

# **Money Matters**

## **Financial Outlook for the County Council**

### **Medium Term Financial Strategy**

<b>Contents</b>	<b>Page</b>
<b>1. Executive Summary</b>	<b>3</b>
<b>2. Chancellor of the Exchequer's July 2015 Budget</b>	<b>6</b>
<b>3. Resources Available</b>	<b>8</b>
<b>4. Spending Pressures</b>	<b>11</b>
<b>5. Future Risks</b>	<b>13</b>
<b>6. Spending on Statutory Services</b>	<b>14</b>

# **Financial Outlook for the County Council: Medium Term Financial Strategy**

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## **1. Executive Summary**

### **1.1 Introduction**

This report outlines the financial position facing Lancashire County Council over the period 2015/16 to 2020/21. The Council is experiencing an on-going period of unprecedented financial pressure as a result of the government's extended programme of austerity combined with significant increases in demand for public services.

It is therefore, whilst difficult, important to consider and update the Council's Medium Term Financial Strategy (MTFS) in order to provide the information necessary to facilitate key decisions to be made that ensure the Council can deliver services to the public within a significantly reduced revenue budget.

The County Council's three year MTFS was approved by Full Council in February 2015 covering the 2015/16 budget and the forecast position for 2016/17 to 2017/18. This identified a funding gap of £18.3m in 2016/17 and £8.1m in 2017/18 (£26.4m in total). The Council also agreed that the MTFS should be reviewed following the General Election in May 2015 to allow a revised revenue budget to be set out. It was also agreed that the period of the MTFS should be extended to cover the full life of the parliamentary term (to 2020/21).

This report therefore looks to consider and revise the assumptions in the MTFS for both funding and expenditure and where possible, project them forward to 2020/21 and reflects the latest available information, in particular the Chancellor's budget report published on 8<sup>th</sup> July 2015.

### **1.2 Financial Overview 2015/16 to 2020/21**

Under a separate Money Matters report the County Council's financial position for 2015/16 has been outlined. This currently forecasts an ongoing financial pressure of £45.646m which has been reflected in the MTFS and in this report. Measures are being taken to minimise the forecast overspend, however, if the position cannot be recovered then it will need to be funded by a contribution from reserves.

This report has considered the assumptions made for the MTFS and has determined a revised forecast of the spending gap from 2016/17 to 2020/21 of £294.6m of which revised savings of £71.4m have been identified. This leaves an outstanding funding gap of £223.2m by 2020/21 and an aggregated funding gap of £693.9m across the five year period (as illustrated below):

	2016/17 £m	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m	Total £m
Expenditure	798.6	749.1	719.1	707.1	706.6	
Revised Savings set out in prior year budget reports*	-27.7	-43.7				
Resources	770.9 705.0	705.4 684.2	719.1 669.0	707.1 663.8	706.6 663.9	
<b>Funding Gap</b>	<b>65.9</b>	<b>21.2</b>	<b>50.1</b>	<b>43.3</b>	<b>42.7</b>	<b>223.2</b>

<b>Aggregated Funding Gap</b>						
2016/17	<b>65.9</b>	<b>65.9</b>	<b>65.9</b>	<b>65.9</b>	<b>65.9</b>	
2017/18		<b>21.2</b>	<b>21.2</b>	<b>21.2</b>	<b>21.2</b>	
2018/19			<b>50.1</b>	<b>50.1</b>	<b>50.1</b>	
2019/20				<b>43.3</b>	<b>43.3</b>	
2020/21					<b>42.7</b>	
<b>Total</b>	<b>65.9</b>	<b>87.1</b>	<b>137.2</b>	<b>180.5</b>	<b>223.2</b>	<b>693.9</b>

\*Note: Previous budget reports to Full Council set out a total of £117.6m of savings to be delivered in 2016/17 and 2017/18 however this has been revised to £71.4m as £46.2m have been deemed as unachievable.

This shows a significant increase in the funding gap since the report to Council on 12<sup>th</sup> February 2015, which is due, in large part, to the extension of the period covered by the MTFS to 2020/21. There have however, also been a number of changes to the funding gap in 2016/17 and 2017/18 and the following table provides a breakdown of the changes to the forecast:

	2016/17 £m	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m	Total £m
<b>Funding gap reported to Council – February 2015</b>	<b>18.3</b>	<b>8.1</b>	-	-	-	<b>26.4</b>
Impact of revised funding assumptions (para 3.2)	-	-	15.2	5.2	-0.1	20.3
Impact of changes to pay assumptions (4.1)	-2.1	-2.1	2.4	2.4	2.4	3.0
Impact of increases due to contractual price inflation (4.2)	-1.8	1.1	18.0	19.6	21.6	58.5
Impact of changes to the forecast of demand (4.3)	18.1	1.3	14.5	16.1	18.8	68.8
Impact of savings through service offers that can no longer be achieved (4.4)	33.4	12.8	-	-	-	46.2
<b>Revised funding gap</b>	<b>65.9</b>	<b>21.2</b>	<b>50.1</b>	<b>43.3</b>	<b>42.7</b>	<b>223.2</b>

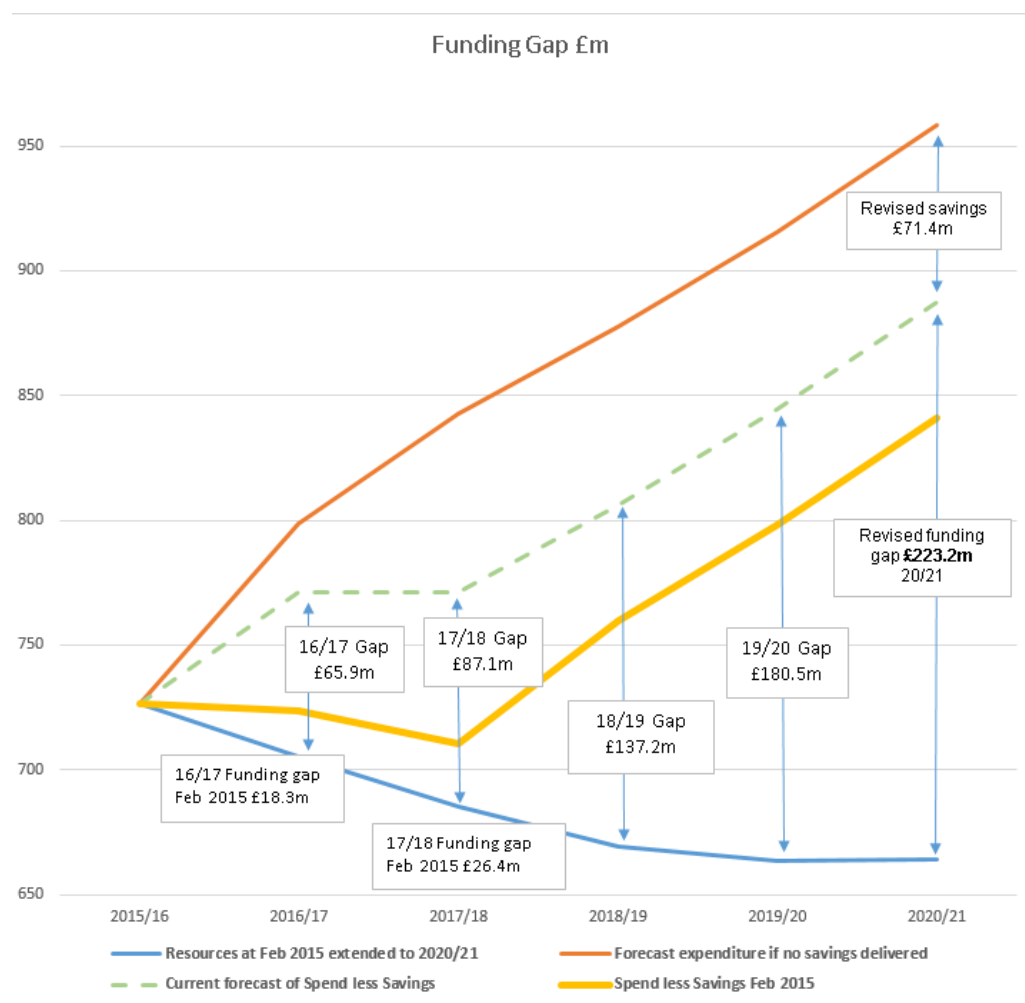
*Note: Forecast pressures for 2018/19 onwards are based on current information, as further information is received the forecast will continue to be developed and could increase further the pressure on the revenue budget.*

This table clearly demonstrates that the funding gap previously reported in 2016/17 and 2017/18 of £26.4m has increased by £60.7m to £87.1m due, in the main, to the identification of savings through service offers that upon further detailed examination are deemed undeliverable.

The extension to the MTFS period to include 2018/19 to 2020/21 has increased the savings gap by £136.1m as a result, in the main, of contractual price increases from third party suppliers of services and pressure from increased demand for services. These pressures are at a similar level to the amounts we have seen over the period from 2011/12 to 2015/16.

**This position does not represent the worst case scenario.** Further demand and price pressures may emerge and the revised savings shown in 2016/17 and 2017/18 may not be possible to deliver. These factors would cause the funding gap to increase further.

The following graph illustrates the profile of the funding gap by comparing total spending to future levels of funding and considering the level of savings that have been identified:



*Note: The revised spending gap of £223.2m assumes that the remaining £71.4m of previously agreed savings included in the forecast for 2016/17 and 2017/18 will be*

*delivered, this represents a risk that could impact upon the revised funding gap at 2020/21 (if these savings cannot be realised).*

Sections 2 to 5 of this report will provide further detail of the factors affecting the forecasts included within the MTFS position illustrated above.

### **1.3 Conclusion**

Lancashire County Council continues to face an unprecedented period of financial constraint through to at least 2020/21.

Whilst the budget announcement by the Chancellor on 8<sup>th</sup> July 2015 has provided indicative figures that have been translated into a forecast of future funding levels, actual funding allocations will only be announced in the Chancellor's Autumn Statement in December. It is not clear if this announcement will confirm funding beyond 2016/17 at this point, however there has been a significant amount of lobbying from the Local Government sector to encourage the DCLG to provide a multi-year settlement to assist with financial planning.

Given the ongoing uncertainty in future years' funding it is clearly a risk that forecasts of funding for 2016/17 and future years may change, potentially significantly, from the figures brought into the MTFS.

The financial commitment required to service statutory demand led services is almost certain to result in using up all available resources. The resource available for discretionary services will be minimal (if any exists at all) and at this stage we cannot say for certain whether or not funding will cover statutory demand led services.

This challenge is further compounded by the nature of Local Government delivery as we see lengthy delivery contracts with expensive break clauses built in, partnership contracts along with properties occupied with long term and residual cost implications.

**Significant reserves will be needed to bridge the 2015/16 outturn position. Service delivery decisions are needed to ensure that a legal 2016/17 budget can be set.**

The County Council, in redesigning the services it provides to the public, faces the challenge of doing so whilst delivering further savings of at least £223m over the next 5 years.

## **2. Chancellor of the Exchequer's July 2015 Budget announcement**

The Chancellor announced various measures in the Budget which covered personal and business tax and expenditure plans. The key areas in the budget which may have an impact on the County Council's financial position are detailed below:

### **2.1 Public Spending**

The Chancellor has provided projections for the level of spending for government departments in future years which are called Resources Departmental Expenditure Limits (DELs). These figures are for the total spend by all departments only and no breakdown by department has been provided.

The published figures identified that the reductions made to total departmental resources are more gradual over the parliamentary term than previously indicated (the period over which departmental savings have to be delivered has been extended by one year).

However, there was **no specific information released on Local Government resources** and this will not be known until the Spending Review is announced in the autumn.

Specific areas of expenditure identified within the total DEL limit figures that were announced are:

- NHS will receive a further £8bn by 2020 (in addition to the £2bn already announced).
- The government is to meet the NATO target of spending 2% of GDP on defence each year.
- During this parliament there is to be a real terms increase in expenditure on defence.
- A new Joint Security Fund is to be created. The government commits to make available up to an additional £1.5 billion a year by the end of the Parliament

In total **£37bn of further spending cuts are required by 2020**. Of this, the Budget included £12bn of welfare reductions and £5bn from the prevention of tax avoidance.

**The remaining £20bn of savings will come from spending departments and will be set out in the Spending Review published in the Autumn of 2015.** The Chancellor did state that "no year will see cuts as deep as those required in 2011/12 and 2012/13".

In the recently published report by HM Treasury "A country that lives within its means – Spending review 2015" (Annex 1) the following table was included that demonstrates the profile of the £20bn of savings (referred to as 'consolidation') that departments will need to deliver:

**Table 1.A: Consolidation plans over this Parliament (£ billion)**

	2016-17	2017-18	2018-19	2019-20
Discretionary consolidation <sup>1</sup>	9	20	31	37
of which announced at Summer Budget 2015 <sup>2</sup>	6	9	13	17
of which welfare reform	5	7	9	12
of which tax avoidance and tax planning, evasion and compliance, and imbalances in the tax system	1	2	4	5
Remaining consolidation	3	11	18	20

<sup>1</sup> Discretionary consolidation is calculated as the sum of: receipts from avoidance and tax planning, evasion and compliance and imbalances in the tax system and welfare policy decisions announced at Summer Budget 2015; and the additional reduction in spending (or equivalent increase in taxes) needed to meet the government's overall fiscal path, compared to a counterfactual in which RDEL excluding depreciation grows in line with whole economy inflation from its 2015-16 level (excluding the OBR's allowance for shortfall) and all other spending (and receipts) follows the OBR's July 2015 Economic and fiscal outlook forecast.

<sup>2</sup> Total welfare policy decisions and total receipts from avoidance and tax planning, evasion and compliance, and imbalances in the tax system as set out in Table 2.1 of Summer Budget 2015.

*Source: Office for Budget Responsibility, HM Treasury policy costings and HM Treasury calculations*

This shows that the profile of savings is not spread evenly over the period and supports the analysis included in section 3.1 of this report that examines the future levels of funding the Council can expect to receive from government.

## 2.2 Public Sector Pay

The Chancellor announced that funding for a public sector pay rise will be limited to 1% for each of the next four years. However, the main announcement on pay was the introduction of a new National Living Wage for all workers aged 25 and over. This will be a compulsory rate and will be introduced from 1<sup>st</sup> April 2016 at a rate of £7.20 per hour. It is anticipated that this will rise incrementally each year to at least £9 per hour in 2020.

## 3. Resources Available

The Budget approved on 12<sup>th</sup> February 2015 included consideration of future years' revenue budgets and identified the following funding resource:

Funding:	Projected Resource	
	2016/17 £m	2017/18 £m
1. Business Rates	180.727	185.319
2. Council Tax	388.839	391.018
3. Revenue Support Grant	130.484	102.887
4. New Homes Bonus	4.990	4.990
<b>Total</b>	<b>705.040</b>	<b>684.214</b>



Based upon the above resources and estimates of spending, the County Council was left with a funding gap of:

	2016/17 £m	2017/18 £m	Total £m
<b>Funding Gap</b>	<b>18.298</b>	<b>8.130</b>	<b>26.428</b>

In deriving these figures, various assumptions on both the level of resources and the expenditure pressures were made. These need to be reviewed in light of the latest information.

### 3.1 Resources from Central Government

The County Council receives a share of the total DEL for Local Government based upon a formula used by the Department for Communities and Local Government as part of the Local Government Spending Review. In recent years the amount received has been calculated in a straightforward manner whereby each authority's allocation is reduced by the amount that the total DEL is reduced.

The MTFS reported to Council in February 2015 assumed an annual reduction in government funding of 7% in both 2016/17 and 2017/18 based on the available information at the time.

At the time of the Chancellor's Autumn Statement in 2014 a much steeper reduction in resources over the next two financial years was implied that led some organisations to forecast a rate of reduction of 15% per year. It would appear, however, that the recent budget announcement has made this forecast somewhat excessive. If the 15% forecast were realised this would increase the funding gap identified in this report at £223m by £45m (if there were a 15% reduction in funding in both 2016/17 and 2017/18).

Information published with the budget report on the 8th July in respect of future years' total DEL has been analysed and shows the following:

Year	Total DEL (all departments) £m	% change
2015/16	337.4	-
2016/17	341.4	1.19
2017/18	339.7	-0.50
2018/19	339.7	0.00
2019/20	344.3	1.35
2020/21	369.6	7.35

The reduction to total DEL will not be applied evenly across the Departments as some have a 'protected' status. **Given the protected status of NHS, Education, International Aid and Defence, non-protected services, including Local Authorities, will face a significant reduction in resources.**

Based on the latest available information, a calculation on the **potential change in non-protected services' resources** over the parliament period shows a change of:

	2015/16 £m	2016/17 £m	2017/18 £m	2018/19 £m	2019/20 £m
<b>Total DEL (all departments excluding depreciation)</b> (Published in the budget report on 8 <sup>th</sup> July)	315.100	319.100	317.400	317.400	322.000
% change		1.27	-0.53	0.00	1.45
<b>Less Protected Departments</b>	(Assumed DEL based on current intelligence)				
NHS/Health	111.900	117.690	121.809	126.123	130.646
International development	7.400	7.518	7.654	7.799	7.955
Education	53.500	54.356	55.334	56.386	57.513
Defence	28.100	28.692	29.355	30.062	30.817
<b>Unprotected services</b>	<b>114.200</b>	<b>110.844</b>	<b>103.248</b>	<b>97.030</b>	<b>95.069</b>
% Reduction		-2.94	-6.85	-6.02	-2.02

Over the period to 2019/20 this would give an estimated reduction in resources for unprotected departments of 16.8%. This forecast of future DEL reductions offers the best basis for estimating the future reductions to funding for local authorities' funding and has therefore been incorporated into the assumptions made in this report for the future funding available for the council.

This assumption is much lower than the 25% and 40% options requested from spending departments for consideration in the Spending Review 2015, however the Spending Review figures include an assumed inflationary increase in resources each years that the Council's MTFS does not.

### 3.2 Impact on the Medium Term Financial Strategy

The County Council's previously reported MTFS assumes a 7% reduction in government funding in both 2016/17 and 2017/18. Whilst this seems consistent with the analysis above for 2017/18, the current assumption is somewhat higher than the implied reduction shown for 2016/17.

However, analysis and commentary across the Local Government sector since the Chancellor's budget report on 8<sup>th</sup> July has consistently asserted that the Local Government sector will have a larger reduction in funding in 2016/17 than other non-protected services.

It is therefore deemed prudent to continue with the forecast of a 7% reduction to government funding in 2016/17 and 2017/18 and then apply the reduction shown above in respect of future DEL levels in 2018/19 and 2019/20 i.e. reductions of 6% and 2% respectively.

The implication of the figures provided with the budget report is that reductions to DEL will end in 2019/20 therefore we have assumed no reduction or increase to funding for 2020/21.

These assumptions provide the following forecast of resources available to the council:

	2015/16 £m	2016/17 £m	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m	Total £m
Level of resources	726.675	705.040	684.214	668.977	663.781	663.926	
Reduction		21.635	20.826	15.237	5.196	-0.145	62.749
<b>Impact on funding gap</b>	-	-	-	<b>15.237</b>	<b>5.196</b>	<b>-0.145</b>	<b>20.288</b>

Note: the assumed level of the reduction in resources for 2016/17 and 2017/18 has not changed since the MTFS reported to Council in February 2015, therefore there is **no additional pressure** as a result of this specific assumption in those years.

#### 4. Spending Pressures

The MTFS includes spending pressures including pay increases, pressure arising from contractual inflation, increased demand for services and the impact of previously agreed savings measures that are no longer achievable.

##### 4.1 Pay

The previously reported MTFS includes provision for a 2% pay award each year in 2016/17 and 2017/18 and also incorporates the impact of a forecast increase in the Living Wage rate as set by the Living Wage Foundation (of which the County Council is an accredited member).

The Chancellor announced a 4 year restriction on public sector pay increases at 1% per year. This could be used as a guide for the Council's assumptions however the 1% limit is not binding on local government employers. If the Council were to revise its assumption on pay award from 2% to 1% a potential saving of £2.1m may be realised in 2016/17 and 2017/18. The MTFS then includes the additional pressure arising from a 1% increase to pay in each subsequent year.

The Chancellor also announced increases to the minimum wage for people aged over 25, referred to as the 'National Living Wage'. This is completely separate to the Living Wage the County Council is committed to paying its employees as an accredited member of the Living Wage Foundation and has no impact on the pay assumptions made in the MTFS.

The impact of the revised pay assumptions identified above on the MTFS are:

	2016/17 £m	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m	Total £m
Impact of 1% pay award	-2.1	-2.1	2.4	2.4	2.4	3.0



## 4.2 Price inflation

Contractual price increases have been reviewed by services and additional pressure has been identified.

The main areas of additional cost pressure resulting from price inflation are:

- £41m for contractual price increases for third party providers of Adult Social Care across the period
- £11m for contractual price increases within the Waste Management contract across the period

The impact of the revised price inflation assumptions identified above on the MTFS are:

	2016/17	2017/18	2018/19	2019/20	2020/21	Total
	£m	£m	£m	£m	£m	£m
Impact of revised price inflation assumptions	-1.8	1.1	18.0	19.6	21.6	58.5

It is clear that the majority of the 'additional' pressure identified is simply as a result of extending the MTFS period by 3 years rather than there being significant increases to previously made assumptions.

## 4.3 Demand Pressures

All services have reviewed the demand pressures faced by the council in future years. The impact of this review has been identified and is reflected in the revised MTFS and it can be seen that the majority of the increase to the funding gap that has been identified is for the period from 2018/19 to 2020/21 (the extended period brought into the MTFS). The main element of this is the increase in demand for Adult Social Care.

There are however, some specific increases in demand identified in 2016/17 as follows:

- £4.4m to reflect the growth in the number of looked after children in 16/17.
- £6.0m of pressure to reflect the potential loss of the Waste PFI Grant in 16/17.
- £8.1m to reflect the on-going pressure on the BTLS contract in 16/17.

The impact of the revised demand assumptions identified above on the MTFS are:

	2016/17	2017/18	2018/19	2019/20	2020/21	Total
	£m	£m	£m	£m	£m	£m
Impact of revised demand assumptions	18.1	1.3	14.5	16.1	18.8	68.8

## 4.4 Savings that will not be delivered

Services have reviewed previously agreed savings to be delivered through the new service offers and identified a number of proposals that are considered to be no

longer deliverable all in relation to Adult Social Care. Work is ongoing to review all service offer savings as part of the monthly monitoring process and further update will be provided in due course.

The impact this has on the MTFS is:

	2016/17	2017/18	2018/19	2019/20	2020/21	Total
	£m	£m	£m	£m	£m	£m
Impact of revised savings assumptions	33.4	12.8	-	-	-	46.2

## 5. Future Risks

The following are key future risks, the full impact of which will not be known at this stage:

### 5.1 Impact of the increase to the minimum wage (the 'National Living Wage')

Whilst the impact of the newly announced National Living Wage has no impact on the costs already forecast for the Council's own employees it **may impact significantly on the rates paid to providers of Adult Social Care commissioned services**. Detailed work to assess the impact of this is required however a preliminary assessment indicates the additional costs could be:

	2016/17	2017/18	2018/19	2019/20	2020/21	Total
Estimated hourly rate	£7.20	£7.65	£8.10	£8.55	£9.00	
Estimated additional cost	£6.9m	£9m	£9m	£8.9m	£9m	£42.8m
<i>Aggregate loss of resources</i>	<i>£6.9m</i>	<i>£15.9m</i>	<i>£24.9m</i>	<i>£33.8m</i>	<i>£42.8m</i>	<i>£124.3m</i>

### 5.2 Public Health Grant

The Council is likely to be subject to an in-year reduction to the Public Health Grant of approximately £4m in 2015/16. As yet it has not been confirmed if this will be repeated in future years. The MTFS assumes that this will not be repeated, therefore this income remains at risk in our assumptions.

### 5.3 Better Care Fund

The budget currently includes £20m of income from the Better Care Fund. This will only be received if it is agreed annually by the six Lancashire Clinical Commissioning Groups (CCGs).

### 5.4 Care Act

The MTFS assumes that any additional spending in relation to the Care Act would be met by Government funding. The recent announcement of a delay to the implementation of the Care Act proposals has no direct impact on the MTFS and funding gap because of this assumption.

## 6. Spending on statutory services

The following graph highlights how service expenditure is under pressure as a result of continuing demand on Adult and Children's social care and waste services, leaving less available funding for other local government services. Whilst this has been the expected picture for some time the Council is beginning to face the real impact of previously projected trends in increased demand and reduced funding. Consequently this makes it imperative that the Council determines the funding of services which are the priority for Lancashire.

