

Report to the Cabinet

Cabinet Meeting to be held on 19 January 2017

Report of the Director of Financial Resources

Electoral Divisions affected:

All

Money Matters – The Financial Strategy for 2017/18 to 2020/21

(Appendices 'A', 'B', 'C', 'D' and 'E' refer)

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Executive Summary

This report provides an update of the forecast outturn Financial Position for 2016/17 on revenue and capital, the County Council's updated Medium Term Financial Strategy (MTFS) for the period 2017/18 to 2020/21, reflecting the provisional settlement for 2017/18, and the position with regard to application of current reserves.

The County Council is facing an unprecedented financial challenge. The Medium Term Financial Strategy reported in December forecast that the council will have a financial shortfall of £146.133m in 2020/21. This is a combination of reducing resources as a result of the government's extended programme of austerity at the same time as the Council is facing significant increases in both the cost (for example, as a result of inflation and national living wage) and the level of demand for its services. The revised position following the provisional financial settlement for 2017/18 is now for a financial shortfall of £153.389m in 2020/21. This revised gap is after the impact of the settlement, new financial pressures, revised council tax projections and includes savings proposals that have previously been agreed by Cabinet.

Recommendations

The Cabinet is asked to:

- (i) Note the current forecast underspend of £15.298m on the revenue budget in 2016/17
- (ii) Note the revised funding gap of £153.389m covering the period 2017/18 to 2020/21 as set out in the revised financial outlook forecast for the Council.
- (iii) Approve the additional budget adjustments for 2017/18, and following years' increases, included in the revised MTFS following the financial settlement.
- (iv) To recommend to Cabinet to make recommendations to Full Council on

9th February 2017 the Band D Council Tax for 2017/18 reflecting a 3.99% increase including 2% to be used for social care as per the new flexibilities.

- (v) Note the contents of the County Council's Reserves position at 31st December 2016.
- (vi) Approve the specific capital programme as presented within the body of the report.
- (vii) Approve the increase in prudential borrowing identified within the Capital Programme report.
- (viii) To note and have regard to the advice of the Director of Financial Resources in relation to the robustness of the budget and the adequacy of reserves.

1. Background and Advice

The detailed reports at Appendices A, B, C, D and E present the County Council's revenue position, reserves position, an updated financial outlook, a revised Medium Term Financial Strategy for the period 2017/18 to 2020/21 as at 31st December 2016 and an update on the Capital Programme, as at 30th November 2016 and the Capital Programme for future years.

Financial Position as at 31st December 2016 (Appendix A)

A revenue underspend is forecast for the County Council of £15.298m and represents a variance of c2.0% against the overall County Council budget. This is subject to a number of assumptions around the anticipated profile of expenditure for the rest of the year which is difficult to predict in some demand led budget areas. The report identifies those areas where forecast pressures exist and will be subject to ongoing detailed review with a focus on controlling and reducing costs and the delivery of an improved financial position by year-end.

It is important to recognise that the forecast variance includes the impact of additional income arising from Treasury Management activities, with a surplus of c£26m now being forecast in this area. This, in great part, reflects opportunities in response to external events post Brexit and is an extremely positive position, however without these gains the County Council would be forecasting an overspend of £11.458m across service budgets. Therefore it is critical to note that there remains an underlying pressure within the forecast from service budgets.

The 2016/17 budget of £713.020m includes a significant savings requirement of c£100m, however many savings will not be fully implemented until 2017/18 or 2018/19 and therefore it was agreed that these would be covered by the use of reserves.

The report provides details as to progress on the achievement and delivery of the savings relating to each Head of Service. The level of reserves that were approved to be applied from the transitional reserve 2016/17 in support of the delivery of savings

was £46.417m and the amount that is now forecast to be required is £34.231m reflecting early delivery of some agreed savings, although this is partially offset by some budget savings that are delayed and will require reserve funding to cover the delay in implementation.

Delivery of the significant savings programme has been identified as a key risk area and the savings plans are subject to detailed regular scrutiny by the Programme Office and Finance.

The Medium Term Financial Strategy (Appendix B)

A revised MTFs was presented to Cabinet in September with a reported funding gap of £146.133m (cumulative gap of £411.207m).

This report considers the impact of budget decisions to be taken by Cabinet and updates other assumptions in light of the most current information available including the impact of the Local Government Finance Settlement in December. As a result of these reviews the overall estimated funding gap has increased to £153.389m, primarily due to the announcement within the settlement that the 2% Adults Social Care Precept could not be applied in 2020/21, which had previously been assumed in the MTFs. However, the cumulative gap has reduced to £407.988m as a result of a reduced gap in earlier years primarily resulting from the introduction within the settlement of a non-recurrent Adult Care Support Grant of £5.543m in 2017/18.

The County Council's Reserves Position (Appendix C)

The County Council by 31st March 2018 is expected to have reserves (excluding schools) of £127.699m, of which £36.000m County Fund will remain leaving a residual amount of £91.699m in service reserves. This does however include £8.354m school PFI expenditure and £4.944m which is not LCC money, meaning in effect the available balance of £78.401m.

If the County Council underspends in 2016/17 as currently forecast this will be a further contribution to reserves. This is not currently included within the forecast reserves position.

The report indicates that there are sufficient funds within the Transitional Reserve to deliver a balanced budget in 2017/18 as per the agreed financial strategy. However this is dependent upon a number of key factors and risks which are as follows:

- All values within reserves that are currently reported to be available funds are transferred into the transitional reserves with no further commitments emerging in these areas now that the transfer has taken place.
- There is limited slippage on the agreed savings programme for 2017/18 and 2018/19. As any slippage will result in a requirement for funding from reserves.

When reviewing the County Council's reserves in conjunction with the Medium Term Financial Strategy (Appendix C) the funding requirement to bridge the financial gap in 2018/19 would total £85.162m. Although there are reserves available at 31st March 2018 of £93.699m (if the currently forecast underspend is achieved) there are

commitments in 2018/19 of £10.450m (excluding non LCC commitments). The forecast available balance to support the 2018/19 budget is therefore £83.249m which means that there will be insufficient funds within reserves to fully meet the 2018/19 budget gap.

Capital Monitoring and Financing Position as at 30th November 2016 (Appendix D)

This report sets out the November 2016 capital monitoring position for 2016/17 against the re-profiled capital programme 2016/17 budget approved by Cabinet on 6th October 2016.

It also compares the 2016/17 November monitoring position with the equivalent position in 2015/16 in order to give an understanding of the progress being made to date with regard to overall spend level.

Capital Programme 2017/18 -2020/21 (Appendix E)

This report covers the capital programme for the period 2017/18 – 2020/21 and also provides details of the financing of the full multi-year capital programme and the expected associated capital charges.

2. The Robustness of the Budget and the Adequacy of Reserves

Section 25 of the Local Government Act 2003 requires that, in giving consideration to budget proposals, Members must have regard to the advice of the Council's Chief Finance Officer (in the case of the County Council the Director of Financial Resources) on the robustness of the estimates and the adequacy of the Council's reserves.

Robustness of the Estimates

This section is concerned with the scale of financial risks faced by the Council as a result of the estimates and assumptions which support any budget. The basis of the estimates on which the budget has been prepared, as in previous years, relies on the forecast of activity and the impact of changes in policy previously agreed by the Council. These forecasts are kept under review as part of the budget monitoring process and actions identified to address financial risks arising from changes in the forecast as they occur. A number of specific risks remain within the budget as follows:

- **Government Funding**

The Local Government Settlement on 17th December 2015 included the Government offering any council that wishes it to take up a four year funding settlement to provide greater certainty around financial planning. The offer only covers Revenue Support Grant, Rural Services Delivery Grant and Transitional Grant. These grants in 2017/18 will represent c11% of our resources and are forecast in the MTFS to reduce further and finish completely by the end of this Parliament when full Business Rate Retention comes in, which will be accompanied by an updated funding formula for local authorities and new responsibilities which are yet to be determined.

Whilst the principle of a longer-term settlement is welcome, the Council has not taken up the offer as previous reports to Cabinet have clearly identified an impending scenario whereby the Council will have insufficient resources to meet statutory responsibilities as they are currently provided. Not accepting the multi-year settlement will mean the level of Revenue Support Grant being confirmed on an annual basis and therefore may be subject to change from the assumptions included within the MTFs, although 2017/18 RSG has been confirmed as being in line with the level forecast within the MTFs.

The Statutory Services Budget Review undertaken by PwC and reported to Cabinet in October validated the financial position as reported through the MTFs and confirmed that even should the County Council reduce its expenditure to the median of lowest quartile by 2020/21 an in-year deficit of £79m would remain. One of the considerations raised within the report was whether the current funding model of the Council is disproportionately contributing to the funding gap. The County Council has continued to lobby Central Government and relevant stakeholders regarding the extreme challenges being faced as a result of the local government finance system.

A subsequent business case prepared by PwC has identified proposals relating to a future Lancashire Public Services Delivery Model, which includes estimates of the financial benefits that could be delivered following implementation and the level of transitional funding required to support the major transformation. However, at this stage it is a proposal to go out to consultation with key partners and stakeholders and has not therefore been factored into any of the MTFs assumptions.

The most significant financial challenge facing upper tier Local Authorities is Adult Social Care. Additional funding has been provided via the Adult Care Support Grant (£5.543m) in 2017/18 and the flexibility to raise an additional Adult Social Care precept. Whilst these are a welcome recognition of the significant cost pressures being faced, the Grant is only for one year and together they do not meet the full cost of additional demographic demand and cost pressures within the Care Sector particularly impacted by the National Living Wage.

- **Service Demand**

This is a key risk facing the Council in both preparing future budgets and managing budgets during the year. As reported in the budget monitoring reports presented to Cabinet over the year, demand for both adult and children's social care services and waste services continues to see increases despite the impact of demand management measures.

Over the period 2017/18 to 2020/21 £91m has been provided in the MTFs for demand pressures of which c58% relates to adult social care, c24% children's social care and c15% waste services. These have been identified based on current and historical trends and population projections where appropriate (particularly linked to the ageing population in respect of Adult Social Care). Whilst for Adult Social Care the estimates are based on assumptions that have previously been a reasonable prediction of demand, during the current financial year significant and unanticipated increased costs in relation to Children's Social care and Waste have been reported to Cabinet in revenue monitoring reports.

Detailed work is being undertaken in all three areas focused on a better understanding of the causes of the increased demand and what steps can be taken to mitigate the financial impact, which, along with funding reductions, is a major contributing factor towards the funding gap reported in the MTFS.

- **Pay**

The MTFS makes provision for pay of a 1% increase each year. Most of the pay bill will continue to be driven by the national pay agreement and this assumption will be kept under ongoing review. The County Council is committed to paying its employees as an accredited member of the Living Wage Foundation who have announced a 5% increase in the Living Wage. The impact of this initial increase and further 5% increases in subsequent years for those staff directly impacted has been factored into the MTFS. This does not address maintaining current differentials in pay grades which will need to be considered in future years.

- **Inflation**

Actual inflation remains relatively low but analysts are anticipating slight increases over coming years. Provision made within the budget is limited to areas where the Council has no choice but to pay increased prices e.g. due to contractual terms. The inflation forecasts used in recent years are based on the future level of inflation implied by yields on interest linked gilts. Historically, this has tended to give a more accurate forecast than the methodology previously used. It is anticipated that the continued use of this methodology will reduce the risk of needing to make catch up additions to the budget for "missed" inflation and the need to absorb additional inflationary costs in year.

A particular issue concerns care markets, primarily residential and homecare, the funding of which is recognised as being a significant issue regionally and nationally. Whilst a significant amount of resource has been included within the MTFS to fund price increases and the estimated impact of the national living wage on care providers, there remains capacity and sustainability issues within the market which the Adult Social Care Precept and Adult Care Support Grant will only partly help mitigate given the scale.

- **Savings Programmes Delivery**

The Council is already committed to the delivery of a significant savings delivery programme (c£154m over the period 2016/17- 2020/21) including £12m of new savings agreed at Cabinet in December a number of which relate to the outcome of the zero based budget review of services agreed within the financial strategy. There are inherent risks with savings plans of this scale and scope and any significant under-delivery of agreed savings will create an additional funding gap. This has been identified as one of the highest level risks in the Council's Risk and Opportunity Register and there are comprehensive arrangements in place to track delivery of financial savings and take corrective actions as required.

The Level of Reserves

The Council holds reserves for a number of reasons:

- To enable the Council to deal with unexpected events such as flooding or the destruction of a major asset through fire.
- To enable the Council to manage variations in the demand for services which cause in year budget pressures.
- To fund specific projects or identified demands on the budget.

There is no 'right' answer to the question of the appropriate level of reserves for a local authority; this is a matter of judgement taking into account:

- The level of risk evident within the budget as set out above.
- A judgement on the effectiveness of budgetary control within the organisation.
- The degree to which funds have already been set aside for specific purposes which will reduce the need for general reserves.

Previous reports to Cabinet have clearly identified that the revenue budget will be heavily supported by the reserves that are currently available to the County Council. The value of the Council's reserves is currently significant but are non-recurrent and, bar the County Fund, are now fully committed over the next 2 years and will not therefore be available in later years to support managing future year budget pressures.

The level of risk evident within the budget is clearly increasing as set out in the analysis above at a time when it is clear that the revenue budget will have to be supported significantly by reserves. The setting up of a transitional reserve was a recognition of this requirement and the effectiveness of budgetary control is a combination of both systems and processes and the risk environment within which the Council is operating. Budgetary control procedures are strong, however, based on the evidence of the current year and given the increased level of financial risk there is a greater risk that the processes in place would not be adequate to reduce any significant overspend over the course of the following years.

In relation to the Council's general reserve (County Fund Balance), the forecast level at 31 March 2017 remains as £36m.

Overall, the Council has an appropriate level of reserves available to manage the financial risks it is facing in 2017/18, but this is unlikely to be the case for 2018/19 and subsequent years. Within the MTFs there is a revised funding gap of £85.162m for 2018/19 and, excluding County Fund and committed reserves but including the projected revenue underspend at the end of quarter 3 of £15.298m, there is estimated to be £83.629m of uncommitted reserves remaining at 1st April 2018.

Even if the 2018/19 gap could ultimately be covered by the use of reserves the forecast funding gap increases to £115.392m in 2019/20 and therefore it is critical that a significant level of additional savings are identified which can be delivered in 2018/19 to minimise the scale of reserves required to support the revenue budget and that

utilisation of those reserves remaining should support, wherever possible, activities which reduce ongoing revenue costs. One of the priority areas for new savings will be in seeking to implement the aim within the current financial strategy of seeking to move to lower quartile cost, of the most appropriate comparator group of local authorities, for all services.

The Council has benefited significantly financially over a number of years from its Treasury Management activity including the investment portfolio, with a projected revenue benefit of £26.756m in 2016/17. It is important to note that one of the consequences of utilising reserves is that this effectively reduces the value of cash backed accounts on the balance sheet which support the investment portfolio. Therefore, based on current planned usage of reserves the size of the portfolio will reduce further significantly and it is reasonable to assume that the scope to generate future gains will also therefore reduce.

Conclusion

Following the ongoing detailed budget monitoring, zero base budget review work, identification of £12m of further budget proposals and a detailed review of the current reserves commitments, a balanced budget for 2017/18 with the use of £54.045m of reserves can be recommended. However, this is clearly dependent on all budget options agreed at Cabinet in December being delivered fully within the timeframes identified, along with the other savings agreed in previous budget cycles. Should any of these budget options ultimately not be taken forward they will need to be replaced with alternative savings to avoid increasing the size of the gap. There also remains a funding gap of £85.162m in 2018/19 and an urgent need to identify proposals for additional savings early in 2017/18 that can be delivered in 2018/19.

Whilst the principle has been agreed of reviewing each and every continuing service using a zero based approach, with reference to our benchmark unit costs, and moving towards the lowest quartile of the most appropriate comparator group, this will need to make early progress during 2017/18 to meet the 2018/19 shortfall and consider whether a sustainable financial position will be achievable over a longer period. Taking everything into account, there remains a strong likelihood that the Council will, during the course of this financial strategy period (in 2018/19 at the earliest), be in the position of being unable to set a budget which will meet the cost of its statutory responsibilities.

List of Background Papers

Paper	Date	Contact/Directorate/Tel
None		
Reason for inclusion in Part II, if appropriate		
N/A		