

Report to the Cabinet

Meeting to be held on Thursday, 7 February 2019

Report of the Chief Executive and Director of Resources

Part I

Electoral Divisions affected:
(All Divisions);

Money Matters 2018/19 Position – Quarter 3

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

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Executive Summary

This report provides an update to Cabinet on the county council's 2018/19 revenue financial position as at the end of December 2018 and an updated Medium Term Financial Strategy (MTFS) covering the period 2019/20 to 2022/23. The MTFS reflects the final financial settlement for 2019/20 announced on 29 January 2019 and also includes c£77m of savings proposals and management actions, identified through the service challenge process and aimed at delivering better and sustainable services at a lower cost that were agreed at Cabinet in December.

The reduction in the forecast funding gap continues to represent a significantly improved position compared to that at the start of the financial year, however a structural funding gap remains and work continues on phase two of the service challenge process to identify further proposals to enable the council to achieve a financially sustainable position over the strategy period.

In summary:

- (i) The 2018/19 revenue forecast outturn is £756.178m, representing a projected underspend of £8.462m (1.11%) of the agreed budget.
- (ii) The MTFS has been updated and revised slightly upwards and now indicates a financial deficit of £47.209m in 2022/23.
- (iii) The Council is forecast to hold a General Reserve against unforeseen issues of £23.437m representing c3% of net budget.
- (iv) The Council is forecast to hold £138.640m of uncommitted transitional reserve which is sufficient to meet the deficit in 2019/20.

Recommendations

The Cabinet is asked to:

- (i) **Note** the current forecast underspend of £8.462m on the revenue budget in 2018/19.
- (ii) **Note** the increased funding gap of £47.209m covering the period 2019/20 to 2022/23 as set out in the revised financial outlook forecast for the Council.
- (iii) **Approve** the budget adjustments for 2019/20, and following years' changes, included in the revised MTFS.
- (iv) **Note** the contents of the county council's reserves position and approve the transfers between reserves contained within the report.
- (v) **Agree to make recommendations to Full Council** on 14 February 2019 a Band D Council Tax for 2019/20 reflecting a 3.99% increase including 1% to be used for social care as per the new flexibilities.
- (vi) **Note** the in-year agreed capital programme is £120.903m with a forecast spend of £131.030m and therefore a delivery variance of £10.127m due to earlier than planned delivery of the multi-year programme.
- (vii) **Approve** a 2019/20 capital delivery programme estimated at £130.289m as presented within the body of the report.
- (viii) **Approve** additional prudential borrowing of £34.924m for 2019/20 as identified within the Capital Programme report.
- (ix) **To note and have regard** to the advice of the Chief Executive and Director of Resources in relation to the robustness of the budget and the adequacy of reserves.

1. Background and Advice

The detailed reports at Appendices 'A' to 'D' present the following:

- County council's 2018/19 forecast revenue position as at Quarter 3 (Appendix 'A').
- Revised Medium Term Financial Strategy for the period 2019/20 to 2022/23 as at Quarter 3, including reserves position (Appendix 'B').
- County council's 2018/19 capital monitoring position as at Quarter 3 and delivery programme for 2019/20 (Appendix 'C')
- Consultation start dates (Appendix 'D')

2018/19 Revenue Position as at 31st December 2018 (Appendix 'A')

A revenue underspend is currently forecast for the county council of £8.462m and represents a variance of 1.11% against the overall revenue budget of £764.640m. The forecast outturn position 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, although this is less so as this report reflects 9 months of the financial year. The report identifies those areas where forecast pressures exist and will be subject to ongoing detailed review. There are also a number of underspending service areas and where these have been validated as reflecting a level of recurrent underspend these have been picked up as management action savings within the MTFS. The focus will remain on continuing to tightly control and drive down costs wherever possible.

As part of monthly monitoring the savings that have been agreed to date are monitored by finance monitoring boards (FMBs). The position at the end of Quarter 3 was that 93% of the financial value of savings were rated as on track, albeit some potentially having to undertake work to avoid any potential delays. The remaining 7% are the most challenging to deliver currently, but services are working hard to deliver those savings and are regularly reporting progress to FMBs.

The Medium Term Financial Strategy (MTFS) and Reserves Position (Appendix 'B')

At Cabinet in December 2018 the medium term financial strategy (MTFS) set out a forecast funding gap of £46.090m by the end of the 4 year period (2019/20 – 2022/23). The updated funding gap contained within the report has slightly increased to £47.209m by 2022/23, however a reduced budget gap is forecast for 2019/20 of £13.446m. This position includes additional costs relating to transport that are offset by some additional income and reduced demand requirements within the waste services budget. The position in 2019/20 is improved by one-off additional business rates levy income of £2.860m. The financial gap includes the impact of service challenge savings that were agreed at December Cabinet totalling c£77m.

The value of the uncommitted Transitional Reserve is currently forecast to be £138.640m by the end of March 2021 if there was no requirement for structural funding support from reserves to the 2019/20 or 2020/21 budgets. The value of the uncommitted transitional reserve is currently forecast to be sufficient to meet the identified funding gaps through to 2022/23, but the intention is to identify further savings and thereby reducing the gap and call on the transitional reserve, for 2020/21 and beyond.

Capital Monitoring as at 31st December 2018 and Delivery Programme for 2019/20 (Appendix 'C')

Cabinet on 13 September 2018 agreed a 2018/19 delivery programme of £114.817m which followed a detailed review of the multi-year capital programme and a prudent assessment of deliverability during the financial year. The in-year delivery programme has subsequently been increased to £120.903m to reflect approved changes. The forecast outturn for 2018/19 based on the position at the end of quarter 3 is £131.030m against the agreed 2018/19 capital delivery programme of £120.903m, a variance of £10.130m or c8.4%. The variance is not the result of net overspending on schemes

and is due to forecast earlier than planned delivery of programme activity which had been profiled into 2019/20 and later years.

The proposed 2019/20 delivery programme of £130.289m includes the completion of previously agreed works already in the programme and the addition of projects identified for utilising the additional grant monies received for specific service blocks. The proposed delivery programme is broadly in line with the forecast outturn position for 2018/19 and will need to be updated for any profiling changes once the actual outturn position is confirmed.

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 Chief Executive and Director of 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.

The table below demonstrates the scale of just a small variance in the assumptions made, showing the potential impact of both a positive and negative movement of 1% across the main areas within the MTFS and the potential impact of a further 0.25% variation on interest rates:

	Potential Full-Year Impact (£m)
Funding (1%)	+/- 4.955
Pay (1%)	+/- 2.551
Price Inflation (1%)	+/- 5.574
Demand (1%)	+/- 5.969
Interest Rates (0.25%)	+/- 1.250

A number of specific risks remain within the budget as follows:

- **Government Funding**

The council did not take up the offer in 2016 of a multi-year finance settlement covering Revenue Support Grant, Rural Services Delivery Grant and Transitional Grant. However, there were very minor changes to the 2019/20 allocations, announced in the Local Government Settlement on 6th December 2018, previously reported to cabinet. Revenue Support Grant is expected to formally end in 2019/20 and the impact on the

council of the Business Rate Retention Scheme and Fair Funding Review from 2020/21 is not yet known. For the purpose of the budget and MTFS a neutral position has been assumed including no Revenue Support Grant from 2019/20 and will be updated when further information is known. Following the successful bid by Lancashire to be a 75% business rates pilot for 2019/20 the county council will no longer receive RSG and the equivalent amount that is expected has been built into the business rates pilot workings.

Additional funding was announced for both adult social care and children's services, with the county council receiving an additional £15m. This was however announced as one-off funding, although as part of the MTFS it has been assumed that this funding will continue due to demand pressures that councils are facing. There was no additional funding announced to support the new pay spine for local government workers and these additional cost pressures have been included in the strategy.

The final settlement has confirmed the Council scope to increase council tax by an additional 1% in 2019/20 on the grounds that it keeps pace with inflation, CPI is currently running at 3%. Adult social care precept arrangements also remain unchanged for Councils with adult social care responsibilities able to add up to a 3% increase in council tax up to a maximum of 6% over the period 2017/18 to 2019/20. These flexibilities are included in the strategy as part of this report.

- **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 continue to see increases despite the impact of demand management measures and additional funds being built into the budget to reflect forecast pressures.

Over the period 2019/20 to 2022/23 £75m has been provided in the MTFS for demand pressures of which £50.5m relates to adult social care and £14.0m children's social care. 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 have occurred and have been reported to cabinet in revenue monitoring reports.

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

- **Pay**

The majority of the pay bill is driven by the national pay agreement and the announcement of a new pay spine represents a significant additional cost pressure reflected in the updated MTFS. The county council also remains committed to paying

its employees as an accredited member of the Living Wage Foundation who have announced a 2.86% increase in the living wage. The impact of this initial increase and further 3.00% (2020/21) and 2.90% (2021/22 & 2022/23) increases in subsequent years for those staff directly impacted has been factored into the MTFs.

- **Inflation**

The Monetary Policy Committee (MPC) of the Bank of England has been set an inflation target by the Government of 2% as measured by Consumer Prices Index (CPI). The CPI has been above this level since early 2017 increasing to 3.1% in November 2017. However, the rate has fallen since then with the November 2018 rate being 2.3%. The Bank of England anticipate that inflation will be within target in the medium term.

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 or the need to absorb additional inflationary costs in year.

A particularly significant area is the care market, primarily residential, nursing and homecare, the funding of which is recognised as a significant issue regionally and nationally. 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.

- **Interest Rates**

In August 2018 the MPC raised the base rate by 0.25% to 0.75%. This followed a previous increase in November 2017 which was the first increase in a decade.

Despite these increase the base rate continues to be at historically low levels and the Bank of England has maintained expectations for slow and steady rate rises in line with the performance of the economy. The county council's treasury advisors predict two more 0.25% rises during 2019 to take official UK interest rates to 1.25%.

- **Savings Programme Delivery**

The council is committed to the delivery of a significant savings programme (c£111m over the period 2019/20 to 2021/22) including c£77m of new savings already agreed by cabinet in December. There are inherent risks with saving plans of this scale and scope and any significant under-delivery of agreed savings will further increase the 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.

Adequacy 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, and
- 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, and
- the degree to which funds have already been set aside for specific purposes which will reduce the need for general reserves.

In relation to the council's general reserve (County Fund Balance), the forecast level at 31 March 2019 is £23.437m. In addition the council continues to hold £10m as a formal treasury management reserve to reflect that, whilst the council's treasury management performance (covering both investment activity and financing costs) has been positive over an extended period, the outlook post-Brexit is particularly uncertain and volatile. The reserve is there hedge against that volatility, including interest rate changes and associated risks over the short-term without directly impacting the revenue account.

The revenue budget has been heavily supported in recent years by the reserves that have been available to the county council and their value has therefore reduced significantly. The value of the council's uncommitted transitional reserve by the end of the financial year is currently forecast to be £139.271m, including the 2018/19 forecast underspend.

The level of risk evident within the budget has been significant in recent years and remains so at a time when it is clear that the revenue budget for 2019/20 will also need to be supported by reserves. The council acknowledges that it needs to move to a sustainable financial position and also that this will take time to implement. The transitional reserve allows decisions to be made in a more measured and considered way but does not of itself negate the need for a sustainable budget to be achieved. While the council's budgetary control procedures are strong in terms of managing in year expenditure, the effectiveness of budgetary control is a combination of systems and processes as well as the risk environment within which the council is operating. It therefore remains an essential requirement that the council continues to ensure that processes are effective in maintaining a grip on in year expenditure and also that there is a clear focus on delivering a balanced and sustainable budget.

As part of the MTFS report, scenario analysis and stress tests of the current financial gap and reserves position have been undertaken. A key scenario that has been tested relates to the savings that require consultation prior to implementation which total £7.529m (£2.150m 2019/20, £5.329m 2020/21 and £0.050m 2021/22). Should cabinet

ultimately not agree to any of these savings being implemented post consultation, then there would be sufficient reserves to support the budget until part way through 2022/23.

Overall, the council has an appropriate level of reserves available to manage the financial risks it is facing from 2019/20 to 2022/23. However, despite the identification of further savings through the service challenge process of c£77m it is necessary that additional savings are identified to be delivered to bring the council to a financially sustainable position. Any utilisation of remaining reserves should support, wherever possible, activities which reduce ongoing revenue costs.

Conclusion

There has been a significant focus nationally on the financial resilience of councils and one of the key areas of concern has been the utilisation of reserves in supporting budgets and the levels of reserves remaining. A key indicator identified by Chartered Institute of Public Finance and Accountancy (CIPFA) in flagging up potential issues is the level of reserves used by a council to meet any funding shortfall in setting the budget compared to the average level of reserves used to fund any structural deficit over the previous 3 financial years. The average over the last 3 years in Lancashire has been c£40m and the proposed use of £13.446m for 2019/20 represents a significant improvement in this regard. This follows strong financial control during the current financial year as evidenced by the forecast revenue underspend which will enable a transfer into reserves and c£77m of further budget proposals being identified. However, this is clearly dependent on all the agreed service challenge savings being agreed and 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 financial gap.

Consultations

Proposals will be subject to appropriate consultation where required and specific legal advice is set out below.

Implications

This item has the following implications, as indicated:

Equality and Cohesion

Cabinet must ensure that they comply with the requirements of the Public Sector Equality Duty as set out in s.149 of the Equality Act 2010.

The budget proposals are set out in this report. In some cases they may have a negative impact on persons with protected characteristics and initial Equality Analysis reports are included where required. These must be taken into account as part of the decision making process.

Risk management and Financial Implications

The county council's overall approach to managing financial risks continues to be to identify and acknowledge risks early and build their impact into financial plans while continuing to develop strategies which will minimise their impact. This approach operates in parallel with the identification and setting aside of sufficient resources to manage the financial impact of the change risks facing the organisation.

The financial risks that could affect the position outlined in the report primarily cover the following:

- *Level of Future Resources from Central Government*
Risks remain in relation to the level of resources the Council receives from the government in terms of Revenue Support Grant, business rates and the fairer funding settlement yet to be announced. At this point in time there is insufficient detailed information regarding the changes to amend the funding assumptions within the MTFS and they have been maintained at a prudent level. Future funding levels could therefore be higher or lower than currently forecast.
- *Demand*
There is continued pressure on the Council's budget, particularly around Adults and Children's Social Care, and the most up to date demand forecasts have been included. Any increase in demand above the current forecast will add additional pressure to future years and conversely reductions in demand will create underspends.
- *Inflation*
A significant level of additional resource has been included in the MTFS, primarily on contractual price increases and particularly on social care where there are nationally recognised funding issues in the residential and domiciliary care markets. In addition, the MTFS includes estimates of the cost of increases that would enable independent sector providers to meet the additional costs of the new national living wage.
- *Delivery*
The MTFS assumes that agreed savings will be delivered in the period 2019/20 to 2022/23. There are also a significant number of other factors, both internal and external, which may impact upon delivery and these will need to be clearly identified and either minimised or optimised as appropriate.

Legal

A number of the proposals set out in the Appendices in the report to cabinet in December (and are included within the MTFS) will require the council to carry out a consultation exercise in accordance with general public law principles. The form of such consultation is not prescribed and the nature and scope of consultation will be determined on a case by case basis.

Cabinet will be aware that the purpose of the Money Matters reports is to assist the county council to set an annual budget. Items included in these reports are diverse and at different stages of planning/implementation.

Public consultation and engagement occurs at the formative stage of a decision and where engagement is a requirement no decision can be taken until this has been completed, the responses analysed and presented as part of the decision-making process. The approach is designed specifically for each consultation exercise, taking into account the proposal being consulted on, those who could be affected, the information they will need to make an informed decision, and the most appropriate ways for them to be aware of the consultation and to respond. This ensures the county council meets its public consultation duty.

Attached at Appendix 'D' is a timetable for those proposals which require full public consultation exercises as a result of the decisions taken at December's Cabinet meeting.

Some proposals requiring engagement are not included in Appendix 'D' because for example, they have not yet reached a stage where consultation is appropriate or because consultation takes place through a different mechanism.

The county council will consult with staff and the recognised trade unions, as appropriate, and where proposals require statutory consultation, this will be conducted in accordance with legal requirements.

List of Background Papers

Paper	Date	Contact/Tel
N/A		
Reason for inclusion in Part II, if appropriate		
N/A		