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Financial Sustainability Assessment – **Merthyr Tydfil County Borough Council**

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Despite a higher than expected settlement, the Council's financial position is still challenging, and failure to deliver to budget or make planned savings risks depleting reserves to a low level.

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Summary

What we reviewed and why

1 The project sought to assess the sustainability of councils' short to medium-term financial position.

2 This included a focus on the financial strategy of each council as well as reviewing financial 'indicators' of each council's financial position in relation to:

- Performance against budget
- Delivery of savings plans
- Use of reserves
- Council tax
- Borrowing

Exhibit 1: about the Council

This exhibit sets out some background information on the Council's net revenue budget, the number of staff it employs and the value of its fixed assets.

The Council's net revenue budget for 2019-20 was £120m

The Council employs around 2,600 people

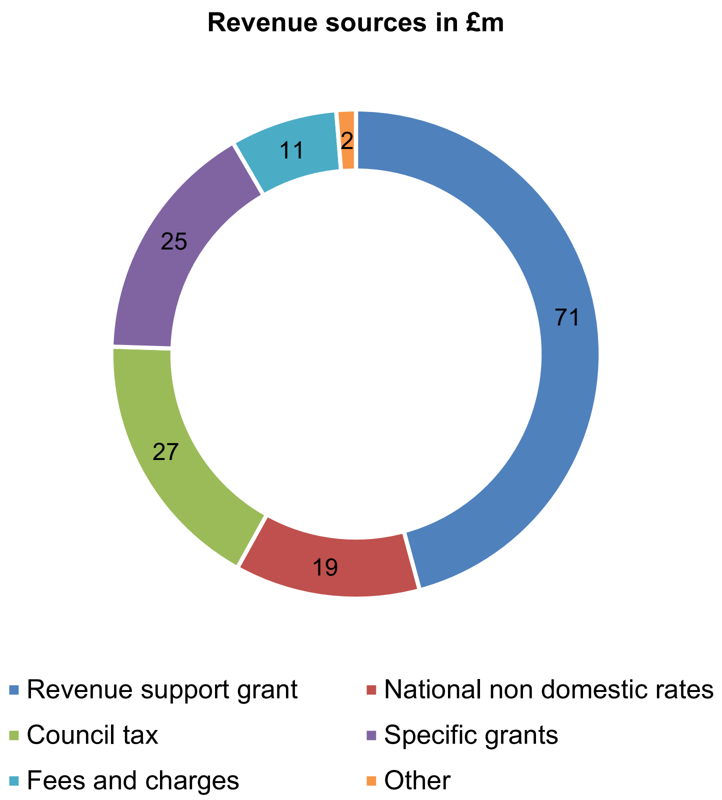
The Council's fixed assets as at 31 March 2019 were £260m

Source: Statement of Accounts 2018-19, staff costs working paper 2018-19

3 We undertook this assessment because we identified financial sustainability as a risk to councils putting in place proper arrangements to secure value for money in the use of resources. In part, this was informed by the recent experiences of some councils in England, our knowledge of the financial situation in councils in Wales, and the general trend of decreasing resources for local government combined with rising demand for some services.

Exhibit 2: the Council's sources of revenue

The pie chart below shows how much money the Council received from different funding sources during 2018-19.



Source: MTCBC Financial Sustainability Self Assessment

4 We undertook the review during the period November 2019 to January 2020.

What we found

5 Overall we found that despite a higher than expected settlement, the Council's financial position is still challenging, and failure to deliver to budget or make planned savings risks depleting reserves to a low level. We reached this conclusion because:

- while the Council's medium-term financial plan sets out its forecast budget deficits, it does not set out how the Council is going to quickly improve its financial sustainability;
- the Council's performance against budget has fluctuated in recent years and it has therefore used a significant amount of reserves to finance the shortfall;
- the Council needs to identify and deliver recurrent efficiency savings which will help to reduce the budget gap over the medium to long term;

- the Council is taking action to strengthen its low level of reserves and improve its financial resilience to unforeseen budget pressures;
- the Council has a relatively low council tax collection rate which decreased in 2018-19 to its lowest since 2011-12; and
- the Council has a relatively low level of borrowing and interest costs and has no borrowing to fund commercial activities.

Detailed report

Despite a higher than expected settlement, the Council's financial position is still challenging, and failure to deliver to budget or make planned savings risks depleting reserves to a low level

While the Council's medium-term financial plan sets out its forecast budget deficits, it does not set out how the Council is going to quickly improve its financial sustainability

Why strategic financial planning is important

6 A clear and robust financial strategy is important to identify the likely level of funding available to a council, as well as the anticipated level of demand for, and cost of, providing services. Given the recent and anticipated funding pressures facing all councils it is also important to identify how it intends to respond to those pressures, and particularly how they will meet projected funding gaps.

What we found

7 It is well documented that the Council has had significant financial difficulties in recent years.[1]

8 The Medium Term Financial Plan (MTFP) 2019-20 to 2022-23 published in March 2019 was based on reasonable projections and assumptions at that time.

9 The MTFP as at March 2019 projected a 2020-21 deficit of £8.1 million, which was unprecedented for the Council. The projected cumulative deficit at that time for the three-year period to 2022-23 was £15.0 million.

10 In December 2019 the Welsh Government announced a 4.8% increase to the Council's revenue support grant for 2020-21. The January 2020 Cabinet report on the Revenue Budget 2020-21 sets out that this increase has, in large part, contributed to the Council's projected deficit for 2020-21 reducing to zero from £8.1 million.

11 The focus of the MTFP is primarily on annual budget setting and the Council needs to consider how it is going to meet its longer-term budget gap, including strengthening the links between its plans to transform its services and its MTFP.

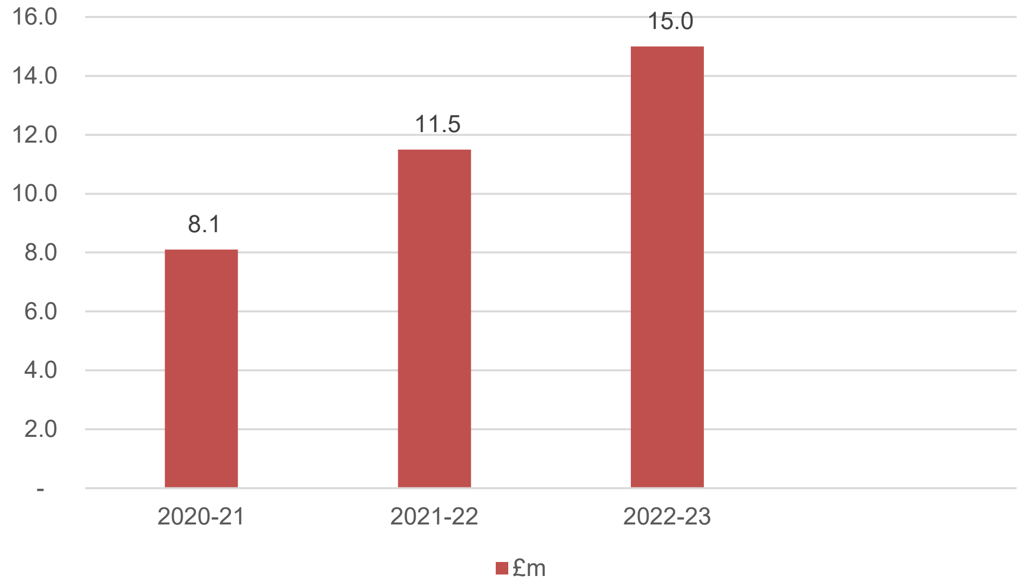
12 The Council has implemented and continues to explore options to improve its financial resilience. Sustainability initiatives and workstreams aimed to help address the budget gap have been re-focussed and are hence in their early stages

[1] 2018-19 Annual Improvement Report including 2017-18 Annual Audit Letter on page 18 and September 2019 External Advisor Scoping Review

of development. The external adviser appointed by the Welsh Government in the summer of 2019 felt there were too many workstreams for the existing capacity within the Council to focus upon and they have since been slightly streamlined.

Exhibit 3: projected funding gap

The following graph shows the cumulative funding gap that the Council has identified for 2020-21 to 2022-23. The figure for 2020-21 does not reflect the updated figure following the provisional settlement announced in December 2019.



Source: MTFP 2020-21 to 2022-23 March 2019

The Council's performance against budget has fluctuated in recent years and it has therefore used a significant amount of reserves to finance the shortfall

Why accurately forecasting expenditure is important

13 It is important that overspending and underspending are kept under control and that actual expenditure is as close to the levels planned as possible. A council that is unable to accurately forecast and plan expenditure runs the risk of creating unforeseen financial pressures that may compromise the ability to set a balanced budget. Significant patterns of underspending may be reducing the ability of a council to deliver its key objectives or meet its statutory responsibilities.

What we found

14 The Council's overall financial performance against budget fluctuates. In 2017-18 the Council had an unexpected surplus of £1.3 million, mainly due to a one-off budget underspend within Social Services (independent residential establishments). In 2018-19 there was a deficit of £0.6 million, with a significant overspend of £1.4 million in Social Services. These figures are after contributions from reserves, which were £1.4 million in 2017-18 and £1.9 million in 2018-19.

15 There is a trend for increased costs within Education for children with additional learning needs, and within Social Services with regard to Looked After Children. Continuing cost pressures and increased demands for these two service sectors alone resulted in combined additional funding of circa £5.4 million approved for the 2019-20 financial year.

Exhibit 4: amount of overspend/underspend relative to total net revenue budget

The following exhibit shows the amount of overspend or underspend for the Council's overall net revenue budget for the last two years and also the year to date as at 31 December 2019.

	Original Budget net revenue budget	Actual Outturn net revenue budget	Amount of overall surplus/overspend	Percentage difference from net revenue budget
2017-18	£114.8m	£113.5m	£1.3m surplus	1.1% surplus
2018-19	£117.5m	£118.0m	£0.5m overspend	0.4% overspend
2019-20	£120.3m	£118.6m[2]	£1.7m surplus[3]	1.4% surplus

Source: MTCBC Financial Sustainability Self Assessment, Revenue budget monitoring 2019-20 quarter 3

The Council needs to identify and deliver recurrent efficiency savings which will help to reduce the budget gap over the medium to long term

Why the ability to identify and deliver savings plans is important

16 The ability to identify areas where specific financial savings can be made, and to subsequently make those savings, is a key aspect of ensuring ongoing financial

[2] This figure is the forecast outturn as at 31 December 2019.

[3] As at 30 September 2019 an overspend of £0.1 million was forecast.

sustainability against a backdrop of increasing financial pressures. Where savings plans are not delivered this can result in overspends that require the use of limited reserves whilst increasing the level of savings required in future years to compensate for this. Where savings plans are not delivered and service areas are required to make unplanned savings, this increases the risk either of savings not being aligned to the Council's priorities, or of 'short-term' solutions that are not sustainable over the medium term.

What we found

17 While the Council has a good track record of delivering savings, the magnitude of its financial deficits makes it difficult to achieve a sustainable financial balance.

18 For the period 2016-17 to 2019-20 (projected) the Council has achieved around 94% of its planned savings. These savings have been mainly based on cuts in service budgets, with the MTFP recording them as assumed savings in the calculation of the budget deficits. However such savings are not, of themselves, the answer to addressing the budget gap over the medium to long term.

Exhibit 5: savings delivered during 2018-19 as a percentage of planned savings

The following exhibit sets how much money the Council intended to save through planned savings during 2018-19 and how much of this it actually saved.

£2.8m	£2.7m	£0.1m	96.4%
Total planned savings	Planned savings delivered	Planned savings not delivered	Percentage savings achieved

Source: Change and Wellbeing Programme Quarter 4 2018-19

The Council is taking action to strengthen its low level of reserves and improve its financial resilience to unforeseen budget pressures

Why sustainable management of reserves is important

19 Healthy levels of useable reserves are an important safety net to support financial sustainability. As well as being available to fund unexpected funding pressures, useable reserves can also be an important funding source to support 'invest to save' initiatives designed to reduce the ongoing cost of providing services. Councils that show a pattern of unplanned use of reserves to plug gaps in their revenue budget that result in reductions of reserve balances reduce their resilience to fund unforeseen budget pressures in future years.

What we found

20 The Council held £12.6 million of useable reserves at 31 March 2019.

21 The Council's Corporate Reserves Policy states that general reserves should remain at 3.5% to 4% of the Council's annual budget net revenue expenditure.

22 For 2018-19 the Council used £1.9 million of its useable reserves as budgeted, there was no use of general reserves. For 2019-20 the Council originally budgeted to use £1.8 million of earmarked useable reserves and £0.5 million of general reserves, which would have reduced its general reserves to the lower limit of its Corporate Reserves policy. However, the current forecast outturn for 2019-20 excludes any use of general reserves, with the use of earmarked useable reserves reducing to £0.6 million.

23 However, latest in-year forecasts indicate that the Council will not need to use its reserves to the extent originally anticipated in 2019-20 and may in fact grow its reserves.

24 On 10 December 2019, Llwydcoed Crematorium Joint Committee approved a one-off redistribution of £1.5 million of its general reserves to Rhondda Cynon Taf County Borough Council and the Council on a proportionate 52%/48% split. This resulted in the Council receiving a one-off £0.7 million in 2019-20 and an estimated recurring annual distribution of approximately £350,000 to the Councils in the same proportion.

25 Under legislation local authorities are required to charge to their revenue account for each financial year a Minimum Revenue Provision (MRP) to account for the cost of their debt in that financial year. On 18 December 2019, the Council approved a revision to its MRP policy based on a more prudent charge to revenue, resulting in a significant budgetary saving for 2019-20 of £0.9 million, and approximately £0.8 million over the medium term.

26 Within its MTFP 2019-20 to 2022-23, the Council planned to use reserves of £0.8 million in 2020-21, with none beyond that. However, the Council is now revising its MTFP to take account of the recent provisional settlement from the Welsh Government which will eliminate the use of reserves in 2020-21. The January 2020 Cabinet report on the Revenue Budget 2020-21 sets out that the Council is planning to contribute £300,000 to General Reserves in 2020-21, this will increase the Council's general reserves to £5.0 million.

Exhibit 6: amount of reserves vs annual budget 2018-19

This exhibit shows the amount of useable reserves the Council had during 2018-19 compared with its net revenue budget for the same year.

£117m

Net Revenue Budget

£12.6m

Total Useable Reserves

11%

Total Useable Reserves as a percentage of Net Revenue Budget

Source: MTCBC Financial Sustainability Self Assessment

The Council has a relatively low council tax collection rate which decreased in 2018-19 to its lowest since 2011-12

Why council tax collection rates are important

27 Failure to collect the amount of council tax due to the Council will result in less income. This in turn may increase the financial pressures on the Council and require it to make additional savings. Whilst council tax is not the biggest source of funding for councils in Wales, it remains a key income source.

What we found

28 In 2018-19 the Council's council tax collection rate was 95.5%, this is its lowest level of collection since 2011-12 and is below the average of 96.1% for the three preceeding years.

29 The council tax increase for 2019-20 was 5.99%, being higher than the 4.15% increase for 2018-19. The rate of 5.99% is assumed over the term of the March 2019 MTFP.

Exhibit 7: council tax collection rates

This exhibit shows the percentage of council tax due that the Council collected during 2018-19.

Income collected from Council Tax at 31 March 2019 was **£25.5m** (95.5%) against a collectable debit of **£26.7m**

Source: Northgate system report, 31 March 2019

The Council has a relatively low level of borrowing and interest costs and has no borrowing to fund commercial activities

Why maintaining sustainable levels of borrowing is important

30 Borrowing can be a valuable source of funding, for example, to fund large scale capital projects such as new schools or leisure centres. However, the cost of repaying borrowing including interest costs can have a long-term impact on ongoing revenue budgets. Councils that fail to properly balance the benefits and costs of borrowing with their current and predicted revenue budgets risk reducing the amount of funding available for service delivery. Borrowing to fund commercial activity has the potential to generate additional income to fund council services, however, it can also bring significant risks that would be associated with any commercial activity.

What we found

31 As at 31 March 2019, the Council's borrowings in gross terms were the lowest of all the councils in Wales, but this is not unexpected given the size of the Council. Borrowing from the Public Works Loan Board was £48.9 million and the Lender Option Borrower Option (LOBO) loans totalled £12.0 million. The capital financing costs to serve this debt were £7.0 million in 2018-19.

32 In recent years the Council has increased its reliance on unsupported borrowing to supports its capital programme.

33 The change in MRP policy (see paragraph 25 above) will result in a lesser increase to capital financing costs over the short to medium term.

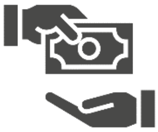
34 The Council does not have any borrowing to fund commercial activities. We understand that the Council will be exploring opportunities to increase its income generation, which may include commercial activities.

Exhibit 8: Council borrowing

The exhibit below shows the total amount of money that the Council has borrowed to fund commercial investments, as well as the cost of all the borrowing that the Council has as a proportion of its net revenue budget.

£0m

Amount of borrowing to fund commercial investments



6.0%

Cost of total borrowing as a proportion of net revenue budget 2018-19

Source: MTCBC Financial Sustainability Self Assessment

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