

# **Money Matters**

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

### **Medium Term Financial Strategy**

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# 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 County Council is experiencing an ongoing 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.

The County Council's three year Medium Term Financial Strategy (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).

In August 2015 Cabinet received a report outlining the latest financial position facing Lancashire County Council which extended the period of the MTFS to cover the period 2015/16 to 2020/21 and identified an estimated funding gap over the five year period of £223m.

This report considers, and where applicable revises, the assumptions in the MTFS in light of current information. As a result of these reviews the funding gap has increased to £262m.

### 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 report provides details of the financial pressure which is forecast to be £37.161m. This is a decrease of £8.484m from the £45.645m quoted in the last MTFS report. The pressure can be summarised as follows:

	August MTFS report	Current MTFS report	Change
	£m	£m	£m
2014/15 base budget pressure	24.838	24.838	0.000
Additional 2015/16 pressure	16.328	12.424	-3.904
Less 2015/16 gains	-7.916	-17.596	-9.680
Reserves applied in 2015/16	12.395	17.495	5.100
<b>Total</b>	<b>45.645</b>	<b>37.161</b>	<b>-8.484</b>

Where it has been identified that the cost pressure or underspend will continue into future years, these have been reflected in the updated MTFS position in this report.

Measures are being taken to minimise the forecast overspend for 2015/16 .This has resulted in a reduced overspend now being reported in comparison to the first report to Cabinet which was the forecast at end of June 2015. However, if the position cannot be fully recovered then any overspend will need to be funded by a contribution from reserves.

The assumptions made in the original MTFs have been reviewed and been updated to reflect the latest information available. The revised forecast funding gap is now estimated to be £262.0m by 2020/21 and an aggregated total of unavailable resources of £848.1m 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	812.5	753.6	725.0	711.4	710.2	
Revised savings set out in prior year budget reports	-17.3	-47.5				
Total Expenditure	795.2	706.1	725.0	711.4	710.2	
Resources	705.0	684.2	669.0	663.8	663.9	
<b>Funding Gap</b>	<b>90.2</b>	<b>21.9</b>	<b>56.0</b>	<b>47.6</b>	<b>46.3</b>	<b>262.0</b>

<b>Aggregated Funding Gap</b>						
2016/17 (£m)	90.2	90.2	90.2	90.2	90.2	
2017/18 (£m)		21.9	21.9	21.9	21.9	
2018/19 (£m)			56.0	56.0	56.0	
2019/20 (£m)				47.6	47.6	
2020/21 (£m)					46.3	
Total (£m)	90.2	112.1	168.1	215.7	262.0	<b>848.1</b>

This shows an increase in the forecast funding gap of £38.8m since the previous report. This increase is made up of a number of changes as shown below:

	2016/17 £m	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m	Total £m
<b>Funding gap reported to Cabinet – August 2015</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>
Impact of revised funding assumptions (para 3.2)	-	-	-	-	-	-
Impact of changes to pay assumptions (4.1)	0.7					0.7
Impact of increases due to contractual price inflation (4.2)	-4.5	-5.0	-1.5	-2.2	-2.2	-15.4
Impact of the National Living Wage (4.3)	3.3	8.5	8.0	7.6	7.2	34.6
Impact of changes to the forecast of demand (4.4)	13.4	-2.0	-0.6	-1.1	-1.4	8.3
Loss of grant income (4.5)	4.0					4.0
Impact of savings through service offers that can no longer be achieved (4.6)	7.4	-0.8	-	-	-	6.6
Revised Funding Gap	90.2	21.9	56.0	47.6	46.3	262.0
Change in Funding Gap	24.3	0.7	5.9	4.3	3.6	38.8

*Note: Forecasted pressures are based on current information. As further information is received the data is subject to ongoing scrutiny and verification by services. The forecast will continue to be developed which could affect further the estimated pressure on the revenue budget.*

The main changes in the period include:

- Reduced inflationary pressure on waste. -£5.8m
- Reduced inflationary pressure on adult social care. -£5.6m
- The impact of the National Living Wage. £34.6m
- Increased demand for children's social care. £9.1m

Further details on the changes are detailed in section 4 of the report.

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 after the Chancellor's Autumn Statement in November. 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 Department for Communities and Local Government (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 ultimately using up all available resources. The Base Budget Review has indicated that the 2016/17 and 2017/18 budgets will need to rely heavily on reserves in order to set a balanced budget.

The County Council, in redesigning the services it provides to the public faces the challenge of doing so whilst delivering further savings of an estimated £262m over the next 5 years.

**Significant reserves of £19.7m are currently forecast to be required to bridge the estimated 2015/16 outturn overspend. There is therefore an urgent need to make the service delivery decisions to ensure that a legal 2016/17 budget can be set.**

## 2. Government spending

Resources received from the government are affected by both total planned spending plans and the distribution to different parts of the public sector.

### 2.1 Government Public Spending Plans

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** which 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 however 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", 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 of this report that examines the future levels of funding the County Council can expect to receive from Central Government.

### 3. Resources Available

#### 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.

Information published with the budget report on the 8th July 2015 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
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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)</b>					
(Published in the budget report on 8 <sup>th</sup> July 2015)	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>110.843</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 County 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 and reductions of 6% in 2018/19 and 2% in 2019/20. This seems consistent with the analysis above for all years except 2016/17 where a higher reduction has been assumed.

However, analysis and commentary across the Local Government sector since the Chancellor's budget report on 8<sup>th</sup> July 2015 has consistently asserted that the Local Government sector will have a larger reduction in funding in 2016/17 than other non-protected services. It was therefore deemed prudent to forecast a 7% reduction to government funding in both 2016/17 and 2017/18.

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

These assumptions provide the following forecast of resources available to the council and as no further information is available, there is no change to the MTFS on the estimated level of resources as reported in August:

	<b>2016/17 £m</b>	<b>2017/18 £m</b>	<b>2018/19 £m</b>	<b>2019/20 £m</b>	<b>2020/21 £m</b>
Level of resources	705.034	684.221	668.977	663.781	663.926

### **3.3 Chancellor of the Exchequer announcement on Business Rates and RSG**

The Chancellor of the Exchequer announced in October that by the end of this Parliament in 2020, Local Authorities will retain 100% of business rates, "all £26bn will be kept by councils instead of being sent up to Whitehall" However, it was also announced that the end of this Parliament will also see an end to the Revenue Support Grant (RSG).

There are various uncertainties about the operation of any new business rate system in terms of redistribution both nationally and between the County Council and the District Councils who collect the business rates; and the impact on other specific grants or new areas of responsibility. Consequently, at this stage it is assumed that the announcement will have a neutral impact on the County Council's resources and the MTFS remains unchanged.

## **4. Net Spending Pressures**

The MTFS covers spending pressures including pay increases, contractual inflation, increased demand for services and the impact of previously agreed savings measures that are either no longer achievable at all or not to the scale or in the timeframes originally planned.

### **4.1 Pay**

In the July Budget the Chancellor announced a 4 year restriction on public sector pay increases at 1% per year. Using this as a guide the MTFS has included an assumed pay award of 1% for each of the years with the cost shown below. This assumption is unchanged since August.

However, a recent court case has concluded that holiday pay for those who work regular overtime should be based on overall pay, including overtime, and not just basic

pay. To accommodate this change £0.648m relating to affected staff has been included as a new recurrent cost pressure.

These pressures are summarised in the table below:

	2016/17	2017/18	2018/19	2019/20	2020/21	Total
	£m	£m	£m	£m	£m	£m
Impact of 1% pay award	2.3	2.3	2.4	2.4	2.4	11.8
Holiday pay costs	0.7					0.7

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. (Also see item 4.3).

## 4.2 Price inflation

Whilst contractual price increases represent a significant cost pressure, the assumptions have been reviewed by services and a reduction of £15.4m overall in the additional pressure previously reported has been identified.

	2016/17	2017/18	2018/19	2019/20	2020/21	Total
	£m	£m	£m	£m	£m	£m
Total price inflation	21.3	16.5	16.5	17.4	19.5	91.2
Impact of revised price inflation assumptions	-4.5	-5.0	-1.5	-2.2	-2.2	-15.4

Some of the key areas of price pressure are:

- An estimated £58m over the period for payments to external providers of social care attract annual inflation in order for the fees paid by the County Council to keep up with increases in the price of resources for suppliers. The County Council has a legal responsibility to demonstrate the suppliers are able to deliver services with the fees paid to them. The inflation assumptions used for externally provided social care are set out below and are based on the application of relevant inflation rates to a costing model:

Service	2016/17	2017/18	2018/19	2019/20	2020/21
Nursing Care	2.5%	2.7%	2.9%	2.9%	2.9%
Residential Care	2.6%	2.9%	3.0%	3.1%	3.1%
Domiciliary Care	2.5%	2.6%	2.7%	2.7%	2.7%
RPI	2.2%	3.0%	3.1%	3.1%	3.1%

- £12.3m for the provision of waste disposal.
- £5.6m on children's social care including agency payments, residence orders, foster and other allowances and payments to health. The payments to the health service are assumed to be at 1% in line with the pay award while the agency payments are capped at 2% per annum. Other allowances are generally at 2.2%.

The main changes on contractual price inflation since the last MTFS are:

- A reduction in the provision for waste costs of £5.8m overall. The movements between this forecast and the previous version reflect further analysis around tonnage diversion rates and the market for offtakes which will reduce the quantities that need to be sent to landfill.
- The adults social care has seen a net reduction in its price pressures of £5.6m overall, primarily as a result of estimated offsetting increases in service user income for those individuals who are financially assessed as being able to meet the additional cost.
- A reduction in provision for concessionary travel of £2.6m overall reflecting the application of a reduced price increase based on the current agreements that are in place.
- An increase in the provision for price inflation on children social care overall of £3.1m reflecting updated assumptions around increases to agency payments, foster care allowances and residence orders with most other allowances increasing in line with inflation.
- A reduction in the prices for bus operators and travelcare of £2.8m
- A reduction in the provision of the cost of street lighting to reflect the latest estimate of costs £2.2m.
- An increase in other price related costs across a number of services totalling £0.5m.

### **4.3 National Living Wage**

In his budget in July the Chancellor announced the introduction of a new National Living Wage for all workers aged 25 and over. This was included as a risk in the previous report but reflects compulsory rates that organisations must pay their staff beginning with a rate of £7.20 per hour from 1<sup>st</sup> April 2016. It is anticipated that this will rise incrementally each year to at least £9 per hour in 2020 and is a cost pressure that has been recognised as significant nationally.

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 is expected to impact significantly on the rates paid to providers of Adult Social Care commissioned services. It is now estimated that the County Council will incur additional costs over the period

of £34.6m due to the implementation of the National Living wage. These have now been built into the MTFS position.

#### 4.4 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 a significant proportion of the funding gap that has been identified is due to demand pressures.

In total it is estimated that the demand pressures are £97.4m. The table below shows the impact by year and the change since the MTFS presented in August, which overall represents an increase of £8.3m.

This is illustrated in the table overleaf:

	2016/17	2017/18	2018/19	2019/20	2020/21	Total
	£m	£m	£m	£m	£m	£m
Total demand pressure	38.4	12.7	13.9	15.0	17.4	97.4
Impact on demand pressure assumptions	13.4	-2.0	-0.6	-1.1	-1.4	8.3

Since the last MTFS there have been a number of changes in the demand assumptions. The key areas are:

- An Actuarial review undertaken since the original MTFS report has revealed a significant shortfall in the provision for insurance claims caused primarily by a significant amount of potential back claims on top of in year new claims. This has resulted in an increasing of the provision by £5.8m in 2016/17 reducing to £4.3m in future years.
- The cost of children's social care is estimated to be £9.1m higher than previously anticipated. Of this £4.1m covers the cost of population changes and the anticipated increase in the number of children in care. The additional £5m relates to initial estimates of the additional social worker capacity requirement reflecting increasing demand and the potential impact of the Ofsted inspection.
- Transport costs via travelcare are anticipated to increase by £1.1m. This reflects estimated increased demand for those services from both Adults and Children's services.
- Demand for adult social care services has been reviewed resulting in a reduced provision of £6.7m. This is largely the result of reviewing potential client numbers for those with mental health needs.
- There are various smaller additional demand pressures across services amounting to £0.5m

In total, adult social care represents approximately 70% of the demand pressures. Adult social care has long seen annual increases in the demand for services and the

MTFS attempts to predict growth in future years largely based on past activity trends but also taking into account future population changes.

In deriving the estimated cost of demand the following projections have been used:

- Older People – population projections from the ONS for the aged over 85 population.

2016/17	2017/18	2018/19	2019/20	2020/21
2.86%	2.78%	3.30%	3.49%	4.21%

- Physical Disability services continue to see increases in the demand for direct payments, where service users receive a cash payment from the County Council for individuals to arrange their own care in place of the County Council commissioning services on their behalf. The average annual growth in Direct Payments for those with physical disabilities over the last 3 years has been 5.5%. As such, an annual increase of this amount has been included in the forecast.
- Learning Disability services has traditionally seen growth in service user numbers of around 3% per annum. The last reliable year of activity information shows a 3.7% increase in the number of people with community based support which makes up the majority of current expenditure for those with learning disabilities. As such a 3.7% increase per annum has been included in the MTFS.
- For Mental Health services the average annual increase in service user numbers in the last 3 to 5 years has been used across Residential, Nursing, Home Care and Direct Payment services to project increased spending over the period.
- As the demand for services increase, so does the increase for formal social care assessment to identify whether an individual has eligible care needs which would entitle an individual to financial support from the County Council to meet their care needs. Population increases in the over 85 population has been used to project forward spending growth in relation to assessment and care management staff.

#### **4.5 Loss of specific grant**

The County Council receives various grants which are specific and form part of the net expenditure pressures rather than the general resources of the authority referred to in section 3 above. The County Council was subject to an in-year reduction to the Public Health Grant of circa £4.3m in 2015/16. Although it has not yet been confirmed if this will be repeated in future years it is anticipated that it will be a continuing reduction. Therefore the MTFS includes a provision for the potential ongoing loss of grant.

#### **4.6 Savings that will not be delivered**

The savings to be achieved are constantly under review. The previous report identified that £46.2m of agreed savings covering adult social care had been assessed as not now being deliverable and the risk assessment of savings has been updated with additional impact as set out below:

<b>Savings Description</b>	<b>£m</b>
Savings on Adult Social Care	5.4
Review of skills provision	1.0
Review of business intelligence	0.2
<b>TOTAL</b>	<b>6.6</b>

## **5. Future Risks**

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

### **5.1 Better Care Fund**

The budget currently includes £20m of income from the Better Care Fund. This will only be received if it is annually re-agreed by the 6 Lancashire CCGs. It is currently assumed that this will continue in the MTFS.

### **5.2 Deprivation of Liberty Safeguards**

The Deprivation of Liberty Safeguards (DoLS) was implemented on 1 April 2009. It provides a legal framework for preventing the unlawful detention of anyone over the age of 18, in a care home or hospital, who lacks the capacity to consent to their care arrangements and residence.

Since March 2013 Lancashire County Council has the responsibility for assessment of people who meet DoLS criteria in hospitals as well as residential care homes and due to a Supreme Court ruling many more people are covered by the regulations. If the legal duty was rigidly applied revised estimates suggest that up to £5m could be the recurrent cost of full compliance. This has not been factored in to the MTFS.