.14 and that £2m is added to the GER to ensure there is sufficient funding to meet the revised budget gap in 2016/17.

Capital Related Priorities

- 4.24. In past years it has been possible to add significant additional schemes to the Capital Programme using surplus revenue funding generated by the early achievement of savings. As the financial strategy has evolved and savings have been required to meet the successive budget deficits, there is less ability to do this above and beyond the use of specific capital resources that come from the Government or developers.
- 4.25. However, as detailed above, it has been possible to release £12.5m to fund a small number of capital related priorities over the next three years. These are shown in the following table:

	£M
Reinstatement of Strategic Infrastructure Investment budget following use to fund loan to Farnborough International Limited	4.5
Community building major capital grant allocations	0.5
ETE Capital bidding funding (3 years)	3.0
Planned repairs and maintenance of corporate estate (3 years)	4.5
Total	12.5

- 4.26. The Strategic Infrastructure Investment budget was used to fund the award of a loan to Farnborough International Limited as part of a significant scheme to erect permanent conference facilities for the Air Show that could also be used throughout the rest of the two-year period in between shows. This source of funding was used since the other projects that this money was due to support such as the development at Whitehill and Bordon were not due to commence

until much later. This therefore replaces the funding for the originally intended use.

- 4.27. Over the last few years additional funding has been provided to enable organisations to bid for funding awards for major improvements to community buildings. This has been a successful scheme and has seen extended and improved community use of existing assets as a result. In order to continue this programme, a further £0.5m is recommended to be added to the capital programme in 2016/17.
- 4.28. Funding for major transport schemes is available either through the Government or through the LEPs, and Hampshire has been successful in attracting these major funds over the last few years. However, the ability to respond to what are very often short term opportunities to bid for funding relies on having adequate resources in place to pull together robust bids. It is therefore recommended that annual funding of £1m per annum for the next three years is continued and provided to the Economy Transport and Environment (ETE) Department, given that the current allocation runs out in 2015/16.
- 4.29. Similarly, additional contributions have been made in recent years to the planned maintenance budget for the corporate estate that has been used very effectively to properly maintain the buildings that we continue to occupy, whilst at the same time limiting the reactive maintenance that is required for these properties. The demands on this budget remain significant and a further allocation of £1.5m per annum is therefore recommended in this report for the next three years.
- 4.30. Following a review of the capital programme last December, certain items which were deemed to be more revenue in nature were moved to revenue accounts in order to ensure full compliance with capital accounting regulations.
- 4.31. In line with this change, both the capital bidding funding and the planned repair and maintenance of the corporate estate will be added as additional cash limit to the relevant Department's budget in due course. Only the £4.5m reinstatement of the Corporate Infrastructure Reserve and the £0.5m for community building major capital grant allocations actually therefore have an impact on the overall capital programme presented elsewhere on this agenda.
- 4.32. In addition, approval is also sought in this report to permanently re-instate the Policy and Resources feasibility budget (that will also move to revenue as part of the changes to the revenue / capital split outlined above). This budget was reduced several years ago to £860,000 per annum in response to the reduced values of capital receipts that were being generated, but has in more recent years been reinstated to the original value of £1.29m in order to fund the baseline activity involved in running a capital programme that is at one of the highest levels ever experienced.
- 4.33. The recurring increase of £430,000 will be added to Policy and Resources cash limit following the transfer from capital to revenue of the other £860,000 and this total funding will be available to fund professional fees and expenses that are incurred in taking forward feasibility studies undertaken by Property Services on a range of schemes across the programme.

5. Local Government Finance Settlement

- 5.1. The final Local Government Finance Settlement for 2016/17 is still awaited at the time of the publication of this report. Overall, the provisional settlement has reduced the County Council's RSG by £48m (37.4%) in 2016/17 alone compared to a forecast reduction of £19m and by 2019/20 the County Council will no longer receive any RSG.
- 5.2. This includes the 'baselining' of funding for the Care Act of circa £7m, the Council Tax Freeze Grant of approaching £5.5m and more than £0.2m for lead local flood authorities to carry out a range of duties, all of which are now included within RSG rather than as separate funding streams.
- 5.3. RSG has been allocated by grouping authorities into different classes and then allocating funding so that each separate class of authority receives the same percentage reduction in settlement core funding, the major component of core spending power which is a new measure introduced by the Government.
- 5.4. Core spending power includes the new Better Care Fund (BCF), which begins in 2017/18, and the NHB but is largely made up of core funding which comprises:
 - Settlement Funding Assessment (mainly Business rates and RSG)
 - Council Tax income
- 5.5. This is a major revision to the methodology for distributing RSG and impacts heavily on Shire Counties and Shire Districts and favours metropolitan authorities, geographically moving funding from the south to the north of England in general terms.
- 5.6. The overall average reduction in RSG is 24.5% but the reduction for Shire Counties is more than 30% and for the County Council exceeds 37%. Significant changes to methodology like this are usually consulted on by the Government over the summer ahead of the settlement announcement, but no such warning was given this year.
- 5.7. The headline figures reported on the outcome of the provisional settlement indicate that funding will fall by 2.8% on average in 2016/17 and be virtually unchanged by 2019/20. However, this is the position for the newly defined measure of core spending power which includes assumptions about council tax increases and does not adequately reflect need or the impact of new burdens. This position is clearly very different to the actual changes in RSG which the County Council faces in 2016/17 and beyond.
- 5.8. When calculating core funding the Government have assumed that local authorities will put up their council tax in line with the OBR's forecast for CPI for each year (which is an annual average of 1.75%) throughout the period to 2019/20, rather than the 1.99% maximum allowed before triggering a referendum.
- 5.9. The maximum increase for Hampshire County Council will be 3.99% which includes an extra 2% flexibility to pay for the increasing costs of adults' social care. The report recommends that the County Council increases council tax by this level in 2016/17, in line with these broad assumptions, which will generate additional funding of more than £20m to offset the majority of the greater than

anticipated grant reduction in 2016/17 and builds the assumption into the MTFS for the period to 2020.

- 5.10. High level guidance has been issued about the way that the 2% additional adults' social care precept must be reported to council taxpayers and the Department for Communities & Local Government (DCLG) to ensure that a referendum is not triggered. This is open to interpretation and our current assessment is that we will need to demonstrate that additional resources are allocated to adults' social care, that are at least equal to the value of the precept. These additional resources will help to meet some of the pressures from growing demand and the cost of the NLW but will not remove the need to make savings from the overall social care budget as part of the Council's MTFS.
- 5.11. Other changes include a reduction in the Education Services Grant (ESG) of just under £1.3m in 2016/17 and significant changes are predicted to the ESG in the future, pending further consultation.
- 5.12. Details of the provisional allocation of the NHB for 2016/17 were also published and for the County Council this amounts to just over £7.6m, with an additional £0.3m of funding forecast to be returned from the top slice, which will be added to the Revenue Grants Unapplied Reserve. A consultation on the NHB has been published alongside the settlement setting out proposals to achieve reductions in the overall national grant allocation of £800m by 2019/20. Indicative figures have been published for the next four years which show the reduction over time and for the County Council indicate the grant will reduce to £4.8m by the end of the period.
- 5.13. As previously agreed this funding is added to the Revenue Grants Unapplied Reserve each year and is committed, up to and including 2016/17, to support Operation Resilience. Given that this commitment ends in 2016/17, and in view of the future reductions that are indicated, it will be timely to reassess the position for future years and this will be considered as part of the updated MTFS and future capital programme prioritisation and planning.
- 5.14. Nationally the funding taken from the NHB will, along with £700m of other existing funding, be recycled into a new BCF which will stand at £1.5bn by 2019/20. For the County Council there will be no significant resources until 2018/19 and these resources will be delivered through reductions in other funding such as the NHB. However, it has at least been confirmed that this will be given direct to local government which should better enable the County Council in directing the best use of the fund towards service integration.
- 5.15. The Public Health Grant will continue as a separate ring-fenced grant in 2016/17 and 2017/18 after which the Government have indicated public health funding may be included within the Business Rates Retention Scheme, although this is not shown in any of the published allocations for the next four years. The grant for 2016/17 has not been issued but the budget includes an assumption that this will be £53m.
- 5.16. The overall reductions outlined in this section, and the impact on the budget for 2016/17, are set out in Section 10.
- 5.17. The Government has offered a four-year settlement to authorities who can 'demonstrate efficiency savings' over the period and the settlement provides

provisional funding figures for the period up to 2019/20. At this stage it has not been clarified what local authorities will be required to provide to the DCLG to satisfy the requirements of this offer.

- 5.18. The provisional figures for 2017/18, 2018/19 and 2019/20 which are set out in the settlement result in an increase in the gap that must be bridged in each of these years due to the unexpected revision in the methodology for distributing RSG which has been applied. In 2017/18 the bottom line impact is that a further £15m is required, on top of the savings to be delivered from Tt2017 Programme to deliver a balanced budget, and the revised gap in 2018/19 is £70m rising by a further £70m in 2019/20 to a cumulative figure of £140m, £10m more than previously set out after assuming council tax increases in each of the four years.
- 5.19. This updated position reflects the changes set out in the settlement, revised assumptions about council tax increases each year for the next four years in line with the government's amended approach, and likely pressures from social care demand and the NLW.
- 5.20. It is imperative during the next 14 months that the County Council is not distracted from delivering the Tt2017 Programme, irrespective of the financial outlook in the years beyond 2017/18. Any failure to deliver recurring sustainable savings for 2017/18 will only serve to worsen the position. It is therefore intended to review reserves and complete a further "housekeeping" exercise, in order that additional one off resources can be found by April 2017 to meet the remaining predicted gap of £15m.
- 5.21. The current financial strategy that the County Council operates, works on the basis of a two-year cycle of delivering Departmental savings to close the anticipated budget gap, providing the time and capacity to properly deliver major savings programmes every two years, with deficits in the intervening years being met from the GER. Given that the GER is now in effect fully utilised to balance the position in 2016/17, the revised gap in the interim year of 2018/19 which is circa £70m cannot be bridged in this way, requiring two stages of savings to be made across 2018/19 and 2019/20.
- 5.22. The implications of these changes are explored in Appendix 7 as part of the Director of Corporate Resources report and will be considered and incorporated into an update of the MTFs which will be prepared for consideration in early summer.

6. Service Cash Limits 2016/17

- 6.1. In December 2015 Cabinet considered a budget update report which set provisional cash limit guidelines for Departments for 2016/17. It is worth reiterating at this stage that cash limits have been cut significantly since the period of austerity began as demonstrated in the following table:

2012/13	2 year target	-16.0%
2013/14	efficiency target	-2.0%
2015/16	2 year target	-12.0%
2017/18	2 year target	-14.5%
		<u>-44.5%</u>

- 6.2. In broad terms a further £140m saving would equate to a reduction of at least 22%, taking the cumulative reduction in cash limits to more than 66% over an eight year period.
- 6.3. Appendix 3 sets out the cash limits that were set for 2016/17 and provides information on adjustments that have been made since this time. Overall, cash limits have increased by £17.4m, some of the reasons for which have been outlined in the individual budget reports to Executive Members. The reasons for the increase are shown in the following table:

	£M
Increase in Dedicated Schools Grant	8.6
Decrease in Pupil Premium and other schools' grants	(2.4)
Carry forward of Children's Social Care Innovation Grant	1.0
Addition of Supporting Troubled Families Grant	2.6
Highways Growth	0.4
Increase in "Bikeability" Cycle Training Grant	0.1
Draw from Public Health Reserve	2.1
Increase in Public Health Grant for 0-5 year old provision	8.8
Reduction in Public Health Grant	(5.0)
Realignment of the Capital Programme	1.2
Total	<u>17.4</u>

- 6.4. In a similar way to the changes for 2015/16 these amendments have not had a bottom-line impact on the revenue budget as they represent transfers between Departments or are the result of changes in grants, contingencies, earmarked reserves or RCCO.

7. Savings Proposals

- 7.1. In line with the current financial strategy, there are no new savings proposals presented as part of the 2016/17 budget setting process. Savings targets for 2017/18 were approved as part of the 2015/16 budget setting process and detailed savings have been developed through the Tt2017 Programme and were

approved by Executive Members, Cabinet and County Council in September and October last year.

- 7.2. Progress on the implementation of the Tt2017 Programme is reported to the Corporate Management Team (CMT) every month and is formally reported on to Cabinet.
- 7.3. It is recognised that each successive savings programme is becoming harder to deliver and the Tt2017 Programme has already highlighted the longer timescales needed to make service changes in some areas, most notably adults' social care, which will require support through the use of cost of change to manage the cash-flow across the period along with the prudent use of contingencies. However, any failure to fully deliver the Tt2017 Programme would significantly worsen the council's position thereafter. That is why senior managers will be placing the highest emphasis on that delivery in the following year.
- 7.4. The last report in December 2015 indicated that £30m of the required savings were already secured. Some savings will be implemented prior to April 2017 and any early achievement of savings can be retained by Departments to meet cost of change priorities. It is anticipated that almost £47m of savings will be achieved in 2016/17, and where these savings have already been reflected in the detailed estimates contained in Appendix 4 there is a corresponding contribution to the relevant Departmental Cost of Change Reserve.

8. Service Budgets 2016/17

- 8.1. As explained in Section 6 Departments have been set cash limit guidelines for 2016/17 which include allowances for inflation, pressures and other agreed changes.
- 8.2. The cash limit for Adults' Services was set at £325m which was a £20.6m increase on the previous year. This reflected the allocation of £10m to adults' social care to reduce the savings they are required to deliver, as agreed as part of the MTFs and a further £10.6m largely in recognition of pressures from rising costs.
- 8.3. Appendix 4 provides a summary for each Department of the main services under their control and shows the original budget for 2015/16, the revised budget for 2015/16 and the proposed budget for 2016/17. All Departments are proposing budgets that are within their cash limits.
- 8.4. Since the position set out in the reports to Executive Members, the overall cash limit for ETE has increased by £479,000 to reflect a change for allowable highways growth of £350,000 and an increase in the Department for Transport "Bikeability" Cycle Training Grant of £129,000.
- 8.5. Fees and charges have been raised where there is scope to do so in policy and economic terms, and the inflation allocation has been calculated on the basis that charges are increased in line with the allowance for inflation on expenditure, taking into account areas where it is not necessarily possible to increase charges due to the nature of the arrangements with the clients that we do business with (for example where a fixed income contribution has been agreed in the past).

Details of income reviews and charges were set out and approved in the budget reports for Executive Members.

9. Workforce Implications

- 9.1. The County Council has from the outset been managing the reduction in the workforce in response to the reductions in Government Grant in a planned and controlled way by the use of controlled recruitment, redeployment of staff where possible and a successful voluntary redundancy scheme, which has been used to effectively and sensitively manage staff reductions at what is a very difficult time.
- 9.2. In preparation for the Tt2017 Programme a final offer of Enhanced Voluntary Redundancy (EVR) was made to all non-school staff in the County Council to create a strong platform and provide early momentum. This early momentum was also particularly important as we moved into the 2015/16 financial year and focused on the need to maintain financial prudence across the County Council to provide a strong base position for the budget for 2016/17 and beyond.
- 9.3. As set out in Transformation reports to Cabinet the EVR scheme has enabled the early delivery of circa £18m of savings and so this strategy has proved effective. Whilst this scheme has now closed an alternative approach has been approved which will continue to enable the reduction and transformation of the workforce required to deliver the significant savings needed in the medium term with the aim of minimising compulsory redundancies.
- 9.4. The table below provides a summary of the workforce changes that are expected to happen by the end of 2016/17 and take account not only of the anticipated reduction in posts as a result of the ongoing implementation of savings proposals but also other changes and transfers that have or will impact on Departments during the year.

	FTE
Original Estimate as at 31 March 2016	9,999
Changes Relating to Early EVR	(358)
Transfers and Other Changes	223
Revised Estimate as at 31 March 2016	<u>9,864</u>
Changes Relating to EVR	(81)
Transfers and Other Changes	(2)
Estimate as at 31 March 2017	<u>9,781</u>

- 9.5. The figures included in the budget report last year did not include assumptions around staff reductions as a result of the EVR process. At the time it was recognised that given the current financial position and the fact that this was the last enhanced offer of voluntary redundancy, the anticipated that the numbers

could be significant and these numbers are shown separately in the analysis above.

- 9.6. The net change in posts is a decrease of 218, which reflects the fact that whilst in some areas the number of roles is reducing and changing (facilitated by the EVR scheme), in others we are reconfiguring services and the workforce to deliver the required outcomes in a different way and expanding business either through partnership working or through the extension of trading activities. This reflects the County Council's continued innovative and diverse approach to tackling the financial challenges that it faces.

10. 2016/17 Overall Budget Proposals

- 10.1. Whilst service budgets make up the vast majority of the total budget there are several other items that need to be taken into account before the overall budget and council tax can be set for the year.
- 10.2. Appendix 5 sets out a summary of the overall revenue account starting with the cash limited expenditure for Departments that have been discussed above. The following paragraphs outline the other items that make up the overall revenue account and provide explanations for any significant variances compared to the 2015/16 budget.
- 10.3. **Interest on Balances and Capital Financing Costs** – The reduction of £6m in capital financing costs primarily reflects the ongoing impact of the revised MRP Policy in 2016/17.
- 10.4. **Pension Costs** – Pension costs for past deficit payments are now accounted for centrally. The increase of £1.2m reflects the agreed recovery plan for the latest actuarial valuation of the fund which will increase by 8% per annum until 2019/20.
- 10.5. **Revenue Contributions to Capital Outlay (RCCO)** – Each year, revenue contributions are made to help fund the capital programme. The significant decrease of approaching £19.9m is largely due to the change in the main contribution which reflects the realignment of the Capital Programme approved in December. This saw a number of maintenance programmes that are strictly revenue in nature to the value of £14.4m moved out of the capital programme but this is offset by an increase in service budgets. The remainder is due to the change in the amount of RCCO drawn down from reserves which is offset by an amount in the reserves section of the revenue account. None of these changes therefore has an impact on the overall budget.
- 10.6. **Contingencies** – The budget for contingencies has increased by approaching £5.7m compared to the 2015/16 original budget. Given the projected pressures and the risk and volatility associated with adults' social care further provision has been made corporately for £5.7m to be held centrally within contingencies and drawn down during the year if needed.
- 10.7. This sum together with the £20.6m described in paragraph 8.2 and an estimated demand pressure of £9m that will initially be met by the Department in 2016/17 gives a total increase in the resources that have been provided to deliver Adults' Services from 2015/16 to 2016/17 of £35.3m (11.6%).

- 10.8. Existing contingency provisions in respect of key risk items such as inflationary pressures, including the 2016/17 pay award which has yet to be agreed and the NLW, and demand pressures have been retained in the base budget. These provisions represent the recommendation by the Director of Corporate Resources of a prudent approach to budgeting given the potential pressures the County Council faces. In addition to these contingencies, the County Council has access to sufficient, albeit declining, reserves as part of an on-going strategy for the management of the County Council's financial resources over the medium term.
- 10.9. **Dedicated Schools Grant** – The increase in this budget is due to the increase in pupil numbers.
- 10.10. **Specific Grants** – This income budget has decreased by £3.1m due to a number of changes which reflect the settlement and updated grant notifications for 2016/17.
- 10.11. **Council Tax Freeze Grant** – This grant has now been 'baselined' into RSG and so is no longer a separately identifiable funding stream. As RSG is then cut and will disappear by 2019/20 without any protection for the council tax freeze elements within it, the impact of this movement is that our council tax freeze funding will also completely disappear.
- 10.12. **Coroners Service** – Although the Coroners Service is reported as part of the Policy and Resources budget, it does not form part of the cash limit, as the County Council has no control over the level of spending within this service. It is therefore shown as part of the overall revenue account and it is anticipated that based on recent years spending patterns that the funding will remain largely the same for 2016/17. Actual spending is of course dependent on the number of cases arising during the year and any spend in excess of this amount will be met from contingencies.
- 10.13. **Earmarked Reserves** – Changes to earmarked reserves mainly reflect changes to other budgets elsewhere in the revenue account. However, the significant increase in the draw from earmarked reserves in 2016/17 is due to the use of the GER to balance the budget as explained in the next section.
- 10.14. The County Council holds reserves for many different reasons, but not all of these are available for general usage. Schools balances are for schools exclusive use and other reserves such as the insurance reserve are set aside as part of the Council's overall risk management strategy or are already planned to be used as is the case with the GER which is utilised in 2016/17 in order to dampen the impact of significant and unexpected grant reductions and to provide the time and capacity to develop savings for implementation.
- 10.15. A comprehensive Reserves Strategy has been presented as part of previous MTFS updates to Cabinet and Council and this has been updated to include the figures at the end of March 2015 and is set out in Appendix 6.
- 10.16. This highlights the point that only 16.6% of reserves are truly available to be used to support revenue spending and to help fund the cost of the change programmes across the County Council. In addition, the GER which comprises the majority of these 'Available Reserves', standing at £50.9m at the end of 2014/15 (before further contributions in 2015/16), is in reality fully committed as

this report includes a planned net draw to balance the budget in 2016/17 of £54.5m.

- 10.17. **Use of General Balances** –The 2015/16 original budget assumed a net contribution to general balances of £0.9m and this prudent annual amount has been continued for 2016/17, to maintain the minimum level of reserves at an appropriate level as recommended by the Director of Corporate Resources, currently around £21.5m.
- 10.18. Appendix 7 represents the Director of Corporate Resources view of the overall budget and the adequacy of reserves which must be reported on as part of the main budget proposals in accordance with Section 25 of the Local Government Act 2003. In particular, it considers risks within the budget and in the MTF5 going forward, updated to reflect the impact of the settlement, and places this in the context of the recommended contingencies and balances set out in this report.

11. Budget and Council Tax Requirement 2016/17

- 11.1. Although this report recommends increasing council tax by 3.99%, there are other changes within the council tax calculation that also have an impact on the budget. The County Council is notified by Hampshire Districts, of the estimated level of collection fund surplus or deficits that needs to be taken into account in setting the council tax for 2016/17. In addition to the figures for council tax, Districts are required to provide estimates of their surplus or deficit on the Business Rates collection fund, following the introduction of Business Rates Retention in April 2014.
- 11.2. For 2015/16 a net council tax collection fund surplus of just over £9.2m is anticipated of which only £1.5m was assumed in the original forecast. This has mainly arisen due to general increases in the council tax base during the year, but also as a result of continued changes in local Council Tax Support Schemes (CTSS) which replaced council tax benefit from April 2014. The impact of these schemes remains difficult to predict in terms of changes in council tax base and collection rates and indications continue to be that the reductions are not as great as originally anticipated.
- 11.3. The current prediction for business rate collection funds is a deficit of circa £1.1m across all Districts, although there are varying levels of surpluses and deficits that make this up. This reflects the fact that there remain risks around appeals and volatility and uncertainty continues such that this position could still be subject to change after this report has been despatched.
- 11.4. Similarly, Districts have provided estimates of what Business Rate income they expect to receive for 2016/17 based on their experience during the current financial year. These estimates have yet to be finalised and, given recent experience about the risk and volatility surrounding this income, at this stage have not been built into the budget position. We will await confirmation of final figures and any adjustment will be reported at County Council.
- 11.5. Final details of the compensation grant that Hampshire is due to receive following the caps and reliefs granted by Government in past budgets have yet to be notified and will therefore change the anticipated income from this source in the

final budget so again we will await confirmation and any adjustment will be reported at County Council.

- 11.6. In addition, Section 5 outlines the fact that following the provisional settlement in December last year, the County Council has received a further reduction in RSG of £29m and other grant changes, which feed into the overall Council Tax calculation.
- 11.7. The financial update report presented to Cabinet in December 2015, forecast that a significant draw would be required from the GER to balance the budget in 2016/17. Taking into account all of the items in this section, gives the following position:

	£M
Original gap	50.3
Further loss of Revenue Support Grant	29.9
Loss of ESG	1.3
Revised Gap	81.5
Increase in Council Tax @ 3.99%	(20.4)
One-off Business rates collection fund deficit	1.1
One-off Council tax collection fund surplus	(7.7)
Draw from GER	(54.5)
Balanced Budget	0.0

- 11.8. The table above shows that as a result of the net one off surpluses in council tax and business rates, the County Council is able to set a balanced budget with a draw of £54.5m from the GER, which almost fully utilises this reserve, leaving a balance of only £0.5m.
- 11.9. Local authorities are required to report a formal council tax requirement as part of the budget setting process and the recommendations to Council later in this report show that the Council Tax Requirement for the year is £532,722,020.

12. Treasury Management Strategy and Investment Strategy for 2016/17

- 12.1. The County Council is required to adopt a treasury management strategy and an annual investment strategy for 2016/17 and these are set out in Appendix 8 for approval. The strategy has been reviewed in light of current and forecast economic indicators and remains broadly unchanged from last year when the adoption of a more active approach to managing the portfolio of existing borrowing was included.

- 12.2. The revised approach of placing a part of the portfolio into longer term investments with other Local Authorities, or equity, bond or property investments is expected to yield additional return as planned.
- 12.3. As part of this decision it was recognised that investments yielding higher returns will contribute additional income to the County Council, although some come with the risk that they may suffer falls in the principal instead. As a consequence, the 2015/16 Investment Strategy recommended that the initial returns from a pooled property fund be used to create a reserve of £0.5m in the County Council's accounts as protection against the irrecoverable fall in value of any investments. It is recommended that a further £0.5m is added to this reserve in 2015/16 as set out in Section 4 to further protect the County Council's funds. This is prudent given the additional risk that is being taken in targeting investments with higher returns.
- 12.4. As agreed by Cabinet in December 2015 for the calculation of MRP from 2015/16 onwards the County Council will change from calculating MRP for supported borrowing on a 4% reducing balance to a 50-year straight line basis. To be more prudent the 50 years has been started from 2008 and the actual calculation will therefore be 1/43's. This will ensure that the County Council continues to take a prudent approach to repaying its supported borrowing, ensuring that the supported borrowing is repaid sooner, as well as contributing to the County Council's immediate financial pressures.

13. Prudential Indicators

- 13.1. The prudential code that applies to local authorities ensures that:
 - Capital programmes are affordable in revenue terms
 - External borrowing and other long-term liabilities are within prudent and sustainable levels
 - Treasury management decisions are taken in line with professional good practice
- 13.2. Some of the limits have been altered to reflect the revised treasury management and investment strategy although this does not expose the County Council to any greater levels of risk.
- 13.3. Appendix 8 also contains the prudential indicators required by the code for the County Council which will now be submitted for approval by the full County Council in setting the budget for 2016/17.

14. Consultation

- 14.1. A consultation was undertaken in order to inform the County Council's ongoing transformation and efficiencies programme in accordance with legal best-practice. The Shaping Hampshire - Spending Review Consultation that was carried out by Ipsos MORI on behalf of the County Council, between 26 May and 6 July 2015 aimed to seek residents' and stakeholders' views on a range of options for finding further budget savings by April 2017, including setting Council

Tax, using reserves and making changes to the way in which services are delivered.

- 14.2. A detailed report on the results of the consultation was presented to Cabinet in September and a summary is contained in Appendix 9. This highlighted that the majority of respondents (79%) supported the County Council's high level financial strategy for dealing with the reductions in Government Grant and gave a helpful view on the options that respondents feel the County Council should consider further in order to manage the anticipated shortfall in funding, including those around the setting of council tax.
- 14.3. A key issue arising from the consultation feedback was respondent's views on council tax increases. 55% of respondents supported an increase in council tax of between 1% and 1.99% and 20% supported an increase of 3%, whilst 21% did not want any increase at all.
- 14.4. As part of the telephone survey, those respondents that supported a council tax increase generally wanted the additional resources that this generated to protect services for vulnerable adults and children. In considering these responses, the County Council must also look at the broader context of raising council tax at the current time. Key advantages of raising council tax which were highlighted include:
- It would, as suggested in the consultation feedback, provide resources that could be used to replace savings proposals that affect vulnerable adults and children.
 - Any increases are recurring in nature and therefore add to the base level of income each year.
 - An increase in council tax is easy to implement and at the point the decision is formally taken, represents guaranteed income to the County Council.
- 14.5. At that time, it was recognised that any final decisions on council tax increases are made by full County Council in February each year and without having clear indications from Government on future financial settlements, the availability of council tax freeze grant and likely referendum limits it was not sensible to make any firm decisions at that point. As a consequence, the previous planning assumption for council tax, of no increase over the period of the MTFS to 2017/18 was maintained. However, what the consultation process provided, was a useful snapshot of residents' views on council tax increases to be taken into account in developing the next stage of the MTFS and future budget setting.
- 14.6. Following the Shaping Hampshire Spending Review Consultation, a series of more detailed consultations are being undertaken, in accordance with best legal practice, on some of the savings proposals included within the Tt2017 Programme.
- 14.7. This second round of consultation is being supported through a range of feedback methods, including online questionnaires, hard copies, telephone surveys, user focus groups and public forums, and it is intended that the outcome of this second round of consultation will help to inform further detailed Executive decisions in the coming months.

Council Tax

- 14.8. Following the announcement of the provisional Local Government Finance Settlement it is now clear that the Government have assumed that local authorities will put up their council tax by the maximum they are allowed. For Hampshire County Council this will be 3.99% which includes an extra 2% flexibility to pay for the increasing costs of adults' social care.
- 14.9. This indicates a shift in Government policy following five years of freezing council tax, supported by the allocation of council tax freeze grant. If the County Council does not increase council tax an additional budget gap of £20.4m in 2016/17 would remain with no identified way to close this that would not severely impact services.
- 14.10. Taking this and the consultation into account, the report recommends that the County Council increases council tax by 3.99%, in line with the government's assumptions which will generate additional funding of more than £20m to offset the majority of the greater than anticipated grant reduction in 2016/17 and enable services for vulnerable adults and children to be better protected.
- 14.11. Whilst this increase, which will see the Council Tax for a Band D property increase by £41.40 per annum to £1,079.28, ends five consecutive years of freezing council tax, the proposed increase will see council tax at a far lower level than it might have been. The table below shows the level of council tax being proposed for a band D property and compares this to level which council tax would have been across a range of scenarios, demonstrating the relative position for 2016/17:

Scenario	Band D Council Tax 2016/17 £	Variance to Proposed Council Tax 2016/17 £
Proposed council tax for 2016/17	1,079.28	
Increase by CPI per annum since 2010/11	1,166.02	+ 86.74
Increase by RPI per annum since 2010/11	1,210.23	+ 130.95
Increase by the referendum threshold each year since 2010/11	1,215.17	+ 135.89

15. Recommendations

RECOMMENDATIONS TO CABINET

- 15.1. The consultation response to the provisional Local Government Finance Settlement published on 17 December contained in Appendix 1 be noted.
- 15.2. The revised planning assumption of a 3.99% council tax increase each year in the period to 2020 be confirmed.

- 15.3. The revised budget for 2015/16 contained in Appendix 2 be approved.
- 15.4. The updated cash limits for Departments for 2016/17 as set out in Appendix 3 are approved.
- 15.5. The proposed service budgets for 2016/17 (which include the implications of the annual review of charges) as set out in Appendix 4 are approved.
- 15.6. The overall budget for the County Council for 2016/17 as set out in Appendix 5 be approved.
- 15.7. Estimated general balances of around £21.5m at 31 March 2017, be approved (paragraph 10.17).
- 15.8. Delegated authority be given to the Director of Corporate Resources, following consultation with the Leader and the Chief Executive to make changes to the budget following Cabinet to take account of new issues, changes to figures notified by District Council's or any late changes in the final Local Government Finance Settlement.
- 15.9. **It be a Cabinet recommendation to Council that**
- a) The Treasurer's report under Section 25 of the Local Government Act 2003 be taken into account when the Council determines the budget and precept for 2016/17 (Appendix 7).
 - b) The Revised Budget for 2015/16 set out in Appendix 2 be approved.
 - c) The Revenue Budget for 2016/17 (as set out in appendices 4 and 5) be approved.
 - d) The one off capital related priorities totalling £12.5m and the recurring increase in the Policy and Resources feasibility budget of £430,000 as set out in paragraphs 4.24 to 4.33 be approved.
 - e) The total **budget requirement** for the general expenses of the County Council for the year beginning 1 April 2016, be £732,646,954.
 - f) The **council tax requirement** for the County Council for the year beginning 1 April 2016, be £532,722,020.
 - g) The County Council's band D council tax for the year beginning 1 April 2016 be £1,079.28, an increase of 3.99% of which 2.00% is specifically for adults' social care.
 - h) The County Council's council tax for the year beginning 1 April 2016 for properties in each tax band be:

	£
Band A	719.52
Band B	839.44
Band C	959.36
Band D	1,079.28

Band E	1,319.12
Band F	1,558.96
Band G	1,798.80
Band H	2,158.56

- i) Precepts be issued totalling £532,722,020 on the billing authorities in Hampshire, requiring the payment in such instalments and on such date set by them previously notified to the County Council, in proportion to the tax base of each billing authorities area as determined by them and as set out below:

Basingstoke and Deane	62,760.20
East Hampshire	48,627.61
Eastleigh	43,336.07
Fareham	42,005.70
Gosport	25,945.90
Hart	38,407.66
Havant	39,428.00
New Forest	69,632.30
Rushmoor	30,172.66
Test Valley	46,439.00
Winchester	46,835.09

- j) The treasury management and annual investment strategies, prudential and financial health indicators for 2016/17 be approved, in accordance with the recommendations in Appendix 8.

RECOMMENDATIONS TO COUNCIL

Council is recommended to approve:

- a) The Treasurer's report under Section 25 of the Local Government Act 2003 and take this into account when determining the budget and precept for 2016/17 (Appendix 7).
- b) The Revised Budget for 2015/16 set out in Appendix 2.
- c) The Revenue Budget for 2016/17 (as set out in appendices 4 and 5).
- d) The one off capital related priorities totalling £12.5m and the recurring increase in the Policy and Resources feasibility budget of £430,000 as set out in paragraphs 4.24 to 4.33.

- e) That the total **budget requirement** for the general expenses of the County Council for the year beginning 1 April 2016, be £732,646,954.
- f) That the **council tax requirement** for the County Council for the year beginning 1 April 2016, be £532,722,020.
- g) That the County Council's band D council tax for the year beginning 1 April 2016 be £1,079.28, an increase of 3.99% of which 2.00% is specifically for adults' social care
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Havant	39,428.00
New Forest	69,632.30
Rushmoor	30,172.66
Test Valley	46,439.00
Winchester	46,835.09

- j)** The treasury management and annual investment strategies, prudential and financial health indicators for 2016/17, in accordance with the recommendations in Appendix 8.

CORPORATE OR LEGAL INFORMATION:**Links to the Corporate Strategy**

Hampshire safer and more secure for all:	yes
Maximising well-being:	yes
Enhancing our quality of place:	yes

Section 100 D - Local Government Act 1972 - background documents

The following documents discuss facts or matters on which this report, or an important part of it, is based and have been relied upon to a material extent in the preparation of this report. (NB: the list excludes published works and any documents which disclose exempt or confidential information as defined in the Act.)

<u>Document</u>	<u>Location</u>
Transformation to 2017: Consultation Outcomes	Cabinet – 21 September 2015
Medium Term Financial Strategy Update and Transformation to 2017 Savings Proposals	Cabinet – 5 October 2015
Budget Setting and Provisional Cash Limits 2016/17	Cabinet – 7 December 2017

IMPACT ASSESSMENTS:

1. Equality Duty

1.1. The County Council has a duty under Section 149 of the Equality Act 2010 ('the Act') to have due regard in the exercise of its functions to the need to:

- Eliminate discrimination, harassment and victimisation and any other conduct prohibited under the Act;
- Advance equality of opportunity between persons who share a relevant protected characteristic (age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, gender and sexual orientation) and those who do not share it;
- Foster good relations between persons who share a relevant protected characteristic and persons who do not share it.

Due regard in this context involves having due regard in particular to:

- a) The need to remove or minimise disadvantages suffered by persons sharing a relevant characteristic connected to that characteristic;
- b) Take steps to meet the needs of persons sharing a relevant protected characteristic different from the needs of persons who do not share it;
- c) Encourage persons sharing a relevant protected characteristic to participate in public life or in any other activity which participation by such persons is disproportionately low.

1.2. Equalities Impact Assessment:

The budget setting process for 2016/17 does not contain any proposals for major service changes which may have an equalities impact. Proposals for budget and service changes which are part of the Transformation to 2017 Programme were considered in detail as part of the approval process carried out in September and October 2015 and full details of the Equalities Impact Assessments relating to those changes can be found in Appendices 3 to 6 in the October Cabinet report linked below :

http://www3.hants.gov.uk/councilmeetings/advsearchmeetings/meetingsitemdocuments.htm?sta=&pref=Y&item_ID=6920&tab=2&co=&confidential=

2. Impact on Crime and Disorder:

2.1. The County Council has a legal obligation under Section 17 of the Crime and Disorder Act 1998 to consider the impact of all the decisions it makes on the prevention of crime.

2.2. The proposals in this report are not considered to adversely affect the prevention of crime.

3. Climate Change:

3.1 How does what is being proposed impact on our carbon footprint / energy consumption?

There are no specific proposals which impact on the County Council's carbon footprint or energy consumption.

3.2 How does what is being proposed consider the need to adapt to climate change, and be resilient to its longer term impacts?

There are no specific proposals which directly relate to climate change issues.

REVENUE BUDGET – LIST OF APPENDICES

1. Response to Consultation on the Provisional 2016/17 Local Government Finance Settlement (*page 31*)
2. Revised Budget 2015/16 (*page 44*)
3. Final Cash Limit Calculation 2016/17 (*page 46*)
4. Proposed Departmental Service Budgets 2016/17 (*page 47*)
5. Proposed General Fund Revenue Budget 2016/17 (*page 54*)
6. Updated Reserves Strategy (*page 56*)
7. Section 25 Report from Chief Financial Officer (*page 63*)
8. Treasury Management Strategy and Investment Strategy 2016/17 to 2018/19 (*page 69*)
9. Summary of *Shaping Hampshire* - Spending Review Consultation (*page 92*)

Hampshire County Council

Response to Consultation on the Provisional 2016/17 Local Government Finance Settlement

Q1. Do you agree with the methodology for allocating central funding in 2016/17, as set out in paragraphs 2.6 to 2.8?

Hampshire County Council is extremely disappointed by the highly unfair and deeply flawed methodology used in the provisional local government finance settlement. Prominent amongst the settlement's many faults is its use of a discredited funding formula (described by the Home Office as "not fit for purpose"), double counting of council tax generating ability and breaches of the new burdens doctrine. The DCLG should urgently reconsider the settlement.

We accept that financial reductions need to be made, but this should be done in an equitable manner. Contrary to this, the settlement redistributes funding from councils which already have a low level of spending per person to those which enjoy a high level of spending per person. This is shown by the DCLG's own figures. In 2015/16 the county and borough councils have a combined core spending power per dwelling in Basingstoke (Hampshire) of just £1,519. Other parts of the country are funded much more generously than Hampshire. Manchester City Council powers away with £1,942 of spending power per dwelling, whilst Islington enjoys £2,177 per dwelling (plus a very generous £560 per dwelling from the Greater London Authority). As these figures show Hampshire is already heavily underfunded by the Government, it is unjustifiable why the settlement should give us some of the heaviest cuts. In 2016/17 a huge £48 million (37.4%) cut is proposed to be made to Hampshire County Council's Revenue Support Grant, with it being completely cut by 2019/20.

The settlement does not question the appropriateness of these differences in council spending power and assumes that councils with a higher spending power deserve this funding. However, this excess funding of some areas is not based on need. It is instead due to a completely discredited formula (the Four Block Model, the allocations from which were frozen into the business rates retention system) having been used to set these levels of funding. Chief amongst the many flaws of the formula was its obsession with allocating funding through deprivation indicators for services which have little or no link with deprivation. For instance, it would be reasonable to expect adult social care funding allocations to be based on indicators which predict the numbers of elderly and disabled people requiring care. However, the adult social care section of the Four Block Model also included indicators for statistics such as "people aged 16-64 who are long term employed or have never worked", which shower resources on some parts of the country whilst severely underfunding areas with high social care pressures such as Hampshire.

The Four Block Model also took into account the council tax base of a council, with the resource equalisation element (excessively) removing grant from a council as its council tax generating ability increased. Being based on the Four Block Model, the Revenue Support Grant and business rates baseline figures thus already take into account the council tax resources of an area. Therefore, the new council tax adjustment added in to the finance settlement calculations in 2016/17 results in the council tax generating ability of a council being double counted. It is deeply concerning that this error has been made. To correct it

the council tax requirement needs to be removed from the calculations used to determine Revenue Support Grant levels.

The fact that the Four Block Model is not a sound method for funding local services is far from being just the view of Hampshire County Council. It is also supposed to be the Government's official policy that the formula is inappropriate. Earlier this year the Home Office described the Four Block Model as "highly complex", "opaque", "out of date" and most damningly "not fit for purpose".¹ Consequently, the Home Office is currently working on a complete replacement of the Four Block Model for allocating police funding. The Department for Education is amongst other Government departments which have acknowledged that many other funding formulas, such as the schools funding formula, are severely biased against shire areas.

Even the 2016/17 settlement consultation paper effectively concedes that the funding allocations are unfair, as it is proposed to give additional funding to support the cost of providing services in rural areas (unfortunately the flawed allocation methodology for the Rural Services Delivery Grant will provide nothing to many councils serving large rural areas). The underfunding of rural services is of course due to the bias of the Four Block Model against shire areas. It is extremely regrettable that, having recognised that rural services are underfunded, the DCLG did not logically progress to the conclusion that the whole formula behind council funding allocations is not fit for purpose.

The case for reviewing the prejudice against shire areas in the settlement funding allocations is indisputable and work must be undertaken to correct this. We appreciate that a thorough review of how Government funding is allocated will require some time to be carried out. Until then, as an interim measure, the finance settlement should abandon the defective "settlement core funding" measure and instead make an even percentage cut solely to the Revenue Support Grant of each council. There is a strong case for also providing additional funding for the most poorly funded authorities such as Hampshire, in recognition of the fact that they are already operating with a low level of funding compared to the demand they face for services.

The position in respect of the changes to the methodology for RSG is then further exacerbated by the proposal to distribute the new Better Care Fund on the same basis. This methodology deducts funding for council tax generating ability, but this is already excessively taken into account in funding allocations. The adult social care relative needs formula is far from perfect (we have already noted its peculiar selection of indicators, such as unemployment levels) but it would at least be more appropriate to use it on its own, rather than with a council tax adjustment which makes it even more biased against shire areas. Using the unadjusted formula would have given Hampshire around £31m as opposed to the 2019/20 provisional figure of £19m, a further loss of £12m recurring funding on top of the £129m loss of RSG we face over the four year period.

Q2. Do you agree with the proposed methodology for calculation of the council tax requirement for 2016/17, as set out in paragraphs 2.10 and 2.11?

¹ <https://www.gov.uk/government/consultations/reforming-police-funding-arrangements-in-england-and-wales>

We very strongly disagree with the settlement's overall treatment of council tax. Resource equalisation was a key feature of the Four Block Model, with Government funding (disproportionately) removed as the council tax generating ability of a council increased. Council funding is still based on the Four Block Model, as the funding allocations from it have been frozen into the business rates retention funding system. Consequently, the levels of Revenue Support Grant and business rates baseline funding for each council already more than fully take into account its council tax generating ability. The additional council tax adjustment being made in the 2016/17 settlement thus double counts the council tax generating ability of Hampshire County Council. This error needs urgently correcting, with the council tax requirement removed and the calculations to determine Revenue Support Grant rerun.

The Revenue Support Grant calculations for each year use the 2015/16 council tax requirement and do not include any increase. We agree with such an approach, as it is the democratic right of elected councillors to determine the authority's council tax level, including whether there should be any increase. It would also be inappropriate for the DCLG to predict any growth to the council tax base as housing growth can vary between years. Any council tax raised from new homes will be needed to provide services to these homes, so can not be used to make up for cuts affecting existing homes.

Unfortunately, other elements of the settlement calculations then do the complete opposite of this approach. Most obviously, the Better Care Fund allocations assume that councils will make a 2% adult social care council tax increase. Detailed examination of other settlement elements also reveals local authorities would have to raise the non adult social care part of council tax in order to receive the amount of money they are supposed to obtain from the settlement.

This is due to the presence of several major funding streams within Revenue Support Grant, which will be completely cut for Hampshire in 2019/20. This includes tens of millions pounds worth of funding for streams such as Learning Disability and Health Reform, Care Act and Early Intervention. However, the settlement's "visible lines" measure claims that Hampshire will still have this funding in 2019/20! As the government grant for them will have been cut and they aren't resourced from current council tax receipts, the settlement thus expects a substantial increase in council tax to pay for them. Many of these visible lines are for the costs of new Government policies. In order to honour the Government's New Burdens doctrine (of reducing pressure on council taxpayers) these are meant to be funded by Government grants, not council taxpayers. That doctrine is therefore being directly undermined by this settlement.

The unreasonable pressure the settlement places on Hampshire's council taxpayers is best shown by its treatment of the council tax freeze grant. The consultation paper claims that "the extra funding for having frozen council tax will continue to be available." However, the 2015/16 council tax freeze grant is being rolled into Revenue Support Grant (which already contains much freeze funding from previous years). Our Revenue Support Grant is proposed to be completely cut, without any protection given to the council tax freeze elements. Therefore, the only possible way for us to maintain our council tax freeze funding is to increase council tax to make up for the grant loss! Such an absurd requirement exposes the inherent contradictions within the settlement.

Such an approach places councils under huge pressure to increase council tax, otherwise they face an even larger funding gap. The entire settlement funding methodology should instead assume no council tax increase, so councils are not penalised if they wish to freeze council tax, especially as the Government has been heavily pressurising them to freeze in recent years. Authorities like Hampshire who have diligently frozen their council tax over the last five years in line with Government policy also face the prospect of being severely disadvantaged compared to others that have put up council tax during the period. The Government had stated that it would build all Council Tax Freeze Grant into baseline RSG and whilst technically this has been the case, this is of course no use whatsoever to an authority such as Hampshire who see their entire RSG cut over the next four year period. As a result our council tax base is some £50m per annum less than it would have otherwise been, with no compensation for this coming from the very Government who urged us to continue to freeze council tax up to the current financial year.

Furthermore, by including council tax in the settlement the Government is strongly mandating how it should be spent. In Hampshire's case, the Government is expecting Hampshire's hardworking taxpayers to pay more tax, not to provide improved services in Hampshire, but to subsidise more generously resourced services elsewhere in the country by enabling a steep cut to Hampshire's Revenue Support Grant. Councils should be free to use council tax revenues as most appropriate to local circumstances. This includes funding services overlooked in the finance settlement, for example, Hampshire faces increased costs from serving a large rural population but receives nothing at present from the Rural Services Delivery Grant to assist with this.

Q3. Do you agree with the proposed methodology in paragraph 2.12 for splitting the council tax requirement between sets of services?

As a solely upper tier authority we are not affected by this item so have no particular opinion on the proposed methodology.

Q4. Do you wish to propose any transitional measures to be used?

With only a few months to go until the start of the new financial year, councils such as Hampshire County Council have suddenly been left in a much worse financial position than expected, due to the Government's decision to target cuts at councils which are already the least generously funded. There was no prior consultation before the announcement to warn councils of such a major change in policy. It will be difficult for councils to make all the required savings in year (especially as the four year cuts have been front loaded in 2016/17) as they may need to consult on how to deal with the difficult position they have been placed in.

Transitional funding will slightly slow the pace of cuts but councils would still end up at the same settlement funding allocation levels. Our response has already made clear that these allocations are indefensible. Far more is needed than transitional measures. A complete review needs to be undertaken of the current underfunding of shire areas. Until this is satisfactorily completed all councils in the same service tier should receive the same percentage cut to their Revenue Support Grant. Additional funding should also be provided to the most poorly funded authorities such as Hampshire. Such an approach would be

consistent with that taken by the Home Office in response to the weaknesses of the Four Block Model. Until a new police funding formula is ready it has followed a policy of making the same percentage cut to the police grant for each Police and Crime Commissioner, because it lacks confidence in the Four Block Model to fairly determine police grant levels.

We are aware that some other councils have discussed short term fixes with the DCLG, such as pension contribution holidays, but do not support these as they just delay rather than resolve the initial problem, as well as creating future problems for areas where holidays have been taken.

Q5. Do you agree with the Government's proposal to fund the New Homes Bonus in 2016/17 with £1.275 billion of funding held back from the settlement, on the basis of the methodology described in paragraph 2.15?

Provisional allocations for the New Homes Bonus have already been calculated and previous experience shows that the final allocations are highly unlikely to significantly differ. Therefore, no more should be held back from the settlement than is required to fund the provisional allocations, with all sums in excess of this released into the settlement now.

In two tier areas the New Homes Bonus is split 80:20 between the district and county council. However, funding for the New Homes Bonus is top sliced the opposite way round. The New Homes Bonus is thus effectively a transfer of resources from upper tier to lower tier authorities. As this settlement is supposed to give greater protection to stretched adult and children's social care services (provided by upper tier councils), now would be an opportune time to correct this inconsistency, with 80% of the New Homes Bonus funding instead taken from the lower tier control total. This would help ensure the Bonus incentivised house building rather than creating a funding shortfall for social care.

We note that the Government appears to recognise that the New Homes Bonus has starved upper tier authorities of resources for social care, as over the next few years it intends to redirect funding from the New Homes Bonus to the Better Care Fund. However, the provisional Better Care Fund allocations published with the settlement show that these resources will not go to where they are most needed, with shire areas once again left severely underfunded.

Q6. Do you agree with the Government's proposal to hold back £50 million to fund the business rates safety net in 2016/17, on the basis of the methodology described in paragraph 2.19?

The high level of top slicing is increasing the severity of cuts to Revenue Support Grant in 2016/17. As the Government currently takes a generous 50% share of local business rates (and 100% of rates from the central list) it would seem fair for the Government to share some of the risks of the business rates system and fund any safety net excess from its central share. The level of safety net payments is greatly affected by how the business rates retention system was designed, which sees some district councils pay very high tariffs and thus at great risk of triggering the safety net. The forthcoming introduction of full local retention of business rates would be an opportune time to see if these risks (and consequently the call on the safety net) can be reduced.

Q7. Do you agree with the Government's proposed approach in paragraph 2.24 to paying £20 million additional funding to the most rural areas in 2016/17, distributed to the upper quartile of local authorities based on the super-sparsity indicator?

We agree that councils which serve rural areas are significantly underfunded as the Four Block Model's excessive focus on deprivation resulted in it failing to recognise the drivers of service costs in rural areas, such as additional staff travel time and the lack of ready access to local support services for more vulnerable service users which in turn puts a higher pressure on local authority services. However, the proposed methodology fails to provide funding to many rural areas, so needs rethinking.

The size of the rural area covered by Hampshire County Council is one of the largest of any council in the country. Despite this, the methodology used to allocate the Rural Services Delivery Grant fails to provide us with any funding. This is because the Super Sparsity Indicator used in the formula measures net sparsity rather than gross sparsity, so Hampshire's rural areas are netted off by the more densely populated parts. This fails to recognise that the increased cost of serving the rural areas still remains. In 2016/17 the illogical situation will remain that rural funding will go to Winchester City Council to support the lower tier services it provides to rural communities, but Hampshire County Council will receive none for the upper tier services it provides to the same communities. The methodology for allocating rural service funding needs to be rethought. Net sparsity should be replaced with a measure of the gross numbers of people living in sparse or rural areas.

Q8. Do you agree with the Government's proposal that local welfare provision funding of £129.6 million and other funding elements should be identified within core spending power in 2016/17, as described in paragraph 2.28?

Transparency over government funding is important but "identifying" funding is not the same thing as actually providing funding. The finance settlement does the former rather than the latter. This is because the funding is being identified out of the core spending power measure, which includes council tax income. The stated funding will thus only be available if council tax revenues are used to help fund what the consultation paper states are "government grants". In some cases, Hampshire's council tax payers are being expected to fully fund these supposed government grants. For instance the Care Act funding is being rolled into Revenue Support Grant, which will be completely cut in 2019/20, so the £11 million "identified" for this in 2019/20 cannot possibly be coming from the Government.

These grants are not currently funded from council tax receipts, so the settlement's methodology expects Hampshire County Council to raise tens of millions of pounds of extra council tax to fund these. The published settlement figures do not contain a breakdown of the visible lines currently within Revenue Support Grant. However, using the information in the consultation paper and from the 2015/16 settlement, it can be determined that our adjusted 2015/16 Revenue Support Grant contains at least £70 million of funding which the settlement claims to protect (visible lines and council tax freeze grants). The notional amount in 2019/20 would be even higher, as some of the visible lines grow in size. A £70 million increase in the non adult social care element of council tax would of course be far in excess of what the Government's own rules deem to be excessive.

The only other way the core spending power measure's methodology could fund these rapidly fading visible lines is by diverting existing council tax receipts. However, these receipts are of course already being used to fund essential services. In particular, a very large amount of council tax receipts are used to fund adult social care. Other vital services funded by them range from child protection to highways maintenance. The settlement's logic is thus shown once again to be hopelessly contradictory. The visible lines methodology requires cuts to the very same social care services the settlement claims elsewhere to protect, as well as requiring unpalatable cuts to other crucial services.

Regarding local welfare provision funding, the consultation paper claims that the settlement nationally contains £129.6m of funding every year for this. However, this amount actually originates from the DCLG's previous decision (after coming under pressure about the abolition of local welfare funding) that it would be "assumed" (the DCLG's own phrasing²) that the 2015/16 settlement contained £129.6m of funding for local welfare. This assumption was made after the settlement control total had already been set and no extra funding was added to the control total. This means that the settlement actually contains £0 for this rather than £129.6m.

If the Government is willing to provide proper amounts of Revenue Support Grant (or separate section 31 grants) to fund specific services then it would be reasonable to separately identify these items within the finance settlement. However, "identifying" funding where none actually exists solely and unhelpfully creates the illusion that local authorities have funding for a service when they have been given none.

Q9. Do you agree with the Government's proposal to include all of the grant funding for the Care Act 2014 (apart from that funded through the Better Care Fund) in the settlement, using the methodology set out in paragraph 3.2?

We strongly disagree with the rolling into Revenue Support Grant of any Care Act funding. This is because the cuts methodology for Revenue Support Grant does not take any account of the Care Act pressures faced by each council. A relatively large proportion of Hampshire's population is in older age groups, so we consequently have above average funding needs. A sensible funding methodology would recognise this and protect Hampshire's Care Act funding. However, because the Revenue Support Grant cuts are unfairly targeted at already poorly funded councils, putting Care Act funding into Revenue Support Grant means that by 2019/20 Hampshire will be left with £0 of Government funding for its Care Act costs.

The Care Act costs are a new burden on councils, as they result from a Government policy. However, by 2019/20 Hampshire's council taxpayers are being expected to pay the entire bill for them. This is in complete breach of the Government's new burdens doctrine, which states that:

"To ensure that the pressure on council tax is kept down, the net additional cost of all new burdens placed on local authorities by central Government must be assessed and fully and properly funded."³

² <https://www.gov.uk/government/consultations/local-welfare-provision-in-2015-to-2016>

³ <https://www.gov.uk/government/publications/new-burdens-doctrine-guidance-for-government-departments>

Using council tax to fund new burdens is the exact opposite of the new burdens doctrine.

In order to help protect funding for councils facing the greatest social care pressures, together with honouring the new burdens doctrine, the Care Act funding should remain a separate grant and be kept out of the core spending power measure.

Q10. Do you agree with the Government's proposal to include all 2015/16 Council Tax Freeze Grant in the 2016/17 settlement, using the methodology set out in paragraph 3.3?

We strongly disagree with the proposal to roll the 2015/16 council tax freeze grant into Revenue Support Grant. The consultation paper claims that this will provide "maximum possible certainty" that the funding will continue. However, because our Revenue Support Grant is being completely cut, without any protection for council tax freeze elements within it, this actually provides absolute certainty that our council tax freeze funding within this will completely disappear. This cut will be applied not just to the 2015/16 freeze grant, but also to all of our freeze grant elements which had been rolled into Revenue Support Grant in previous years.

The claim that the Government's methodology protects council tax freeze funding depends on councils making council tax increases to replace the losses to council tax freeze grant. This is completely nonsensical, as it requires a council tax freeze to be funded by a council tax increase!

Expecting council taxpayers to fund what is supposed to be a council tax freeze grant is deeply unfair on them and punishes councils for supporting Government policy. Instead of this, all council tax freeze funding (including grants relating to earlier years) should be taken out of Revenue Support Grant, paid as a protected separate grant and not included in the settlement core funding calculation.

Q11. Do you agree with the Government's proposal to include all 2015/16 Efficiency Support Grant funding in the settlement and with the methodology set out in paragraph 3.5?

We do not receive Efficiency Support Grant so have no particular view on this.

Q12. Do you agree with the Government's proposal to include funding for lead local flood authorities in the 2016/17 settlement, as described in paragraphs 3.6 and 3.7?

We disagree with the proposal to roll all lead local flood authority funding in to the settlement. As with all the other rolled in grants discussed above, making Hampshire's flood defence grant part of Revenue Support Grant will result in it being cut by 37.4% in 2016/17 and completely removed by 2019/20. The methodology being used to implement the Revenue Support Grant cuts fails to give any consideration to an area's flood defence needs, so it is totally inappropriate to subject flood defence funding to it.

Part of the flood funding it is proposed to roll into Revenue Support Grant is a new burdens grant for sustainable drainage systems. Our response to question 9 noted that the cost of

new burdens is not meant to fall on council taxpayers. However, as the settlement states that Hampshire should have £17,507 for this item in 2019/20, and Revenue Support Grant will be £0 in that year, this is yet another breach of the new burdens doctrine as the full cost of it will fall on Hampshire's taxpayers.

Q13. Do you agree with the Government's proposal to pay a separate section 31 grant to lead local flood authorities to ensure funding for these activities increases in real terms in each year of the Parliament?

We would welcome some lead local flood authority funding being paid as a separate section 31 grant. This will slightly compensate for the flood defence funding going into Revenue Support Grant which the settlement proposes to totally cut. It would be helpful if further details about this grant could be provided as soon as possible.

A settlement which cuts the vast majority of Hampshire's flood defence grant should not be claiming that the Government is providing real terms protection for flood defences. Examination of the settlement figures reveals that flood defence funding (not Government grant) will only be protected in real terms if councils use council tax to make up for the grant cuts. Flood defence is a high priority for Hampshire. However, we have already noted in this response that the settlement unreasonably expects Hampshire's council taxpayers to pay up huge amounts to fund all sorts of Government policies, ranging from the full costs of the Care Act to subsidising more generously resourced services in other parts of the country. There are limits to how much the Government should be expecting from Hampshire's taxpayers as well as to the limitations of any additional tax we are able to raise.

Q14. Do you have any views on whether the grant for lead local flood authorities described in paragraph 3.8 should be ring-fenced for the Spending Review period?

A poorly drafted ringfence could prevent the grant from being spent on innovative flood defence schemes, so we would prefer this grant to not be ringfenced.

Q15. Do you agree with the Government's proposal to adjust councils' tariffs / top ups where required to ensure that councils delivering the same set of services receive the same percentage change in settlement core funding for those sets of services?

We fundamentally disagree with the proposal to make cuts to the business rates income of councils (by adjusting their top up and tariff) once their Revenue Support Grant has been completely cut. This would see a raid launched on Hampshire County Council's business rates top up income in 2019/20 and potentially in years beyond that period. Our consultation response has set out that the whole model upon which the finance settlement is based is deeply flawed and starves shire areas of funding. All councils scheduled to lose their Revenue Support Grant are likely to be underfunded authorities. Rather than making them even worse off the Government needs to urgently review the grant system to address the long term underfunding of shire areas.

We wish to draw attention to why the Government originally made local authorities (such as Hampshire) top up authorities. The top up was meant to provide greater financial stability for important services, especially adult and children's social care. A settlement which cuts top up funding thus once again contradicts its claim to provide greater protection for these very services.

An assault on business rates income will also damage confidence in the Government's proposals to introduce full local retention of business rates over the coming years. Such a system is supposed to benefit the provision of local services by giving long term certainty over funding levels. This better stability for services entirely evaporates if business rates income is constantly at risk of arbitrary deductions by the Government. Such actions also punish councils which have supported business growth.

Q16. Do you have an alternative suggestion for how to secure the required overall level of spending reductions to settlement core funding over the Parliament?

The proposed deep cuts for the country's most poorly funded councils should be halted. Instead, to achieve the required level of savings, for each tier the Government should apply the same percentage cut to the Revenue Support Grant of each council. This would reduce the scale of cuts in shire areas to more manageable levels. It will also avoid double counting the council tax generating ability of councils. This would be in line with the approach adopted by the Home Office as, having recognised that the allocations produced by the Four Block Model are not fit for purpose, it has been applying the same percentage cut to the police grant for each Police and Crime Commissioner until a new funding formula can be introduced.

The above approach should be an interim measure until a full inquiry into the bias of the local government grant system against shire councils such as Hampshire can be completed. A new funding system should then be introduced which fairly and adequately funds all parts of the country based on proper indicators of need. As noted earlier for instance, adult social care funding should be firmly based on indicators of care needs for the elderly and disabled, rather than including a bizarre indicator for working age unemployment.

Such a review needs not only to consider how resources made available by the Government are distributed, it also needs to include an assessment of the minimum level of funding required to fund adequate provision of statutory local services across the sector. The County Council's long term financial strategy relied on potential council tax increases to help balance the budget over the longer term, taking into account the limited ability to reduce spending on social care, given the huge increases in demand and package costs. The provisional settlement effectively removes any benefit that Hampshire would have received from council tax increases meaning that the longer term viability of providing the full range of services at a minimum level is put severely at jeopardy.

Our responses to earlier questions have also noted that this settlement expects councils to use council tax to fund some major new burdens arising from Government policies. The pressure this places on council tax is in complete breach of the new burdens doctrine, as well beyond, in real terms, the capacity of any additional council tax we can raise. Government departments need to take responsibility and make internal efficiencies to

release funding for their new burdens, rather than expecting council taxpayers to foot the bill.

Q17. Do you have any comments on the impact of the 2016/17 settlement on persons who share a protected characteristic, and on the draft equality statement published alongside this consultation?

We completely disagree with the statement on page 7 of the equality statement that the settlement will “direct resources to councils that need them most”. The statement’s claim is contradicted a few sentences earlier in the very same document, where it admits that the settlement will only “provide greater protection for some councils providing adult social care and children’s services”. This admission that a funding methodology which is supposedly meant to protect adult social care doesn’t in fact work is a clear indication that the whole settlement funding methodology is defective, right from the 2015/16 starting funding levels. Our responses to the previous questions in this consultation have clearly set out that the settlement makes deep cuts to what are already the least generously funded councils in England. The equality statement’s concept of which councils are most needy is erroneously based on an entirely discredited funding formula methodology. It is also a settlement which punishes those councils which have fought over the past five years to avoid council tax increases, in line with government policy, not least because the council tax is a regressive system which disproportionately disadvantages sections of the community on lower income.

Local authorities will continue to do their utmost to avoid cutting services for vulnerable protected groups but this is becoming increasingly difficult to achieve due to the planned scale of Government funding cuts for county councils. The size of protected groups in an authority frequently does not correlate with how grant dependent it is. This is due to flaws in the Four Block Model, which used a narrow range of deprivation focused needs indicators and thus failed to sufficiently recognise the service cost drivers in shire areas. These areas are therefore less grant dependent compared to the numbers of protected groups in them because they were never adequately funded.

Other Comments

Adult Social Care

Hampshire County Council welcomes the Government’s acknowledgement that across the country the adult social care system is under severe strain due to demographic changes and cost pressures, such as the national living wage. Shire counties are particularly badly affected as they tend to have a larger proportion of older residents than many other areas.

We are extremely concerned though that the resources being made available by the Government are nowhere near sufficient to meet these pressures, with funding actually being redistributed away from shire areas with the greatest social care pressures. Revenue Support Grant is a major source of funding for adult social care and ours will plummet from £129 million in 2015/16 to £0 in 2019/20. The Government will then start making cuts to our business rates top up grant, which also helps fund social care. The Government expects Hampshire’s council taxpayers to restore some of this loss, but this will only slightly lessen the cut and provide nothing to meet growing demographic and cost pressures. The ability of

council tax to help plug the funding shortfall is further reduced by the settlement expecting Hampshire's council taxpayers to pay up to lessen a wide variety of grant cuts, ranging from meeting all the costs of the Care Act to protecting flood defence spending.

The Government is also providing £1.5bn of additional funding to the Better Care Fund. However, the flawed methodology being used to allocate it means Hampshire will receive over a third less than we had expected from this, which even then severely underfunded local needs. The methodology ignores that the settlement already places greater social care demands on Hampshire's council tax revenues than in many other areas, such as being expected to fund the full costs of the Care Act, so the revenues should not be used to lower our Better Care Fund allocation. Furthermore, we have already noted that the adult social care relative needs formula contains bizarre indicators such as working age unemployment levels, so it produces allocations which bear no reality to actual social care needs. The net additional funding is even lower as the £1.5bn does not appear to be new funding for local government. £800m is being taken from the New Homes Bonus, so our New Homes Bonus income (which could have helped fund care) is expected to reduce. The remaining £700m comes from a top slice to the Local Government Departmental Expenditure Limit, which would probably have been distributed as Revenue Support Grant otherwise. Furthermore, none of these Better Care Fund resources arrive until near the end of the Spending Review period, whereas the DCLG plans to front load the decimation of our Revenue Support Grant at the beginning of the Spending Review period. When the grant does arrive, in order for it to go to services where the pressure is greatest, it must be ensured that it is paid to local authorities and not the NHS.

Overall, by 2019/20 the funding from the Better Care Fund and any social care precept would not meet even two thirds of the social care cost pressures in Hampshire resulting from the National Living Wage and demographic changes. Existing social care demands also need to be funded and our Revenue Support Grant, used to help resource these, will have been completely cut by then. A finance settlement which makes sweeping cuts to the funding used to resource social care cannot justify its claim that it protects councils providing adult social care services. We welcome the concern Government ministers are showing about social care but they need to ensure that their rhetoric matches reality.

It should also be remembered that whilst adult social care dominates the financial landscape for many authorities (perhaps only after the impact of Government grant reductions), many councils such as Hampshire are still dealing with high levels of children's social care spend following a significant increase in looked after children, arising from additional referrals following the Daniel Pelka case. In recent years an additional £22m has been allowed for within our budget for additional children's social care costs, which have begun to plateau but still remain at historically high levels.

Settlement Timing and Future Years

In response to previous finance settlement consultations we have frequently emphasised the need for timely Government funding announcements. By not announcing the finance settlement until just before Christmas, the Government hinders the efficient and effective use of billions of pounds of taxpayers' money, as it gives local authorities an unacceptably short amount of time to prepare their budgets. This is a particular problem this year as there was no prior technical consultation to provide even an indication of the likely figures. A flawed settlement methodology which makes the deepest cuts to the most poorly funded

areas of the country was not expected and has left many councils with little time to address the resulting funding gap.

Councils do not just need details of the settlement grants to plan their 2016/17 budget, they also need details of all the other specific grants due from Government departments. At the time of submitting this response in mid January, details of many of these were still awaited. We urge the Government to publish all of these with the utmost urgency and to announce them more promptly in future years. The current vacuum of information from the Government creates much uncertainty and worry for the users and staff of highly appreciated local services funded by these grants.

A finance settlement providing several years of funding information is welcome in principle, but the methodology for allocating the funding needs to be sound. The unfortunate decision to combine a longer term settlement with a deeply flawed funding methodology means that the underfunding of shire areas will be locked into funding allocations for four years, with the position getting increasingly worse as every year passes. We would prefer there to be a one year settlement, including emergency revisions to address the many issues with the provisional 2016/17 settlement. A longer term settlement should be introduced once a fair funding methodology has been developed which properly funds need and removes the bias against shire areas.

We note that for local authorities to have post 2016/17 allocations confirmed they will be required to publish an Efficiency Plan. Further reporting requirements will arise for councils which implement an adult social care precept increase. It is important that full details of these reporting requirements are confirmed as soon as possible and kept to a minimum. Overly prescriptive requirements could prevent councils from managing Government cuts in a way which has the least impact on their communities. Hampshire County Council will always seek to be as efficient as possible. However, given the scale of Government cuts being imposed on an authority with an already low level of funding per household, this will result in reductions to services. This is the inevitable impact of an unfair finance settlement which targets shire areas for the deepest cuts and eliminates their Revenue Support Grant.

Revised Budget 2015/16

	Original Budget 2015/16	Adjustment	Adjusted Budget 2015/16	Revised Budget 2015/16	Variance
	£'000	£'000	£'000	£'000	£'000
<u>Departmental Expenditure</u>					
Adults' Services	304,370	5,553	309,923	309,923	0
Children's - Schools	748,625	(651)	747,974	747,974	0
Children's - Non schools	161,361	4,335	165,696	165,696	0
Economy, Transport and Environment	103,770	7,291	111,061	111,061	0
Policy and Resources	133,779	12,152	145,931	145,931	0
TOTAL	1,451,905	28,680	1,480,585	1,480,585	0
<u>Capital Financing Costs</u>					
Committee Capital Charges	116,719	11,081	127,800	127,800	0
Capital Charge Reversal	(117,228)	(11,705)	(128,933)	(128,933)	0
Interest on Balances	(7,250)	22	(7,228)	(7,528)	(300)
Capital Financing Costs	68,896	0	68,896	59,896	(9,000)
	61,137	(602)	60,535	51,235	(9,300)
<u>Pension and IAS 19 Costs</u>					
Pensions - Int and Expected Ret on Assets	18,150	0	18,150	18,150	0
Contribution from Pension Reserve	(45,843)	0	(45,843)	(45,843)	0
IAS 19 Departments	19,706	0	19,706	19,706	0
Non Distributed costs	23,429	0	23,429	23,429	0
Soft Loan	(10)	0	(10)	(10)	0
	15,432	0	15,432	15,432	0
<u>RCCO</u>					
Main Contribution	22,559	(11,216)	11,343	11,343	0
Funded by Dedicated Schools Grant	6,256	(6,256)	0	0	0
RCCO From Reserves	5,588	750	6,338	6,338	0
	34,403	(16,722)	17,681	17,681	0
<u>Other Revenue Costs</u>					
Contingency	33,209	(3,953)	29,256	24,450	(4,806)
Dedicated Schools Grant	(698,617)	(982)	(699,599)	(699,599)	0
Specific Grants	(151,392)	(4,878)	(156,270)	(156,270)	0
Council Tax Freeze Grant	(5,475)	8	(5,467)	(5,467)	0
Flood Protection Levy	603	0	603	603	0
Coroners Expenditure	1,331	0	1,331	1,331	0
Business Units (Net Trading Position)	(570)	0	(570)	(570)	0
	(820,911)	(9,805)	(830,716)	(835,522)	(4,806)
Net Revenue Budget	741,966	1,551	743,517	729,411	(14,106)

	Original Budget 2015/16	Adjustment	Adjusted Budget 2015/16	Revised Budget 2015/16	Variance
	£'000	£'000	£'000	£'000	£'000
Net Revenue Budget (Repeated)	741,966	1,551	743,517	729,411	(14,106)
<u>Contributions to / (from) Earmarked Reserves</u>					
Transfer to / (from) Earmarked Reserves	7,158	(856)	6,302	21,308	15,006
Trading Units Transfer to / (from) Reserves	679	(95)	584	584	0
Business Strategy Opportunities	(1,500)	0	(1,500)	(1,500)	0
RCCO from Reserves	(5,738)	(600)	(6,338)	(6,338)	0
	599	(1,551)	(952)	14,054	15,006
Contribution to / (from) Balances	900	0	900	0	(900)
BUDGET REQUIREMENT	743,465	0	743,465	743,465	0

Final Cash Limit Calculation 2016/17

	December Cash Limit Guideline £'000	Transfer £'000	Other Changes £'000	Final Cash Limit 2016/17 £'000
Adults' Services	324,989			324,989
Children's - Schools	749,846	3,400	6,211	759,457
Children's - Non Schools	163,539		3,577	167,116
ETE	111,000		479	111,479
CCBS	34,416	1,226	860	36,502
Corporate Services	42,489			42,489
Public Health	49,206		5,922	55,128
P&R Other	19,588	(4,626)	399	15,361
	1,495,073	0	17,448	1,512,521

Notes:**Transfers**

- There is a transfer from P&R to CCBS and Children's - Schools which primarily reflects a transfer of responsibility for aspects of Repair and Maintenance budgets.

Other Changes

- The increase for Children's - Schools reflects an increase in DSG (£8.6m) which is offset by reductions in the Pupil Premium and other schools grants (£2.4m).
- The increase for Children's - Non-Schools reflects the known carry forward of the Department for Education Social Care Innovation Grant of £964,000 and the transfer of responsibility for the Supporting Troubled Families Programme (STFP) into Children's Services from 1 April 2016, grant funding for which is now being assumed of £2.6m.
- The increase for ETE is for allowable highways growth of £350,000 and an increase in the Department for Transport "Bikeability" Cycle Training Grant of £129,000.
- The increase for CCBS is due to the movement of the Policy and Resources feasibility budget from capital into revenue following a review of the capital programme.
- The increase for Public Health is due to the inclusion of the full year funding for Children aged 0 to 5 and a draw from the Public Health Reserve which are partly offset by reductions in the level of the Public Health Grant assumed for 2016/17.
- The increase for P&R Other is due to final changes associated with the realignment of R&M budgets across capital and revenue.

Adults' Services Budget Summary 2016/17

Service Activity	Original Budget 2015/16 £'000	Revised Budget 2015/16 £'000	Proposed Budget 2016/17 £'000
Physical Support	88,104	94,798	105,686
Sensory Support		1,770	1,770
Memory Cognition	42,020	31,474	36,730
Learning Disabilities	106,938	113,258	112,869
Mental Health	6,583	7,330	9,148
Social Support	322	1,140	1,136
Assistive Equipment & Technology	2,771	5,152	5,740
Social Care Activities	26,409	26,671	27,732
Information & Early Intervention	1,670	2,484	2,764
Commissioning & Services Delivery	29,553	25,846	21,414
Total Adults' Services Budget	304,370	309,923	324,989

Children's Services Budget Summary 2016/17

Service Activity	Original Budget 2015/16 £'000	Revised Budget 2015/16 £'000	Proposed Budget 2016/17 £'000
Schools Budget			
Individual Schools Budgets	530,830	530,834	538,070
De-delegated Items	3,950	3,950	4,124
High Needs Block	85,901	86,397	90,783
Early Years Block	61,668	61,909	61,672
Central Provision Within Schools Budget	10,012	10,253	10,594
Other Grants	56,264	54,631	54,214
Total Schools Budget	748,625	747,974	759,457
Non-Schools Budget			
Other Education & Community – Special Education	5,267	5,246	5,691
Other Education & Community – Learner Support	33,099	33,678	32,863
Other Education & Community – Access	413	235	394
Young People's Learning Development	1,035	1,122	1,064
Adult and Community Learning	269	59	95
Services for Young Children	8,763	8,492	8,583
Youth Support Services	5,399	3,409	1,504
Strategic Management	4,151	6,776	5,656
Assessment and Care Management	19,714	21,948	20,104
Children Looked After	61,092	64,840	60,741
Family Support Services	16,902	18,490	20,301
Youth Justice	2,219	2,939	2,117
Other Children & Families Services	2,518	2,588	2,515
Unaccompanied Asylum Seeking Children	500	500	500
Central Budgets	20	636	67
Contribution to / (from) Cost of Change	0	(5,262)	4,921
Total Non-Schools Budget	161,361	165,696	167,116
Total Children's Services Budget	909,986	913,670	926,573

ETE Budget Summary 2016/17

Service Activity	Original Budget 2015/16 £'000	Revised Budget 2015/16 £'000	Proposed Budget 2016/17 £'000
Highways Maintenance	16,109	16,075	16,171
Street Lighting	9,458	9,458	9,823
Winter Maintenance	5,870	5,870	6,011
Concessionary Fares	13,383	13,369	13,625
Other Public Transport	5,501	5,464	5,145
Road Safety	1,681	1,819	1,788
Other Highways, Traffic & Transport Services	(13)	(13)	(18)
Staffing & Operational Support	10,460	10,490	8,346
Total Highways, Traffic and Transport	62,449	62,532	60,891
Waste Disposal Contract	35,153	40,771	40,189
Environment & Other Waste Management	364	915	643
Strategic Planning	1,680	1,257	1,017
Chichester Harbour Conservancy	187	187	191
Total Waste, Planning and Environment	37,384	43,130	42,040
Economic Development	948	971	754
Departmental & Corporate Support	2,989	2,979	2,847
Contribution to / (from) Cost of Change	0	1,449	4,947
Total ETE Budget	103,770	111,061	111,479

Notes:

The overall cash limit for ETE has increased by £479,000 since the position set out in the report to the Executive Member and the associated budgets for service activities above reflect this change for allowable highways growth of £350,000 and an increase in the Department for Transport "Bikeability" Cycle Training Grant of £129,000.

Policy & Resources Budget Summary 2016/17

Service Activity	Original Budget 2015/16 £'000	Revised Budget 2015/16 £'000	Proposed Budget 2016/17 £'000
Culture, Communities and Business Services:			
Transformation and Business Management:			
Transformation	0	217	337
Rural Broadband	94	94	97
Community and Regulatory Services:			
Regulatory Services	1,807	1,651	1,345
Community Grants & Policy Fund	1,472	1,421	1,226
Sport	196	196	214
Community	303	277	228
Library Services	12,410	12,085	11,695
Business Support	799	791	741
Scientific Services	(10)	(10)	(13)
Asbestos	(25)	(121)	(12)
Culture & Heritage:			
Countryside	2,881	3,042	2,682
Outdoor Centres	385	361	332
Arts & Museums	2,989	3,129	2,967
Archives	892	861	799
Risk, Health & Safety	214	196	190
Sir Harold Hillier Gardens	412	412	412
Property Services and Facilities:			
Direct Services	(966)	(968)	(1,006)
Property Services	1,337	1,457	2,144
Office Accommodation / Workstyle	5,642	5,640	5,560
Facilities Management	2,925	3,087	2,824
Print Sign Workshop	190	148	0

Service Activity	Original Budget 2015/16 £'000	Revised Budget 2015/16 £'000	Proposed Budget 2016/17 £'000
Contribution to / (from) Cost of Change	1,277	947	3,740
Total CCBS	35,224	34,913	36,502
Corporate Services:			
Policy & Governance:			
Legal	2,272	2,321	2,399
Governance	1,453	1,575	1,706
Performance & Communications	1,510	1,660	1,585
Transformation	1,867	1,778	1,906
Corporate Resources:			
Customer Business Services (CBS)	7,165	7,079	7,091
HR	2,623	2,792	2,882
Finance	3,510	3,496	4,050
Internal Audit	684	683	709
IT	18,465	16,993	17,183
Other Corporate Services	3,980	1,980	2,978
Total Corporate Services	43,529	40,357	42,489
Public Health:			
Central Public Health	2,482	2,732	2,497
Information and intelligence	39	10	18
Nutrition, Obesity and Physical Activity	1,594	1,416	1,158
Drugs and Alcohol	9,475	9,621	9,621
Tobacco	3,149	2,157	2,438
Dental	180	180	116
Children 5 – 19	4,121	3,955	4,036
Health Checks	1,527	1,583	1,477
Miscellaneous Health Improvement and Wellbeing	6,351	6,342	5,923
Sexual Health	11,329	10,571	10,377

Service Activity	Original Budget 2015/16 £'000	Revised Budget 2015/16 £'000	Proposed Budget 2016/17 £'000
Infection Prevention and Control	116	28	29
Children 0 – 5	8,843	8,829	17,438
Total Public Health	49,206	47,424	55,128
P&R Other:			
Other Direct Services			
Grants to Voluntary Organisations	247	247	236
Grants / Contributions to Councils of Community Services and Other Bodies	888	888	907
Members Devolved Budgets	624	624	624
Supporting Troubled Families	1,622	2,574	0
Other Direct and Corporate Services	664	466	724
Total Other Direct Services	4,045	4,799	2,491
Repair and Maintenance	(905)	15,758	10,166
Members Support Costs	1,706	1,706	1,726
Other Central Support Services	974	974	978
Total P&R Other	5,820	23,237	15,361
Total P&R Cash Limited Services Budget	133,779	145,931	149,480
Coroners	1,331	1,331	1,367
Transfers (to) / from reserves:			
School Library Service	(48)	(48)	(121)
River Hamble	(27)	(20)	(51)
Segensworth Unit Factories	(12)	(12)	(12)
Hampshire Printing Services	(30)	(131)	0
Corporate Procurement County Supplies	(141)	(259)	(288)
HC3S	(484)	(484)	(219)
Hampshire Transport Management (HTM)	0	(147)	(22)
Education Financial Services	0	78	78

Service Activity	Original Budget 2015/16 £'000	Revised Budget 2015/16 £'000	Proposed Budget 2016/17 £'000
Education Personnel Services	(113)	159	91
Government Grants:			
Inshore Fisheries and Conservation	(204)	(204)	(204)
Supporting Troubled Families	(1,622)	(1,662)	
Local Reform and Community Voice	(540)	(540)	(540)
Public Health	(49,206)	(46,160)	(53,000)
Total Net Expenditure	82,683	97,832	96,559

Revenue Budget 2016/17

	Original Budget 2015/16 £'000	Adjustment £'000	Budget 2016/17 £'000
<u>Departmental Expenditure</u>			
Adults' Services	304,370	20,619	324,989
Children's - Schools	748,625	10,832	759,457
Children's - Non schools	161,361	5,755	167,116
Economy, Transport and Environment	103,770	7,709	111,479
Policy and Resources	133,779	15,701	149,480
	1,451,905	60,616	1,512,521
<u>Capital Financing Costs</u>			
Committee Capital Charges	116,719	0	116,719
Capital Charge Reversal	(117,228)	106	(117,122)
Interest on Balances	(7,250)	(84)	(7,334)
Capital Financing Costs	68,896	(6,000)	62,896
	61,137	(5,978)	55,159
<u>Pension and IAS 19 Costs</u>			
Pensions - Interest and Expected Return on Assets	18,150	0	18,150
Contribution from Pension Reserve	(45,843)	0	(45,843)
IAS 19 Departments	19,706	0	19,706
Non Distributed costs	23,429	1,200	24,629
Soft Loan	(10)	0	(10)
	15,432	1,200	16,632
<u>RCCO</u>			
Main Contribution	22,559	(10,049)	12,510
Funded by Dedicated Schools Grant (DSG)	6,256	(6,256)	0
RCCO from Reserves	5,588	(3,594)	1,994
	34,403	(19,899)	14,504
<u>Other Revenue Costs</u>			
Contingency	33,209	5,681	38,890
Dedicated Schools Grant	(698,617)	(9,482)	(708,099)
Specific Grants	(151,392)	3,138	(148,254)
Council Tax Freeze Grant	(5,475)	5,475	0
Flood Protection Levy	603	0	603
Coroners Expenditure	1,331	36	1,367
Business Units (Net Trading Position)	(570)	0	(570)
	(820,911)	4,848	(816,063)
Net Revenue Budget	741,966	40,787	782,753

	Original Budget 2015/16 £'000	Adjustment £'000	Budget 2016/17 £'000
Net Revenue Budget (Repeated)	741,966	40,787	782,753
<u>Contributions to / (from) Earmarked Reserves</u>			
Transfer to / (from) Earmarked Reserves	7,158	(55,349)	(48,191)
Trading Units Transfer to / (from) Reserves	679	0	679
Business Strategy Opportunities	(1,500)		(1,500)
RCCO from Reserves	(5,738)	3,744	(1,994)
	599	(51,605)	(51,006)
Use of General Balances	900		900
BUDGET REQUIREMENT	743,465	(10,818)	732,647
Funded by			
Business Rates and Government Grant	(227,169)	35,409	(191,760)
Business Rates Collection Fund Deficit / (Surplus)	(1,490)	2,590	1,100
Council Tax Collection Fund Deficit / (Surplus)	(9,915)	650	(9,265)
COUNCIL TAX REQUIREMENT	504,891	27,831	532,722

Reserves Strategy

Introduction

The level and use of local authority reserves has been a regular media topic over a number of years often fuelled by comments from Government that these reserves should be used to significantly lessen the impact of the austerity measures that have seen a greater impact on local government than any other sector.

The County Council has continually explained that reserves are kept for many different purposes and that simply trying to bridge the requirement for long term recurring savings through the use of reserves only seeks to use up those reserves very quickly (and mean that they are not available for any other purposes) and merely delays the point at which the recurring savings are required.

At the end of the 2014/15 financial year the County Council's earmarked reserves together with the general fund balance stood at more than £462m a decrease of approaching £20m on the previous year, indicating that a tipping point has now been reached and we would now expect reserves to start to reduce to the end of the decade. This Appendix sets out in more detail what those reserves are for and outlines the strategy that the County Council has adopted and articulated in using reserves and more importantly in contributing to them.

Reserves Position 31 March 2015

Current earmarked reserves together with the General Fund balance totalled £462.1m at the end of the 2014/15 financial year. The table below summarises by purpose the total level of reserves and balances that the County Council holds and compares this to the position reported at the end of 2013/14.

The narrative beneath the table explains in more detail the purpose for which the reserves are held and in particular why the majority of these reserves cannot be used for other reasons.

	Balance 31/03/2014 £'000	Balance 31/03/2015 £'000	% of Total %
<u>Fully Committed to Existing Spend Programmes</u>			
Capital Grants Unapplied	71,778	48,368	10.5
Revenue Grants Unapplied	40,667	36,161	7.8
General Capital Reserve	129,272	133,926	29.0
Street Lighting Reserve	3,893	6,263	1.4
Community Transport Reserve / Other	1,651	1,795	0.4
	247,261	226,513	49.0
<u>Departmental / Trading Reserves</u>			
Trading Accounts	14,691	15,725	3.4
Departmental - Cost of Change Reserve	30,543	42,651	9.2
	45,234	58,376	12.6

	Balance 31/03/2014 £'000	Balance 31/03/2015 £'000	% of Total %
<u>Risk Reserves</u>			
Insurance Reserve	24,837	26,808	5.8
Investment Risk Reserve		500	0.1
Local Government Resource Review	6,150		
	30,987	27,308	5.9
<u>'Available' Reserves</u>			
Corporate Policy Reserve	3,676	3,976	0.9
Invest to Save	10,073	9,461	2.0
Corporate Efficiency Reserve	8,931	8,981	1.9
Organisational Change Reserve	7,854	3,593	0.8
Grant Equalisation Reserve	50,464	50,881	11.0
	80,998	76,892	16.6
<u>HCC Earmarked Reserves</u>			
	404,480	389,089	84.2
Schools Reserves	49,572	52,462	11.3
	454,052	441,551	95.5
<u>Total Earmarked Reserves</u>			
General Fund Balance	27,697	20,598	4.5
	481,749	462,149	100.0
<u>Total Reserves and Balances</u>			

Fully Committed to Existing Spend Programmes

These reserves, which account for almost half of total reserves are already fully committed in the main to existing revenue or capital programmes. They really represent the extent to which resources, in the form of government grants or revenue contributions to capital, are received or generated in advance of the actual spend on the project.

Specifically, the street lighting reserve represents the anticipated surplus generated by the financial model for this PFI scheme that is invested up front and then applied to the contract payments in future years.

These reserves increased significantly in recent years following a change to International Financial Reporting Standards which required unapplied government grants to be shown as earmarked reserves and due to the fact that significant revenue contributions were made to fund future capital investment using the surplus funds generated from the early achievement in savings (a deliberate strategy that is explained in more detail later in this paper).

These reserves do not therefore represent 'spare' resources in any way and are now being utilised as planned. They fell by more than £20.7m in 2014/15 and account for the overall decrease in the level of reserves between 2013/14 and

2014/15. The fall in reserves is in line with the Medium Term Financial Strategy (MTFS), which anticipated a decline as our financial plans are delivered over the medium term.

Departmental / Trading Reserves

Trading services within the County Council operate as semi-commercial organisations and as such they do not receive specific support from the County Council in respect of capital investment or annual pressures arising from spending or income fluctuations.

Given this position, any surpluses generated by the trading services are earmarked for their use to apply for example to equipment renewal, service expansion, service improvement, innovation and marketing. They are also used to smooth cash flows between years if deficits are made due to the loss of the customer base and provide the time and flexibility to generate new revenues to balance the bottom line in future years.

Departmental reserves are generated through under spends in annual revenue expenditure and Council policy was changed in 2010 to allow Departments to retain all of their under spends in order to provide resources to:

- Meet any potential overspends in future years without the need to call on corporate resources
- Manage cash flow funding issues between years where specific projects may have been started but not fully completed within one financial year.
- Meet the cost of standard redundancy and pension payments arising from the down sizing of the work force
- Invest in new technology and other service improvements, for example the new Children's Services integrated system
- Undertake capital repairs or improvements to assets that are not funded through the existing capital programme where this is essential to maintain service provision or maximise income generation.
- Meet the cost of significant change programmes and restructures such as the Corporate Services Review implementation, which was fully funded from planned savings within the Corporate Services Department.

By utilising reserves in this way, and allowing Departments and trading areas to retain under spends or surpluses it encourages prudent financial management as managers are able to ensure that money can be re-invested in service provision without the need to look to the corporate centre to provide funding. This fosters strong financial management across the County Council and is evidenced by the strong financial position that the County Council is in at this point in time.

Risk Reserves

The Council holds specific reserves to mitigate risks that it faces. The County Council self insures against certain types of risks and the level of the insurance reserve is based on an independent valuation of past claims experience and the level and nature of current outstanding claims.

The Local Government Resource Review reserve was established in 2011/12 to cover the risk of reduced income resulting from business rates appeals and localisation of council tax benefit. Both of these changes represented a significant

risk transfer from central to local government and therefore a separate risk reserve was created to mitigate potential losses arising from these sources in order to soften the impact on the budget setting process in any one year. Each year, as part of the budget setting process, the Chief Financial Officer reviews the level of reserves and the purpose for which they are held. As part of this review, it was highlighted that Local Government Resource Review reserve was no longer required since volatility in the system around business rates retention and council tax support schemes (that replaced council tax benefit) have now worked through the system and the impact of these is already reflected in the budget that was set for 2015/16. It was therefore recommended that the £6.15m within this reserve was transferred to the Grant Equalisation Reserve (GER) as part of the closure of the accounts for 2014/15.

The Investment Risk reserve was established in 2014/15 to mitigate the slight additional risk associated with the revised approved investment strategy as a prudent response to targeting investments with higher returns.

'Available' Reserves

The above paragraphs have explained that the majority of reserves are set aside for specific purposes and are not available in general terms to support the revenue budget or for other purposes.

This leaves other available earmarked reserves that are under the control of the County Council and total nearly £76.9m at the end of last financial year. Whilst it is true to say that these reserves could be used to mitigate the loss of Government grant reductions, the County Council has decided to take a more sophisticated long term approach to the use of these reserves, that brings many different benefits both directly and indirectly to the County Council and residents of Hampshire. They are broken down into four main areas:

Corporate Policy Reserve – This small reserve is available to fund new budget initiatives that are agreed as part of the overall budget. It offers the opportunity to introduce specific service initiatives that might not have otherwise gained funding and are designed to have a high impact on service users or locations where they are applied. Past initiatives have included:

- Targeted speech and language therapy
- Apprenticeship and graduate placement schemes
- Funding for rural grants
- Funding for troubled families programme
- Olympic legacy
- The 'Have Your Say' community bidding budget

Invest to Save / Corporate Efficiency Reserve – These reserves are earmarked to provide funding to help transform services in order to make further revenue savings in the future. Rather than just prop up the budget on a short term basis, the County Council feels it is a far more sensible policy to use available reserves to generate savings and improve services over the longer term, by re-designing services and investing in technology and other solutions that make services more modern and efficient.

Organisational Change Reserve – The County Council is one of the largest employers in Hampshire and inevitably, large reductions in Government grant

leading to reduced budgets means that there is a significant impact on the numbers of staff that are employed in the future.

The County Council, as a good employer, has attempted to manage the reduction in staff numbers as sensitively and openly as possible and introduced an enhanced voluntary redundancy scheme back in 2011. The scheme offered an enhanced redundancy rate for people who elected to take voluntary redundancy and this has been a highly successful way of managing the reductions in staff numbers, whilst maintaining morale within the rest of the workforce who are not required to go through the stress and uncertainty of facing compulsory redundancies.

In fact, since the scheme was introduced, voluntary redundancies account for around 98% of the total number of staff that have left the organisation as a result of specific restructures and service re-design.

Whilst this scheme has now closed an alternative approach has been approved which will continue to enable the reduction and transformation of the workforce required to deliver the significant savings needed in the medium term with the aim of minimising compulsory redundancies

Departments are still responsible for meeting the 'standard' element of any redundancy package, but the Organisational Change Reserve was put in place to meet the 'enhanced' element of the payment. The reserve was previously topped back up to provide funding to continue the voluntary redundancy scheme and following the previous (and final) Enhanced Voluntary Redundancy process and will need to be further reviewed no later than December of this year in the context of the new scheme and the requirement for future organisational change.

Grant Equalisation Reserve – This reserve was set up many years ago to deal with changes in Government grant that often came about due to changes in distribution methodology that had an adverse impact on Hampshire compared to other parts of the country.

In 2010/11, the County Council recognised that significant reductions in local government spending were expected and built in contributions as part of the MTFs over the CSR 2010 period from the GER in order to smooth the impact of the grant reductions.

Over the last few years, it has become clear that the period of austerity will continue for much longer than initially anticipated by Government and therefore the County Council has taken the opportunity to increase the reserve in order to be able to continue the sensible policy of smoothing the impact of grant reductions without the need to make 'knee jerk' reactions to offset large decreases in grant.

It should be highlighted that the total 'Available Reserves' outlined above account for only 16.6% of total reserves and balances that the County Council holds and of these, the majority have been set aside as part of a longer term strategy for dealing with the significant financial challenges that have been imposed on the County Council. In addition, the GER which comprises the majority of these 'Available Reserves', standing at £50.9m at the end of 2014/15, is in reality fully committed as the MTFs includes a net draw required to balance the budget in 2016/17 of more than £50m.

The reserves detailed above represent the total earmarked reserves of the County Council and amount to £389.1m (before the planned material draw from the GER) as shown in the table on first page of this Appendix. In addition, the County

Council is required to show schools reserves as part of its accounts and it must hold a minimum level of general balances, both of which are outlined below.

Schools Reserves

Schools reserves account for nearly £52.5m or 11.3% of total reserves and balances. These reserves must be reported as part of the County Council's accounts, but since funds are delegated to schools any surplus is retained by them for future use by the individual school concerned. Similarly, schools are responsible for any deficits in their budgets and they maintain reserves in a similar way to the County Council in order to smooth fluctuations in cash flow over several years.

The County Council has no control at all over the level or use of school reserves.

General Fund Balance

The General Fund Balance is the only reserve that is in effect not earmarked for a specific purpose. It is set at a level recommended by the Chief Financial Officer at around 2.5% of the budget requirement and in effect it represents a working balance of resources that could be used at very short notice in the event of a major financial issue.

The current balance stands at £20.6m, which is close to the recommended minimum of around 2.5% of the budget requirement (£18.6m in 2015/16).

Reserves Strategy

The County Council's approach to reserves has been applauded in the past by the Government and the External Auditors as a sensible, prudent approach as part of a wider Medium Term Financial Strategy. This has enabled the County Council to make savings and changes in service delivery in a planned and controlled way rather than having to make urgent unplanned decisions in order to reduce expenditure.

This approach is well recognised across local government and an article in the Municipal Journal by the Director of Local Government at the Chartered Institute of Public Finance and Accountancy stated

“What reserves do allow authorities to do is to take a more medium term view of savings and expenditure and make decisions that give the best value for money. This is better than having to make unnecessary cost reductions in the short term because they do not have the money or funding cushion to allow for real transformation in the way they provide services.”

We are now in an extended period of austerity which will last longer than anyone had previously predicted and the medium term view highlights a continued need for reserves to smooth the impact of reductions in funding and enable time for the planning and implementation of change to deliver savings.

The County Council's strategy for reserves was well established and operated effectively based on a cyclical pattern as follows:

- Planning ahead of time and implementing efficiencies and savings in advance of need
- Generating surplus funds in the early part of the programme
- Using these resources to fund investment and transformation in order to achieve the next phase of savings.

This cycle was clearly evident during the last four financial years, with surplus funds generated in advance of need as part of budget setting and then supplemented by further savings in the year. Savings in advance of need within Departments and savings in contingency amounts due to the successful implementation of the full early savings programme meant that the Council was able to provide:

- Departmental reserves to pay for the cost of change associated with their own transformation programmes
- Top up funding to the Organisational Change Reserve to provide resources to continue the very successful voluntary redundancy programme as a means of releasing staff in a sensitive and controlled manner that has helped maintain morale across the Council
- Funding within the Invest to Save Reserve to help with the Transformation to 2017 Programme that will deliver the next phase of savings to 2017/18.
- Additional funds for the GER to help smooth the impact of grant reductions and give the County Council maximum flexibility in future budget setting processes

However, the late and unexpected impact of the provisional Local Government Finance Settlement in December 2015 has in effect utilised the full amount available in the GER and whilst this does not impact on the robustness of the budget for 2016/17 it does have a major impact on the ability to deliver a balanced budget in the future.

The financial landscape has significantly shifted and looking ahead the indications are that the next four years will be the most challenging period of the prolonged austerity measures which increases the potential necessity to use reserves to alleviate the initial and ongoing financial shocks over the period to 2020

A further review of all reserves is therefore required to ensure that there is sufficient financial capacity to cope with the challenges ahead and this will be undertaken in line with the update of the MTFS which will be prepared for consideration in the summer.

Section 25 Report from Chief Financial Officer

Section 25 of the Local Government Act 2003 requires the Chief Financial Officer (the Director of Corporate Resources) to report to the County Council when setting its council tax on:

- the robustness of the estimates included in the budget
- the adequacy of the financial reserves in the budget.

The County Council is required to have regard to this report in approving the budget and council tax. It is appropriate for this report to go first to Cabinet and then made available to the County Council in making its final decision.

Section 25 concentrates primarily on the risk, uncertainty and robustness of the budget for the next financial year rather than the greater uncertainties in future years. However, given the significant impact of the provisional local government settlement announced in December 2015, this report considers not only the short term position but also the position to 2019/20 in the context of the County Council's current Medium Term Financial Strategy (MTFS).

Robustness of Estimates in the Budget

The budget setting process within the County Council has been operating effectively for many years and is based on setting cash limits for Departments each year allowing for pay and price inflation and other marginal base changes in levels of service whether these be the increasing cost of social care or the requirement to make savings to balance the budget.

Individual Departments are then required to produce detailed estimates for services that come within the cash limits that have been set. More recently, the requirement to make savings has dominated the budget setting process and separate major programmes for Transformation to 2015 (Tt2015) and Transformation to 2017 (Tt2017) have been put in place to effectively and corporately manage the delivery of savings within the required timescales.

Appropriate provision for pay and price inflation are assessed centrally with Departmental input and are allocated to Department's cash limits. Specific inflationary pressures within the financial year are expected to be managed within a Department's bottom line budget but contingencies are still held centrally in the event that inflationary pressures have a severe impact in any one area (e.g. energy costs).

Separate work is also undertaken to assess the demand led areas of service provision, which mainly relate to:

- Adults' Social Care
- Children's Social Care
- Waste Disposal

Any requirement to increase budgets in these areas is considered corporately and may require additional savings to be made across the board to meet the increased demand. This is seen as a more effective way of managing cost pressures and enables strategic decisions to be made about allocation of resources and the impact on service provision rather than all of those decisions potentially being made in isolation by the Department.

Budget management within the County Council remains strong as demonstrated by the outturn position each year since austerity began and as reflected in the External Auditors annual opinion who has given an unqualified opinion on the annual accounts and in securing value for money / financial resilience.

Budget 2016/17

The budget for 2016/17 has been produced in line with the process outlined in the section above and therefore I am content that a robust, Council wide process has been properly followed and driven through our Finance Business Partners working with the Operational Finance Team. Further oversight is then provided by the Head of Finance and myself in presenting the final budget and council tax setting report to Cabinet and County Council.

The budget relies on a draw from the Grant Equalisation Reserve (GER) of some £54.5m, which whilst significant is entirely in line with the MTFs that has been put in place during this period of austerity, which provides the time and capacity to properly deliver major savings programmes every two years, with deficits in the intervening years being met from the GER.

The value of the draw from reserves to balance the budget is much greater than anticipated as a result of the significant impact of the provisional settlement announced in December 2015 and whilst this does not impact on the robustness of the budget for 2016/17 it does have a major impact on the ability to deliver a balanced budget in the future.

Once again, the robustness of the budget is underpinned by adequate contingencies for volatile areas such as social care as well as by the existence of Departmental cost of change reserves, which can be used to meet unforeseen costs during the year as well as providing funding for investment to achieve transformational savings.

Risks in the Budget 2016/17

In some respects the significant changes to local government finance over the last 6 years have changed the profile of risk faced by most Authorities. In reality the biggest financial risks now relate purely to reductions in Government funding, changes in Government policy and social care demand and cost pressures. These items together with other traditional risks are outlined below:

Government Funding and Policy – The MTFs has made projections about the likely reductions in Government grant over the next four years and plans were in place to deliver a balanced budget by 2017/18 based on the Tt2017 Programme we are currently implementing. The provisional settlement has had a massive impact on

those projections, but this can be accommodated in 2016/17 by putting up council tax in line with Government policy and drawing £54.5m from the GER.

Other significant changes to funding or policy during the year would have to be covered by contingencies or general balances, but generally once grant levels have been set in the final settlement due in January they do not change, although there have been in year changes implemented previously, most recently the in year cut to Public Health grant this year.

Social Care Demand Pressures – The number of Children Looked After increased dramatically last year following a much greater level of referrals in the system as a result of the Daniel Pelka case. The increase has now plateaued and more recent months have seen a small decline, but the overall base level is at least £12m higher than it was in previous years. Separate contingency provision exists should numbers begin to rise again and enhanced monitoring in this area continues to be a focus of the Children's Services Management Team and the supporting finance teams.

Adults' social care is a far more volatile picture given the significant numbers involved and the significant ongoing changes to the client base. A major piece of work was undertaken last year using detailed activity data to predict future activity and average costs and a long term strategy for managing social care finances alongside the delivery of savings and changes to the operating model was considered and approved by the Corporate Management Team.

Additional funding has been made available to Adults' Services Department to reflect the increasing costs of care and adequate contingency provision has been provided centrally to cope with unexpected fluctuations in demand during the year. However past experience has shown that Adults' Services have been effective in managing demand against budget to achieve a balanced position by year end and enhanced monitoring in this area will continue to inform that process and highlight any early warning signs that may then need to be corrected.

This will include potential risks associated with the delivery of Tt2015 savings, which are already reflected in the 2015/16 budget and have been implemented, but do still represent a financial risk. Due to the nature of adult's social care in particular, it is not always possible to distinguish whether or not cost pressures arise due to further increased demand or the potential failure to have delivered a savings proposals and therefore it is necessary to manage the total budget against total activity and demand within the system, which is already in place and should highlight issues irrespective of how they have arisen.

Pay and Price Risk – Pay inflation has been capped for some time now in line with Government policy, which is expected to continue at least until 2019/20. Provision has been made in 2016/17 for the costs of the current pay award being offered to local government which assumes some changes in the lower scales to deal with the impact of the National Living Wage (NLW). However, it should be borne in mind that an additional 1% on the pay bill equates to around only £2.5m, which when set in the context of an additional loss of grant of £29m and risks within social care, is no longer as a great a risk as it once was.

Similarly the impact of price inflation has been taken into account in setting the budget and it would take a major departure from the Council's assumptions to create a financial problem that we could not deal with. One exception to this is the impact of the NLW on the costs of social care services in the private sector which are expected to start to have an impact in 2016/17 and beyond. It is difficult to predict at this stage what the eventual impact will be given the number of different variables involved and whilst some additional provision has been made for this in the budget this may be an area that affects the price of social care services in the market place during the year and would need to be managed alongside other social care pressures outlined above.

Treasury Risk – The County Council has limited exposure to interest rate risk as most long term borrowing is undertaken on a fixed rate. At the present time we are not undertaking any new or replacement long term borrowing due to the significant 'cost of carry' involved and our ability to internally borrow given our high level of reserves and cash balances. However, we do need to be mindful of the fact that we do not want to store up a large value of external borrowing that needs to be taken out in less favourable circumstances as our reserves reduce. Given current predictions on base rate levels and the fact that long term borrowing rates are based on the price of gilts rather than the underlying base rate, this is still considered low risk at this stage.

On the investments side, the absolute value of estimated income is only £7.25m per annum, which is minimal against the County Council's overall budget, however, the change in investment strategy two years ago which moved part of the portfolio to medium term investments has increased the risk in the portfolio overall. This has been mitigated by the creation of an investment risk reserve which will deal with any changes in valuations of investment and provide a buffer against any significant drop in returns.

The Adequacy of Reserves

The County Council's policy on general balances is to hold a minimum prudent level which on the basis of the previous risk assessment is around 2.5% of net expenditure. The projected level of general fund balances will be 2.8% of net expenditure at the beginning of 2016/17 which reflects the declining level of spend, rather than an increase in the level of balances held. However, as the period of austerity extends and more savings are taken from the budget every two successive years, the greater the potential risks in the budget.

Overall the level of earmarked reserves that the County Council holds stands at £441.6m (including schools) and these underpin its overall MTFs and capital programme and the majority of reserves are held for specific purposes as set out in the Reserves Strategy in Appendix 6.

Those reserves that are available to support the revenue position are used sensibly to manage change and provide the time and capacity to properly implement savings plans that seek to minimise the impact on service users. For 2016/17 the level of the

Grant Equalisation Reserve is sufficient to meet the higher than predicted budget deficit, but this leaves very little for managing cash flow issues later in the decade.

Budget 2016/17 – Conclusion

Given the details outlined above, provided that the County Council considers the above factors and accepts the budget recommendations, including the level of earmarked reserves and balances, a positive opinion can be given under Section 25 on the robustness of the estimates and level of reserves for 2016/17.

The Position to 2017/18

The County Council is on track to deliver its next phase of £98m of savings as part of the Tt2017 Programme, although it is recognised that some savings will not be realised until after the 2017/18 financial year, for which Departmental cost of change reserves will be used to bridge the gap.

The value of savings was based on previous projections of Government grant reductions and following the unexpected impact of the December 2015 settlement, it is now anticipated that there will be a further £15m gap (after assuming two successive council tax increases of 3.99%) by 2017/18.

It is imperative during the next 14 months that the County Council does not get distracted from delivering the Tt2017 Programme, irrespective of the financial outlook in the years beyond 2017/18. Any failure to deliver recurring sustainable savings for 2017/18 will only serve to worsen the position to 2017/18.

Overall, given the current financial strength of the County Council and barring any further unexpected shocks either from Government or in service delivery and economic terms, it would appear that the position to 2017/18 is still manageable in line with the current MTFS, albeit that additional one off resources will need to be identified to meet the £15m gap currently predicted.

The Position to 2019/20

Looking ahead to both 2018/19 and 2019/20, the financial landscape will be significantly different and the County Council will no doubt face the biggest ever challenge to its overall financial sustainability.

The County Council has made strong representations to the Government about the change in RSG distribution methodology and would hope to see some movement as a result of this, however we must plan at this stage on the basis of a worse case scenario, which would mean a further gap of £140m by 2019/20 after assuming:

- A 3.99% council tax increase for each of the four years to 2019/20
- Successful implementation on a recurring basis of all the savings in the Tt2017 Programme.
- Costs of social care demand do not rise by more than we are predicting

- The impact of the National Living Wage on social care provision does not exceed current predictions.
- No further financial shocks during the period.

Bridging a gap of £140m after already removing £340m of expenditure is a massive undertaking particularly as each successive savings programme is becoming harder to deliver and many areas cannot be re-visited due to the nature of the revised service models or contractual arrangements that will have been put in place.

The Tt2017 Programme has already highlighted the longer timescales needed to make service changes in some areas, most notably adults' social care and given the national focus on the problems in this area, we must consider the extent to which significant further savings will be achievable in this area or from social care costs for Children.

Within ETE the major contract areas of highways and waste disposal will have already been renegotiated or re-tendered and the scope for further significant savings is therefore limited.

However placing a dis-proportionate burden on the remaining services to make the majority of the savings would mean the decimation of those services, many of which contribute to making Hampshire a great place to live and work or provide core essential central services to the County Council and a range of significant partners.

The idea of using council tax increases as a potential solution to some of the financial pressure has effectively now been taken away from us following the December 2015 settlement, leaving very few other options for dealing with the biggest two year gap that we have yet faced.

A further problem relates to the fact that we predict a £70m deficit in 2018/19 and will have no Grant Equalisation Reserve left to bridge it, requiring two stages of savings to be made across 2018/19 and 2019/20.

At this stage, we do need to concentrate on delivering the position to 2017/18 and we await the final settlement and various consultation papers that been outlined by the Government. This will inform a revised MTFS that will be presented in the summer (dependent on timing of other announcements and consultation documents).

Whilst this does paint a very bleak picture, we must remember that some neighbouring authorities are currently struggling to balance their 2016/17 budgets, with no spare reserves to help them achieve this and I will keep closely in touch with Society of County Treasurer colleagues as the picture unfolds over the next few months.

Carolyn Williamson

Director of Corporate Resources

25th January 2016

Treasury Management Strategy and Investment Strategy 2016/17 to 2018/19

1. Summary

- 1.1. The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the CIPFA Code) and the Prudential Code require authorities to determine the Treasury Management Strategy Statement (TMSS) and Prudential Indicators (PIs) on an annual basis. The TMSS also includes the Annual Investment Strategy (AIS) that is a requirement of the Department for Communities and Local Government's (DCLG) Investment Guidance.
- 1.2. As per the requirements of the Prudential Code, Hampshire County Council adopted the CIPFA Treasury Management Code at its meeting in February 2012. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the CLG Guidance.
- 1.3. The purpose of this TMSS is, therefore, to approve:
 - Treasury Management Strategy for 2016/17
 - Annual Investment Strategy for 2016/17, including proposals for changes to the investment of the County Council's cash balances to increase the yield earned on investments
 - Prudential Indicators for 2016/17, 2017/18 and 2018/19 shown in Appendix C
 - Minimum Revenue Provision (MRP) Statement shown in Appendix D
- 1.4. The County Council has potentially large exposures to financial risks through its investment and borrowing activity, including the loss of invested funds and the effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's treasury management strategy.
- 1.5. **This Report recommends the following be approved:**
 - **Treasury Management Strategy and Annual Investment Strategy for 2016/17 (and the rest of 2015/16) including:**
 - Prudential Indicators for 2016/17, 2017/18 and 2018/19 – Appendix C
 - Minimum Revenue Provision (MRP) Statement – Appendix D
 - That authority is delegated to the Director of Corporate resources to manage the Council's investments according to the risk assessment process in the Investment Strategy as appropriate to most effectively manage the Council's investments.
- 1.6. **An additional £0.5m is added to the £0.5m reserve created in the County Council's accounts in the Treasury Management Strategy 2015/16 as protection against the irrecoverable fall in value of any investments.**

2. Introduction

- 2.1. In February 2012 the County Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition (the CIPFA Code) which requires the County Council to approve a treasury management strategy before the start of each financial year.
- 2.2. In addition, the Department for Communities and Local Government (DCLG) issued revised Guidance on Local Authority Investments in March 2010 that requires the County Council to approve an investment strategy before the start of each financial year.
- 2.3. This report fulfils the County Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the DCLG Guidance.
- 2.4. The County Council has potentially large exposures to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the County Council's treasury management strategy.

3. External Context

- 3.1. The following paragraphs explain the economic and financial background against which the Treasury Management Strategy is being set.

Economic background

- 3.2. Domestic demand has grown robustly, supported by sustained real income growth and a gradual decline in private sector savings. Movements in transport costs, and alcohol and tobacco prices contributed to annual CPI inflation rising to 0.0% in November. Wages are growing at 2.4% a year, and the unemployment rate has dropped to 5.2%. Mortgage approvals have risen to over 70,000 a month and annual house price growth is around 3.5%. These factors have boosted consumer confidence, helping to underpin retail spending and hence GDP growth, which was an encouraging 2.3% a year in the third quarter of 2015. Although speeches by the Bank of England's Monetary Policy Committee (MPC) members sent signals that some were willing to countenance higher interest rates, the MPC held policy rates at 0.5% for the 82nd consecutive month at its meeting in December 2015.

Interest Rate Forecast

- 3.3. Uncertainty over the outcome of the forthcoming EU referendum could put downward pressure on UK GDP growth and interest rates. The County Council's treasury advisor, Arlingclose, projects the first 0.25% increase in UK Bank Rate in the third quarter of 2016, rising by 0.5% a year thereafter, finally settling between 2% and 3% in several years' time. Persistently low inflation, subdued

global growth and potential concerns over the UK's position in Europe mean that the risks to this forecast are weighted towards the downside.

- 3.4. A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix A.

Credit outlook

- 3.5. The varying fortunes of different parts of the global economy are reflected in market indicators of credit risk. UK banks operating in the Far East and parts of mainland Europe have seen their perceived risk increase, while those with a more domestic focus continue to show improvement. The sale of most of the government's stake in Lloyds and the first sale of its shares in RBS have generally been seen as credit positive.
- 3.6. Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the UK, USA and Germany. The rest of the European Union will follow suit in January 2016, while Australia, Canada and Switzerland are well advanced with their own plans. Meanwhile, changes to the UK Financial Services Compensation Scheme and similar European schemes in July 2015 mean that most private sector investors are now partially or fully exempt from contributing to a bail-in. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the County Council; returns from cash deposits however remain stubbornly low.

4. Balance Sheet Summary and Forecast

- 4.1. As at 31 December 2015 the County Council had £526m of borrowing and £512m of investments. This is set out in further detail at Appendix B. Forecast changes in these sums are shown in the balance sheet analysis in Table 1.

Table 1: Balance Sheet Summary and Forecast

	31.03.15	31.03.16	31.03.17	31.03.18	31.03.19
	Actual	Estimate	Estimate	Estimate	Estimate
	£m	£m	£m	£m	£m
Capital Financing Requirement	762	753	739	724	696
Less: Other long-term liabilities					
- Street lighting PFI	(115)	(117)	(113)	(110)	(106)
- Waste management contract	(65)	(60)	(55)	(49)	(42)
Borrowing CFR	582	576	571	565	548
Less: External borrowing					
- Public Works Loan Board	(277)	(270)	(257)	(243)	(236)
- Market Loans (LOBOs)	(73)	(73)	(73)	(73)	(73)
Internal (over) borrowing	232	233	241	249	239
Less: Reserves and balances	(462)	(421)	(439)	(360)	(336)
Less: Working capital	(252)	(250)	(250)	(250)	(250)
Resources for investments	(714)	(671)	(641)	(610)	(586)
New borrowing or (investments)	(482)	(438)	(400)	(361)	(347)

- 4.2. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The County Council's current strategy is to maintain borrowing and investments below their underlying levels, known as internal borrowing.
- 4.3. The Council's CFR is forecast to reduce over the next few years, as are the Council's reserves, but the current internally borrowed position can be maintained if this continues to be advantageous.
- 4.4. CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the County Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the County Council expects to comply with this recommendation during 2016/17.

5. Borrowing Strategy

- 5.1. The County Council currently holds £350m of loans as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in Table 1 shows that the County Council does not expect to need new borrowing in 2016/17. The County Council may however borrow to pre-fund future years'

requirements, providing this does not exceed the authorised limit for borrowing of £640m

Objectives

- 5.2. The County Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the County Council's long-term plans change is a secondary objective.

Strategy

- 5.3. Given the significant cuts to public expenditure and in particular to local government funding, the County Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.
- 5.4. By doing so, the County Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise.
- 5.5. In addition, the County Council may borrow short-term loans (normally for up to one month) to cover unexpected cash flow shortages.

Sources

- 5.6. The approved sources of long-term and short-term borrowing are:
- Public Works Loan Board (PWLB) and its successor body
 - UK local authorities
 - any institution approved for investments (see below)
 - any other bank or building society authorised to operate in the UK
 - UK public and private sector pension funds (except the Hampshire Pension Fund)
 - capital market bond investors
 - special purpose companies created to enable local authority bond issues
- 5.7. In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:
- operating and finance leases
 - hire purchase
 - Private Finance Initiative
 - sale and leaseback

- 5.8. The County Council has previously raised the majority of its long-term borrowing from the PWLB but it continues to investigate other sources of finance, such as local authority loans and bank loans that may be available at more favourable rates.

LOBOs

- 5.9. The County Council holds £73m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the County Council has the option to either accept the new rate or to repay the loan at no additional cost. In the current low interest rate environment it is unlikely that any lender will exercise their options but there remains an element of refinancing risk. The County Council will take the option to repay LOBO loans at no cost if it has the opportunity to do so.

Short-term and Variable Rate loans

- 5.10. These loans leave the County Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators at section 7 of this strategy.

Debt Rescheduling

- 5.11. The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The County Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

6. Investment Strategy

- 6.1. The County Council holds invested funds representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the County Council's investment balance has ranged between £491m and £633m, and similar levels are expected to be maintained in the forthcoming year.

Objectives

- 6.2. Both the CIPFA Code and the CLG Guidance require the County Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The County Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

Strategy

- 6.3. Due to the increasing risk from bank 'bail-ins' and continued low returns from short-term unsecured bank investments, the County Council aims to further

diversify into more secure and/or higher yielding asset classes during 2016/17. This is especially the case for the estimated £285m that is available for longer-term investment. Approximately 70% of the County Council's surplus cash is not subject to bail-in risk as it is invested in local authorities, corporate bonds, pooled property funds, and secured bonds. Whilst the remaining cash is subject to bail-in risk, 65% of these instruments are saleable, and 11% is subject to a reduced risk of bail-in as it is invested in money market funds. The remaining 24% that is subject to bail-in risk is invested either in instant access bank accounts, or in notice accounts which have interest rates that are commensurate with the risk. This diversification will represent a continuation of the new strategy adopted in 2015/16. Investment Limits.

Investment Limits

- 6.4. Given the impact of the Bank Recovery and Resolution Directive, and the recast Deposit Guarantee Schemes Directive, which has increased the credit risk that unsecured bank/building society investments could be 'bailed-in', the following investment limits are proposed to mitigate the risk whilst allowing sufficient flexibility to manage the County Council's investment balances.
- 6.5. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Maximum limits will also be placed on fund managers and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 2: Investment Limits

	Cash limit
Any single organisation, except the UK Central Government	£70m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£70m per group
Any group of pooled funds under the same management	£70m per manager
Registered Providers	£70m in total
Money Market Funds	50% in total

Approved Counterparties

- 6.6. The County Council may invest its surplus funds with any of the counterparty types in Table 3, subject to the cash limits (per counterparty) and the time limits shown.

Table 3: Approved Investment Counterparties and Limits

Credit Rating	Banks Unsecured	Banks Secured	Government	Corporates	Registered Providers Unsecured	Registered Providers Secured
UK Govt	n/a	n/a	£ Unlimited 30 years	n/a	n/a	n/a
AAA	£35m 5 years	£70m 20 years	£70m 30 years	£35m 20 years	£35m 20 years	£35m 25 years
AA+	£35m 5 years	£70m 10 years	£70m 25 years	£35m 10 years	£35m 10 years	£35m 10 years
AA	£35m 4 years	£70m 5 years	£70m 15 years	£35m 5 years	£35m 10 years	£35m 10 years
AA-	£35m 3 years	£70m 4 years	£70m 10 years	£35m 4 years	£35m 10 years	£35m 10 years
A+	£35m 2 years	£70m 3 years	£35m 5 years	£35m 3 years	£35m 5 years	£35m 5 years
A	£35m 13 months	£70m 2 years	£35m 5 years	£35m 2 years	£35m 5 years	£35m 5 years
A-	£35m 6 months	£70m 13 months	£35m 5 years	£35m 13 months	£35m 5 years	£35m 5 years
BBB+	£20m 100 days	£35m 6 months	£20m 2 years	£20m 6 months	£20m 2 years	£35m 2 years
BBB	£20m next day only	£35m 100 days	n/a	n/a	n/a	n/a
None	£35m 6 months	n/a	£35m 25 years	n/a	£35m 5 years	£35m 25 years
Pooled funds	£70m per fund					

This table must be read in conjunction with the notes below.

Credit Rating

- 6.7. Investment decisions are made by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used.

Banks Unsecured

- 6.8. Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. Unsecured investment with banks rated BBB or BBB- are restricted to overnight deposits at the County Council's current account at NatWest (which is currently rated as BBB+).

Banks Secured

- 6.9. Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank/building society's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank/building society will not exceed the cash limit for secured investments.

Government

- 6.10. Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 30 years.

Corporates

- 6.11. Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Investing with any unrated corporate entity will be judged on a case-by-case basis and only considered if suitable security can be obtained for the County Council's investment.

Registered Providers Secured and Unsecured

- 6.12. Registered Providers of Social Housing, formerly known as Housing Associations; these bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain a high likelihood of receiving government support if needed. Registered Providers can issue loans and bonds, either on an unsecured or secured basis. The secured loans and bonds are secured on the underlying assets of the Registered Provider.

Pooled Funds

- 6.13. Shares in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Money Market Funds that offer same-day liquidity and aim for a constant net asset value will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.
- 6.14. Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the County Council to diversify

into asset classes other than cash without the need to own and manage the underlying investments. Depending on the type of pooled fund invested in, it may have to be classified as capital expenditure. Because pooled funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the County Council's investment objectives will be monitored regularly.

Risk Assessment and Credit Ratings

- 6.15. Credit ratings are obtained and monitored by the County Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:
- no new investments will be made,
 - any existing investments that can be recalled or sold at no cost will be, and
 - full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.
- 6.16. Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Investments Targeting Higher Returns

- 6.17. As part of the 2014/15 Investment Strategy it was agreed to target £90m for higher yielding investments such as long-term investments with other Local Authorities, or equity, bond or property investments. This amount is in addition to £15m that was identified for long term investments, associated with the Street Lighting PFI. Investments yielding higher returns will contribute additional income to the County Council, although some come with the risk that they may suffer falls in the principal instead.
- 6.18. The Investment Strategy gives the flexibility to allow the Director of Corporate Resources' staff with the assistance of the advisers, Arlingclose, to continue to look for opportunities and invest the remaining target in higher return instruments.
- 6.19. The 2015/16 Investment Strategy recommended that the initial returns from a pooled property fund be used to create a reserve of £0.5m in the County Council's accounts as protection against the irrecoverable fall in value of any investments. It is recommended that a further £0.5m is added to this reserve to

further protect the County Council's funds. This is prudent given the additional risk that is being taken in targeting investments with higher returns.

Other Information on the Security of Investments

- 6.20. The County Council understands that credit ratings are good but not perfect predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.
- 6.21. Based on the available information and the advice of the County Council's advisers, Arlingclose, the Director of Corporate Resources may reduce the investment limits shown in Tables 2 and 3, and suspend investing with certain counterparties as necessary.
- 6.22. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the County Council's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

Specified Investments

- 6.23. The CLG Guidance defines specified investments as those:
- denominated in pound sterling,
 - due to be repaid within 12 months of arrangement,
 - not defined as capital expenditure by legislation, and
 - invested with one of:
 - the UK Government,
 - a UK local authority, parish council or community council, or
 - a body or investment scheme of "high credit quality".
- 6.24. The County Council defines "high credit quality" organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

Non-specified Investments

- 6.25. Any investment not meeting the definition of a specified investment is classed as non-specified. The County Council does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, (i.e. those that are due to

mature 12 months or longer from the date of arrangement), pooled funds that the County Council intends to hold as long-term investments (for more than a year) and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in Table 4 below.

Table 4: Non-Specified Investment Limits

	Cash limit
Total long-term investments	£285m
Total investments without credit ratings or rated below A- (excluding investments with other local authorities)	£190m
Total non-Sterling investments	£0m
Total investments in foreign countries rated below AA+	£0m
Total non-specified investments	£475m

Liquidity Management

- 6.26. The County Council has due regard for its future cash flows when determining the maximum period for which funds may prudently be committed. Historic cash flows are analysed in addition to significant future cash movements, such as payroll, grant income and council tax precept. Limits on long-term investments are set by reference to the County Council's medium term financial position (summarised in Table 1) and forecast short-term balances.

7. Treasury Management Indicators

- 7.1. The County Council measures and manages its exposures to treasury management risks using the following indicators.

Interest Rate Exposures

- 7.2. This indicator is set to control the County Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the amount of principal borrowed or invested will be:

	2016/17	2017/18	2018/19
Upper limit on fixed interest rate investment exposure	£285m	£250m	£250m
Upper limit on variable interest rate investment exposure	£700m	£700m	£700m
Upper limit on fixed interest rate borrowing exposure	£780m	£760m	£740m
Upper limit on variable interest rate borrowing exposure	£780m	£760m	£740m

- 7.3. Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Short-term instruments (with a maturity of less than one year) are classed as variable rate.

Maturity Structure of Borrowing

- 7.4. This indicator is set to control the County Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	Lower
Under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and within 20 years	75%	0%
20 years and within 30 years	75%	0%
30 years and above	100%	0%

- 7.5. Time periods start on the first day of each financial year.

Principal Sums Invested for Periods Longer than 364 days

- 7.6. The purpose of this indicator is to control the County Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

	2016/17	2017/18	2018/19
Limit on principal invested beyond 364 days	£285m	£250m	£250m

8. Other Items

- 8.1. There are a number of additional items that the County Council is obliged by CIPFA or DCLG to include in its Treasury Management Strategy.

Policy on Use of Financial Derivatives

- 8.2. Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of

the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

- 8.3. The County Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the County Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.
- 8.4. Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit. The use of financial derivatives is not planned as part of the implementation of the Treasury Management Strategy and any changes to this would be reported to members in the first instance.

Investment Training

- 8.5. The needs of the County Council's treasury management staff for training in investment management are assessed annually as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.
- 8.6. Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA and other appropriate organisations.
- 8.7. CIPFA's Code of Practice requires that the Council ensures that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities. All County Council members were invited to a workshop presented by Arlingclose on 23 November 2015, which gave an update on treasury matters.

Investment Advisers

- 8.8. The County Council has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. The quality of this service is controlled through quarterly review meetings with the Director of Corporate Resources and her staff and Arlingclose.

Investment of Money Borrowed in Advance of Need

- 8.9. The County Council may, from time to time, borrow in advance of need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the County Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment

and borrowing interest rates may change in the intervening period. These risks will be managed as part of the County Council's overall management of its treasury risks. The total amount borrowed will not exceed the authorised borrowing limit of £640m.

Appendix A – Arlingclose Economic & Interest Rate Forecast January 2016

Forecast:

- Arlingclose forecasts the first rise in UK Bank Rate in Q3 2016. Further weakness in inflation, and the MPC's expectations for its path, suggest policy tightening will be pushed back into the second half of the year. Risks remain weighted to the downside. Arlingclose projects a slow rise in Bank Rate, the appropriate level of which will be lower than the previous norm and will be between 2 and 3%.
- The projection is for a shallow upward path for medium term gilt yields, with continuing concerns about the Eurozone, emerging markets and other geo-political events, weighing on risk appetite, while inflation expectations remain subdued.
- The uncertainties surrounding the timing of UK and US monetary policy tightening, and global growth weakness, are likely to prompt short term volatility in gilt yields.

	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
Official Bank Rate													
Upside risk		0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.75	1.75
Downside risk				-0.25	-0.25	-0.50	-0.50	-0.75	-0.75	-1.00	-1.00	-1.25	-1.25
3-month LIBID rate													
Upside risk	0.20	0.30	0.30	0.30	0.35	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	0.55	0.60	0.70	0.80	0.95	1.05	1.15	1.30	1.40	1.55	1.65	1.80	1.85
Downside risk		-0.20	-0.30	-0.45	-0.55	-0.65	-0.80	-0.90	-1.05	-1.10	-1.20	-1.20	-1.20
1-yr LIBID rate													
Upside risk	0.25	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.45	0.45	0.45	0.45	0.45
Arlingclose Central Case	1.10	1.20	1.35	1.45	1.55	1.70	1.80	1.95	2.00	2.10	2.15	2.15	2.15
Downside risk	-0.15	-0.25	-0.35	-0.50	-0.60	-0.70	-0.85	-0.95	-1.10	-1.15	-1.25	-1.25	-1.25
5-yr gilt yield													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	1.50	1.55	1.60	1.70	1.80	1.90	2.00	2.10	2.20	2.25	2.30	2.35	2.35
Downside risk	-0.35	-0.45	-0.55	-0.60	-0.70	-0.80	-0.90	-1.00	-1.10	-1.15	-1.20	-1.25	-1.25
10-yr gilt yield													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	2.00	2.05	2.10	2.20	2.30	2.40	2.50	2.60	2.65	2.70	2.75	2.80	2.80
Downside risk	-0.35	-0.45	-0.55	-0.60	-0.70	-0.80	-0.90	-1.00	-1.10	-1.15	-1.20	-1.25	-1.25
20-yr gilt yield													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	2.45	2.50	2.55	2.55	2.60	2.65	2.70	2.75	2.80	2.85	2.90	2.95	2.95
Downside risk	-0.30	-0.40	-0.50	-0.55	-0.65	-0.75	-0.85	-0.95	-1.05	-1.10	-1.15	-1.20	-1.20
50-yr gilt yield													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	2.45	2.50	2.55	2.60	2.65	2.70	2.75	2.80	2.85	2.90	2.95	3.00	3.00
Downside risk	-0.25	-0.35	-0.45	-0.50	-0.60	-0.70	-0.80	-0.90	-1.00	-1.05	-1.10	-1.15	-1.15

Appendix B – Existing Investment & Debt Portfolio Position

	31.12.2015 Actual Portfolio £m	31.12.2015 Rate of Return %
External Borrowing:		
PWLB – Fixed Rate	276.79	
Other Loans	73.00	
Total External Borrowing	349.79	4.85%
Other Long Term Liabilities:		
Street Lighting PFI	116.60	
Waste Management Contract	60.19	
Total Gross External Debt	526.58	
Investments		
Direct Deposits		
- Close Brothers	15.00	
- Svenska Handelsbanken	1.45	
	16.45	0.95%
Certificates of Deposit		
- Bank of Montreal	15.00	
- Credit Suisse	10.00	
- Landesbank Hessen Thueringen	20.00	
- Lloyds	20.00	
- Nationwide	5.00	
- Nordea AB	30.00	
- Rabobank	10.00	
- Standard Chartered	10.00	
	120.00	0.64%
Covered Floating Rate Notes		
- Lloyds	7.20	
- Nova Scotia	10.00	
- Toronto Dominion	10.00	
- Yorkshire Building Society	15.00	
	42.20	0.74%
Covered Fixed Bonds		
- Lloyds	10.00	
- Yorkshire Building Society	15.00	
	25.00	1.16%
Corporate Floating Rate Notes		
- BMW US Capital LLC	10.00	0.84%
Corporate Fixed Bonds		
- Heathrow Funding Ltd	5.36	
- Linde Finance	5.00	
- Transport for London	10.01	
	20.37	2.26%
Pooled Property Funds		
- CCLA	20.00	
- Aviva Lime	15.00	

	31.12.2015 Actual Portfolio £m	31.12.2015 Rate of Return %
	35.00	4.56%*
Other Local Authorities	226.00	1.71%
Money Market Funds - Aberdeen (SWIP)	17.12	0.50%
Total Investments	512.14	1.49%
Net Debt	14.44	-

*average estimated annual income return to 31 December 2015

Appendix C - Prudential Indicators 2016/17

The Local Government Act 2003 requires the County Council to have regard to the Chartered Institute of Public Finance and Accountancy's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the County Council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure

The County Council's planned capital expenditure and financing may be summarised as follows:

Capital Expenditure and Financing	2015/16 Revised £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
Total Expenditure	243	237	219	156
Capital receipts	13	6	9	4
Grants and other income	134	195	176	148
Revenue contributions	73	21	16	1
Contributions from reserves	6	2	4	2
Total Financing	226	224	205	155
Prudential borrowing	17	22	19	3
Less repayments from capital receipts etc	(5)	(9)	(5)	(2)
Finance lease	5	0	0	0
Total Funding	17	13	14	1
Total Financing and Funding	243	237	219	156

Estimates of Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the County Council's underlying need to borrow for a capital purpose.

Capital Financing Requirement	31.03.16 Revised £m	31.03.17 Estimate £m	31.03.18 Estimate £m	31.03.19 Estimate £m
Total CFR	753	739	724	696

The CFR is forecast to fall by £57m over the next three years as capital expenditure financed by debt is outweighed by resources put aside for debt repayment.

Gross Debt and the Capital Financing Requirement

In order to ensure that over the medium term debt will only be for a capital purpose, the County Council should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

Debt	31.03.16 Revised £m	31.03.17 Estimate £m	31.03.18 Estimate £m	31.03.19 Estimate £m
Borrowing	343	330	316	309
PFI liabilities	177	168	159	148
Total Debt	520	498	475	457

Total debt is expected to equal or remain below the CFR during the forecast period.

Operational Boundary for External Debt

The operational boundary is based on the County Council's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the County Council's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance lease, Private Finance Initiative and other liabilities that are not borrowing but form part of the County Council's debt.

Operational Boundary	2015/16 Revised £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
Borrowing	620	610	600	580
Other long-term liabilities	180	170	160	150
Total Debt	800	780	760	730

Authorised Limit for External Debt

The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the County Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	2015/16 Revised £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
Borrowing	640	640	630	620
Other long-term liabilities	230	210	200	190
Total Debt	870	850	830	810

Ratio of Financing Costs to Net Revenue Stream

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2015/16 Revised %	2016/17 Estimate %	2017/18 Estimate %	2018/19 Estimate %
General Fund	5.87%	5.73%	5.61%	5.66%

Incremental Impact of Capital Investment Decisions

This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax levels. The incremental impact is the difference between the total revenue budget requirement of the current approved capital programme and the revenue budget requirement arising from the capital programme proposed earlier in this report.

Incremental Impact of Capital Investment Decisions	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
	£	£	£
General Fund - increase in annual band D Council Tax	1.72	4.15	2.66

Adoption of the CIPFA Treasury Management Code

The County Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition in February 2012.

Appendix D – Annual Minimum Revenue Provision Statement 2016/17

Where the County Council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the County Council to have regard to the Department for Communities and Local Government's Guidance on Minimum Revenue Provision (the DCLG Guidance) most recently issued in 2012.

The broad aim of the DCLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The DCLG Guidance requires the County Council to approve an Annual MRP Statement each year, and whilst it provides a range of options for the calculation of MRP the guidance also notes that other options are permissible provided that they are fully consistent with the statutory duty to make prudent revenue provision.

MRP in 2016/17: As agreed by Cabinet in December 2015 for the calculation of MRP from 2015/16 onwards the County Council will change from calculating MRP for supported borrowing from a 4% reducing balance to a 50 year straight line basis. To be more prudent the 50 years has been started from 2008 and the actual calculation will therefore be 1/43's. This will ensure that the County Council continues to take a prudent approach to repaying its Supported Borrowing, ensuring that the supported borrowing is repaid sooner, as well as contributing to the County Council's immediate financial pressures.

The County Council will continue to apply the Asset Life or Depreciation Method (which are Options 3 and 4 from the range provided by the DCLG) in respect of unsupported capital expenditure funded from borrowing.

MRP in respect of leases and Private Finance Initiative schemes brought on Balance Sheet under the International Financial Reporting Standards (IFRS) based Accounting Code of Practice will match the annual principal repayment for the associated deferred liability.

Capital expenditure incurred during 2016/17 will not be subject to an MRP charge until 2017/18.

Summary of *Shaping Hampshire* - Spending Review Consultation

A report was presented to Cabinet on 21 September 2015 which provided a summary of the headline findings from the *Shaping Hampshire* - Spending Review Consultation that was carried out by Ipsos MORI on behalf of the County Council, between 26 May and 6 July 2015.

The Consultation was undertaken against the background of the next stage of the County Council's transformation and efficiencies programme, *Transformation to 2017* in order to inform the County Council's ongoing transformation and efficiencies programme, and in accordance with legal best-practice.

The Spending Review Consultation aimed to seek residents' and stakeholders' views on three main options for managing the shortfall in funding, and achieving anticipated savings of £98 million by April 2017, namely by:

- Raising the rate of Council Tax
- Using the County Council's reserves differently
- Reducing spending on specific services.

The Spending Review Consultation also included questions on which services respondents considered to be 'most important' for the County Council to continue to deliver; usage of a range of services; and an opportunity to add views or suggestions on further options.

A total of 2,774 responses were received using two methods of consultation:

- An open consultation - available online and via a paper copy (available to any stakeholder or member of the public)
- A telephone survey - targeted at a representative sample of 1,500 residents.

Overall there was clear support for the County Council's current financial strategy with 79% of respondents supporting the approach to dealing with reductions in Government Grant.

Respondents also favoured savings being found through a combination of the three key options namely increasing Council Tax, using more of the County Council's reserves and reducing spending on some services. There was less support for using more of the County Council's reserves (in combination with service spending reductions), and very limited support for finding the anticipated savings through reductions in funding for services alone.

A key issue arising from the consultation feedback was respondent's views on council tax increases. 55% of respondents supported an increase in council tax of between 1% and 1.99% and 20% supported an increase of 3%, whilst 21% did not want any increase at all.

Most residents and stakeholders were opposed to reducing spending on services for children, older people and vulnerable people, ranking these as the 'most important' services for the County Council to continue to support and deliver. As part of the

telephone survey, those respondents that supported a council tax increase generally wanted the additional resources that this generated to protect services for vulnerable adults and children.

The findings from the Consultation were used to inform the departmental Executive Lead Member budget reports in September, in order for recommendations to be made to Cabinet and the full County Council in October 2015 on the Medium Term Financial Strategy 2016/17 and were also be taken into consideration in the planning of the Transformation to 2017 programme.

The full Cabinet report and the full report by Ipsos MORlis are linked below:

<http://www3.hants.gov.uk/budget/spendingreviewsurvey.htm>

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