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| **Subject:** | **SECTION 25 REPORT** |
| **Meeting and Date:** | **Cabinet – 5 February 2024**<br>**Overview and Scrutiny Committee – 19 February 2024**<br>**Cabinet – 4 March 2024**<br>**Council – 6 March 2024** |
| **Report of:** | **Mike Davis, Section 151 Officer** |
| **Portfolio Holder:** | **Councillor Sue Beer, Portfolio Holder for Finance, Governance, Climate Change and Environment** |
| **Decision Type:** | **Key Decision** |
| **Classification:** | **Unrestricted** |
| **Purpose of the report:** | To advise Members of the robustness of the budget and the adequacy of reserves. |
| **Recommendation:** | To receive the report and to take the report into consideration when approving the 2024/25 Budget and Medium-Term Financial Plan (MTFP) which is elsewhere on the agenda. |

## 1. The Purpose of a "Section 25" Report

1.1 The Local Government Act 2003 (Section 25) requires that the s151 Officer reports to members on the robustness of the estimates made for the purposes of the budget calculations and the precept for the Council's council tax and the adequacy of the proposed financial reserves, so that Members can have regard to them when considering the annual budget and precept.

1.2 There is no prescribed format for a Section 25 report, but the s151 officer should bring to Members attention any matters or factors that are material and significant in considering the budget and the Council's financial position.

## 2. Summary

2.1 It is the opinion of the s151 officer that the Council's budget has been prepared on a rigorous and robust basis and the Council's reserves are sufficient for its immediate needs.

2.2 However, it is also the opinion of the s151 officer that there are two significant factors that can undermine the budget over the next year or two because of the actions of the Department for Environment Food and Rural Affairs (DEFRA) and the Department for Levelling Up, Housing and Communities (DLUHC).

2.3 Accordingly, DDC faces a stark choice. Either we maintain border controls to protect UK farming and the food chain, at the Council's own expense, massively deplete our reserves, and greatly increase the risk of the chief finance officer[1] being required to make a report pursuant to s.114 of the Local Government Finance Act 1988 in 2025/26.

[1] Frequently referred to as the "Section 151 Officer" or s151 Officer.

2.4 Or we effectively follow the logic of DEFRA's withdrawal of Dover Port Health Authority (PHA) funding, cease the already too limited controls at the border and expose the UK to the high risk of African Swine Fever and other Products of Animal Origin (POAO) risks.

2.5 DEFRA

2.6 DEFRA is withdrawing 68% (£2.5m out of £3.7m) of PHA funding from Dover in 2024/25 and the remaining 32% (£1.2m) in 2025/26. Over 90% of all African Swine Fever (ASF) risk related pork trade arrives via Dover.

2.7 Despite vague DEFRA assurances, the failure to properly resource the port health function poses a critical and irresponsible bio-security threat to the UK pork industry and the UK food chain, primarily through exposure to ASF from illicit and uncontrolled insanitary pork imports which are coming into the country through the Port of Dover (POD) at 1 – 2 tonnes per day. This matter has long been known to DEFRA and documented to them and reported in the press.

2.8 As the designated PHA for the POD, this risk to the UK pork industry and food chain is of extreme concern to the Council. The Council proposes to maintain the current service at its own expense, the cost being £2.8m in 2024/25. This will take circa 33% of all DDC Council Tax income in 2024/25 and would increase to 47% in 2025/26, paid for by the residents of the district, to protect the UK.

2.9 The logical solution is for DEFRA to:

(a) re-instate the funding on an on-going basis,

(b) cancel their proposed changes to border controls at the Short Straits, and

(c) maintain all checks on imported food at the point of entry in Dover.

2.10 DLUHC

2.11 The system of local government finance and local audit has failed and is not sustainable. Funding is allocated on a single year basis, late in the year [2], using out of date information. DLUHC are refusing to base DDC's 2024/25 settlement on the latest business rates data, despite this being submitted by DDC in good time. This has cost DDC £300k per annum.

## 3. Background

3.1 The rest of this report sets out:

(a) The Impact of working with DEFRA and being a PHA

(b) The strategic challenges and macroeconomic background

(c) The local government funding model

(d) The robustness of the General Fund (GF), Housing Revenue Account (HRA) and capital budgets

(e) Governance process

(f) Identification of options

[2] The final settlement for 2024/25 was announced on 25/1/25, too late for this report.

(g) Resource implications

(h) Corporate implications.

4. **The impact of working with DEFRA and being a Port Health Authority**

4.1 DDC is the designated PHA for the POD and is also responsible for import controls in respect of goods arriving through the Channel Tunnel (CT) from Coquelles.

4.2 As such, DDC plays a key role in UK biosecurity for agriculture and the food chain. DEFRA have indicated that they wish DDC to maintain and expand its PHA activities (by expanding its ASF safeguard work into Coquelles), but DEFRA are also planning to ultimately remove all their funding[3] for this work and remove the means by which DDC could generate additional funds to provide the service.

4.3 In 2016 the UK voted to leave the EU. One of the drivers for this was the argument that the UK could then take back control of its borders.

4.4 It has taken DEFRA 6 years to develop an inadequate model for the control of food and other imports, particularly in relation to Products of Animal Origin (POAO). The Council does not consider that this model is deliverable.

4.5 Although the issues are complex, there are some simple and incontestable factors that need to be understood.

(a) DDC is the designated PHA for the POD and is also responsible for import controls in respect of the Channel Tunnel (CT). Of the food that arrives via the Short Straits, and which requires an imported food check, to ensure its safety for consumption, 82% arrives via Dover, with a further 18% arriving via the Channel Tunnel, so DDC are providing a national service for the UK.

(b) DEFRA continue to have a very limited understanding of the service, its implications and scale at the Short Straits. DEFRA's capacity and delivery modelling remains flawed and in error by an order of magnitude. DEFRA continue to underestimate the volume of these imports by at least 1 million consignments pa, or 33%.

Detailed analysis of HMRC documents by DDC shows that there are a minimum of 2.9m consignments per annum arriving via the Short Straits that require a control from Dover. The DEFRA data is reporting 1.7m, which is an under report of over 1m consignments, but an improvement from their original assessment, where DEFRA maintained, for several years, as they created the model and undertook their forecasting, that there were just **90,000** consignments pa, or **just 3%** of the actual flow. The Council has no confidence in their understanding of the trade and their data analysis.

(c) As part of emergency safeguard measures imposed by the Government in respect of the risk relating to the introduction of ASF to the UK, joint interventions by DDC and Border Force have been taking place since September 2022.

(d) It is not possible to confirm the exact quantities of illicit pork arriving via Dover, but it is widely recognised that over 90% of all ASF risk related pork trade

[3] Of the £3.2m from DEFRA to provide controls in respect of illegal imports and to prevent African Swine Fever, £2m will be withdrawn in 2024/25, and the remaining £1.2m will be withdrawn in 2025/26. Additionally, they are also removing DDC's capability to generate any income from "sanitary and phyto sanitary" (SPS) checks on products from the rest of the world and the EU when they arrive, at Dover. Dover PHA will have deficits of £2.8m in 2024/25 and £4m in 2025/26.

arrives via Dover. Current total illegal meat seized at Dover in a small number of exercises over short periods is 64 tonnes.

This is widely accepted as the tip of the iceberg. These meat and meat products from both the EU and Rest of World are found in extremely unhygienic and unacceptable conditions, travelling for days without temperature control and appropriate packaging or labelling.

Food has been transported in old wheelie bins, amongst dirty washing and even amongst live animals (pets) with blood and liquor dripping onto ready to eat foods within the vehicle and from the vehicle. ASF is spreading across Europe, with cases as close as Germany. If it crosses the short straits the impact on the UK will be catastrophic and will result in national culling programmes, UK food export bans and crippling damage to confidence in our food safety. **The Foot & Mouth outbreak in 2001 cost the UK £8bn.**

(e) Withdrawal of Funding

On 15 December 2023, DEFRA (Lord Douglas-Miller) wrote to DDC advising that it was cutting the funding for counter ASF checks to £1.2m in 2024/25 (from £3.7m in 2024/45), and the final 33% (£1.2m) to be withdrawn in 2025/26. It was suggested by Lord Douglas-Miller, that DDC would be able to operate the service on a “cost recovery” basis, via charges on illegal importers[4] of products of animal origin.

This raises a number of questions and concerns:

(i) Fundamentally there are two changes that the government plan to impose on Dover Port Health, which whilst they are separate and new, are intrinsically linked and of catastrophic impact if implemented. One is the proposal to cut our existing funding for personal import (non-income generating) checks for ASF. The second is to remove commercial imported food (income generating) checks (SPS) from Dover to Sevington, consequently removing the council’s ability to be able to self-finance its wider port health duty.

(ii) DEFRA have been unable to demonstrate how a service can be self-funding. Border Force have certainly not tried to be self-funding. It is also questionable whether DDC has the legal powers to do so.

(iii) If it were lawful to raise fines against importers, the recovery rate of fines from foreign nationals operating in an illicit market will be extremely low.

(iv) DDC cannot afford to fund the deficit of such a service on behalf of the UK indefinitely, but is proposing to do so in 2024/25, at a cost of £2.8m to DDC Council Taxpayers. The Council continues to work tirelessly to engage with DEFRA on this matter, but with limited success.

(f) Risks to human health

UK consumers will be at high risk as insanitary pork enters the UK food chain with no controls. This risk also spreads to other basic food hygiene controls and food fraud (like the horse meat scandal) where unfit cheap meat is being mis-labelled and avoiding controls, to be sold on the black market.

(g) Inspection facilities and wasted DEFRA investment.

[4] Some of these are likely to be part of organised crime.

DEFRA have invested over £30m on Bastion Point, an inspection facility at Whitfield. The facility was completed 2 years ago, the fridges are running, all utilities are operational, and it is fully equipped and furnished to a high standard and good design, but DDC have not been allowed access, no minister has ever visited it, and it remains undesignated as a Border Control Post (BCP) and unused. This facility is desperately needed to help prohibit and contain diseases at the border.

In contrast, DEFRA plans to consolidate all SPS checks on Rest of World and EU imports at the poorly designed facility at Sevington, and ask the importers, unaccompanied, to take their illicit products 22 miles from the point of entry and exit at Dover, to Sevington for inspection.

This is not proposed or allowed at any other UK frontier, because it would be unsafe to do so and would undermine UK biosecurity, public and animal health and plant and food and feed controls. This is a change in policy that will create a gaping hole in the UK's border security. It frankly beggars belief that this is even being considered.

## 5. The strategic challenges and macroeconomic background

5.1 The budget and MTFP are approved on an annual basis and so it would be easy to neglect the longer-term strategic picture. But the Council operates in an environment where demands for services, and their costs, are increasing due to several factors including:

(a) Increasing homelessness,

(b) Government failure to address the funding deficit on Supported Housing claims,

(c) Higher standards for recycling,

(d) Increasingly detailed micro-management and direction from government,

(e) A degree of cost shunt from partner organisations,

(f) An aging population,

(g) A high inflation environment, and

(h) Increases in the living wage.

5.2 This is taking place within a low growth economy where local authorities' share of GDP is also in decline:

> "Since 2010-11, local authority spending has fallen from 7.4 to 5.0 per cent of GDP, and it falls further in our forecast to 4.6 per cent of GDP in 2028-29. Given local authorities' statutory duty to provide a range of services where demand is likely to continue to grow, for example adult and child social care, pressure on local authority finances and services will continue." Economic and Fiscal Outlook – November 2023 (Office for Budget Responsibility, 2023).

5.3 Against this backdrop there has been a complete collapse in the system of local authority audit and alongside that, several Section 114 reports issued by s151 officers and many more warnings against their likelihood in the future. Some of these reports and warnings have been issued because of poor governance which has led some councils to take unwise decisions or fail to make adequate responses to increasing pressures.

5.4 However, S114 report warnings are now being reported for councils that are not regarded as having behaved imprudently but are struggling to meet the financial pressures they face. This is happening at unitary, upper tier and lower tier councils across the political divide. Should it happen at upper tier / unitary level in Kent, the impact is likely to be felt across all Kent councils.

5.5 S114 reports were virtually unheard of in practice until 2018/19, but there have been several since that time, including:

(a) Northamptonshire (twice)

(b) Croydon (twice)

(c) Slough

(d) Nottingham (twice)

(e) Northumberland

(f) Thurrock

(g) Woking

(h) Birmingham.

5.6 Councils that have warned of possible future s114 reports[5] include:

(a) Kent

(b) Medway

(c) Hampshire

(d) Coventry

(e) Somerset

(f) Guildford

(g) Kirklees

(h) Southampton

5.7 Grant Thornton (DDC's auditors) have warned that a quarter of English Councils are at risk of financial failure by the end of 2024/25 (Grant Thornton: quarter of authorities at risk of financial failure | Public Finance). Following recent decisions by DEFRA, DDC should now be added to the growing list of Councils warning of potential s114 reports in the future.

5.8 Across the sector, we are likely to continue to see downwards pressure on council resources and upwards pressure to spend, and use reserves, across local government to meet these demands. This is not a strategically sustainable position.

## 6. The local government funding model

6.1 The local government funding model is deeply flawed to the point that it is both inexplicable and unsustainable. Key issues include:

(a) Single year late settlements

Although the Council is required to produce a multi-year financial plan / forecast, the government generally budgets one year at a time and provides single year settlements to Councils, late in December and very close to the coming financial year. In fact, proposed changes to the settlement for 2024/25

[5] Institute for Government 9 October 2023

were announced on 25th January 2024. The government have also reneged on past promises with regards to the settlement including, inter alia, housing rents and new homes bonus.

This instability and short time horizon are wholly inadequate for proper financial planning of essential public services.

(b) Risk Transfer

The instability of the main income streams for local government has shifted significant risk from a "pooled risk" borne across the sector, to a local risk borne separately by each council, to deal with the volatility of business rates, new homes bonus, revenue support grant and planning fees, together with the capping of other streams such as Council Tax and Housing Rents below inflation. As a result, Councils have had to maintain increased reserves to cope with the potential fluctuations in income.

At the same time DLUHC have urged Councils to use their reserves to "balance" the budget.

As a long-term strategy, in the face of greater pressures in the future, this is not prudent, responsible or sustainable.

(c) Complexity

The structure of local government and the funding model are very complex, to the point that they are beyond rational explanation to non-specialists.

This is especially true of Business Rates Retention (BRR) which involves local calculations, understanding and forecasts of several elements including:

- Business Rates income
- Revaluations
- Appeals
- Tariffs
- Top-Ups
- Safety nets
- Re-sets
- Levies
- Multi-authority pooling arrangements.

The situation is exacerbated by DLUHC's refusal to amend the 2024/25 settlement for the latest BR data, submitted by DDC in good time.

(d) Local Autonomy

Although they are sovereign bodies, councils have little real financial autonomy.

There is no constitutional settlement for councils and so they are highly constrained in the actions they can take. In practice councils do not have the freedom to set the Council Tax and Housing Rents they would choose to. Nor do they set Business Rates or Planning Fees.

The Council Tax capping regime traps Councils at their historic charging levels, without enabling any adjustment to meet local need or indeed acknowledge the local disparities that see, for example, Folkestone & Hythe DC (a very similar Council to DDC in size, location and demographics) benefiting from some £2.6m per annum additional income due to decisions taken on Council tax some 20 years ago and fixed in place by government ever since.

At the same time, Councils are often centrally directed as to the standards of the services they should deliver and even the methods of delivery.

(e) Challenge Funding

In order to appear to (partially) address some of the funding deficits, the government has used “challenge funding” and both large and small grant streams to an ever-increasing degree.

The LGA report that, as at February 2020, there were 448 different grants[6] (probably not a comprehensive number). Much of this is challenge funding, for which bidding resources must be committed by councils without any guarantee of success, and many of these grants are small and detailed and amount to micro-management.

Typically, grants then generate returns to be completed on new ICT systems, follow up questions, audit etc. This is unpredictable, resource intensive and grossly inefficient.

(f) Transparency

The current model is opaque. DLUHC do not publish or share the details of the settlement calculation. In practice it is based on past settlements rolled forward for many years, and then adjusted to enable government to declare a “minimum guaranteed increase” in core spending power. The “Fair Funding Review”, promised for many years to re-base the settlement, has never arrived.

Settlements do not have any up-to-date basis in the comparative resources and needs of different councils.

(g) Core Spending Power

The calculation and announcement of the maintenance and increase in core spending power is misleading. It does not consider the income from Business Rates growth. If such income were kept in reserves, DLUHC would urge councils to spend it. But when it is spent and is part of the Council’s baseline budget, DLUHC do not take it into account when calculating (and overstating) their maintenance of Core Spending Power. This means that the local government settlement is less generous than publicly stated.

## 7. The robustness of the General Fund (GF), Housing Revenue Account (HRA) and capital budgets

7.1 Key Assumptions

7.2 The key assumptions that underpin the budget are reviewed annually by the s151 officer and are specifically stated in the Budget and Medium Term Financial Plan (B&MTFP).

7.3 The B&MTFP also contains a “ready reckoner” that provides a sensitivity assessment, where possible, of the assumptions.

7.4 In addition, the budget and the project programmes have been drawn up based on corporate priorities and known available resources. Projects are fully funded (mainly from grants, reserves and any affordable borrowing) and affordable. No reliance is placed on capital receipts and grants that have not been confirmed and secured.

7.5 Risks

[6] Local Government Association “Fragmented Funding” 3 October 2023.

7.6 The key financial risks to which DDC is exposed are set out in the B&MTFP. The risks have been reviewed by the s151 officer alongside the Corporate Risk Register for completeness, impact and mitigation.

7.7 Alignment to Corporate Plan

7.8 The Council's Corporate plan sets out its objectives and priorities. The Leader and Cabinet, Chief Executive, Directors and Heads of Service all provide their input and financial and budget data in accordance with the Corporate Plan for inclusion in the B&MTFP.

7.9 The HRA Budget

7.10 The HRA budget has been produced taking into account the requirement for continued investment in the HRA stock, a continuing backlog of repairs from East Kent Housing's period of management, and the available HRA reserves.

7.11 However, to further strengthen the HRA budget and planning, a stock condition survey is proposed during 2024/25 to ensure the programme of investment remains affordable and that stock condition is maintained.

7.12 Scale and Servicing of Debt

7.13 A number of high profile s114s have been issued due to disproportionate debt levels that councils have been unable to service.

7.14 DDC's long term debt commitments are:

| **Debt Type** | **Value £000** |
|---|---:|
| HRA Self Financing Debt | 65,375 |
| Other Debt | 4,000 |
| **Total** | **69,375** |

7.15 The bulk (94%) of DDC's debt was incurred at the instruction of DLUHC (actually one of its many predecessor departments). In 2012 the Council was required, by legislation, to borrow circa £90m from the Public Works Loan Board (PWLB), pay this to DLUHC and service the debt from HRA rents. DLUHC assured Councils that they could raise rents by CPI+1% to service the debt. This promise was not kept. Instead, rents were frozen as a cash figure for several years leaving the HRA with continuing substantial losses in rent income.

7.16 Nonetheless DDC is servicing the outstanding debt which is now down to £65m. However, the annual cost to DDC tenants is £4.7m and this money could otherwise be used on much needed social housing.

7.17 The remaining debt of £4m is historic and manageable. At the present time the Council does not add to its borrowing and uses its cash flow (often referred to as internal borrowing) to support capital expenditure. Any borrowing that has been assumed or modelled in project viability assessments is "prudent" and complies with the affordability requirements of the Prudential Code.

7.18 Income Streams

7.19 In addition to the (unpredictable, single year) settlement, the Council does rely on income from its major income streams. These are set out in the B&MTFP and are reviewed annually to ensure that the assumptions on future income levels are reasonable.

7.20 The Council does not rely on other income streams from exceptional, unusual, commercial or high risk sources.

7.21 Adequacy of Reserves

7.22 The Council's balances and earmarked reserves are set out in full in the B&MTFP together with an explanation of the purposes for each reserve and its current and future planned use.

7.23 The Council holds a General Fund balance which must be maintained for unexpected in-year events. The Council also holds earmarked reserves for planned and committed purposes and essential / unavoidable expected expenditure such as elections, maintenance etc.

7.24 The local government Minister Simon Hoare said "authorities can and indeed should consider drawing on their reserves to meet any funding pressures because council cash balances have generally increased since the beginning of the pandemic."

7.25 However, total English council reserves fell by £2.2bn in 2022-23 and are expected to fall further this year because grant funding has not kept pace with high costs and rising demand. Councils cannot take short-term one-off decisions as the reserves left are to manage future risk and uncertainties, one of those being future funding. Suggesting the money is there to be used to support budgets is misguided and unhelpful and undermines the position of the Section 151 Officer. The one-off nature of such an approach could place significant risk on further Section 114 reports.

7.26 If the Council chooses to support its Port Health Authority service at a cost of £2.8m in 2024/25 and £4m thereafter, its useable reserves will deplete at £233k per month in 2024/25 and at £333k per month in 2025/26 unless corrective action is taken. If the DEFRA funding is not restored, or severe corrective action is not taken to reduce expenditure on services, the Council's position could become untenable and trigger a s114 report.

## 8. Governance Process

8.1 The Council manages its budget process in a clear and effective way as follows.

(a) September - November – initial budget projections produced and discussed with Leader and Portfolio Holder.

(b) November / December – refinement of the projections, inclusion of changes and Corporate priorities.

(c) Late December – single year local government settlement consultation received.

(d) Ad hoc decisions from other government departments.

(e) Late January - single year local government settlement response to consultation received and proposed settlement confirmed or further amended.

(f) January / February – first budget report to Cabinet.

(g) February – briefing to Overview and Scrutiny Committee as required.

(h) February – Overview and Scrutiny meeting to scrutinise the budget.

(i) February / early March – Cabinet budget meeting and recommendations to Council.

(j) By 9th March – Council approve the budget and set the Council Tax.

8.2 The late timing of the local government settlement and the late notification of the withdrawal of DEFRA funding make achieving the committee dates particularly challenging and risk undermining the process.

## 9. Identification of Options

9.1 The s25 report from the s151 Officer is for receiving and considering by Cabinet, Scrutiny and Council as they consider the budget. Unless Members believe they have grounds to reject the report, their only option is to receive it.

## 10. Resource Implications

10.1 There are no specific resource implications from this report. The resource implications flow from the B&MTP to be considered in association with this report.

## 11. Corporate Implications

11.1 Comment from the Strategic Director (Finance and Housing): The Strategic Director has produced this report and has no further comments to add (MD).

11.2 Comment from the Solicitor to the Council: The Solicitor to the Council has been consulted in the preparation of this report and has no further comments to make.

11.3 Comment from the Equalities Officer: This report advising Members of the robustness of the budget and the adequacy of reserves, does not specifically highlight any equality implications. In discharging their duties Members are required to comply with the public sector equality duty as set out in Section 149 of the Equality Act 2010 http://www.legislation.gov.uk/ukpga/2010/15/section/149 .

## 12. Background Papers

Budget and Medium Term Financial Plan working papers.

Contact Officer: Mike Davis