Appendix B

Money Matters
Financial Outlook for the County Council Medium Term Financial Strategy as at 30th June 2016

Lancashire County Council

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Financial Outlook for the County Council: Medium Term Financial Strategy

1. Executive Summary

1.1 Introduction

This report updates the financial position facing Lancashire County Council over the period 2017/18 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.

Cabinet have received reports throughout the 2015/16 financial year on the MTFS to cover the period 2016/17 to 2020/21. The last report that highlighted the financial gap to Members was at Full Council in February 2016 where the shortfall in funding by 2020/21 was identified as £194.854m, however following an agreed adjustment at Full Council the revised gap was £196.644m.

Although an underspend of £0.601m was achieved in 2015/16 the County Council is still facing a hugely challenging future with savings of c£100m to achieve as part of the 2016/17 budget and significant additional inflation and demand pressures across Children's Social Care, Adults Social Care and Waste Services which have emerged in recent months. This report considers the impact of budget decisions taken by Cabinet and updates other assumptions in light of the most current information available. As a result of these reviews the funding gap has reduced to £147.944m. Whilst this appears positive overall this reflects different funding assumptions to that presented previously in that the impact of a 3.99% increase (including the 2% Adult Social Care precept) for each of the next 4 financial years is included, which is partially offset by increasing spending pressures to those previously identified and agreed.

The table below provides a detailed analysis and movements between the previously reported financial gap and the revised financial gap:

	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m	Total £m
Spending Gap as reported to Full Council February 2016	46.518	51.733	50.614	47.779	**196.644**
Add change to forecast of spending:					
Pay and Pensions	1.297	1.841	1.764	2.261	**7.163**
Price Inflation and Cost Changes	3.339	-3.242	-1.958	-1.250	**-3.111**
Service Demand and Volume Pressures	15.954	1.936	3.875	4.078	**25.843**
Other	-3.639	1.694	0.759	0.000	**-1.186**
Loss of specific grants	3.668	1.797	1.778	0.000	**7.243**
Undeliverable savings	0.729	0.000	0.000	0.000	**0.729**
Total change to forecast of spending	**21.348**	**4.026**	**6.218**	**5.089**	**36.681**
Funding	-19.888	-19.837	-22.654	-23.002	**-85.381**
Total change to forecast of resources	**-19.888**	**-19.837**	**-22.654**	**-23.002**	**-85.381**
Revised funding gap	**47.978**	**35.922**	**34.178**	**29.866**	**147.944**

1.2 Conclusion

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

The financial commitment required to fund statutory demand led services as they are currently delivered is almost certain to result in using up all the available resources available at a point within the timeframe covered by this financial strategy. We cannot be certain of the point at which funding may not cover statutory demand led services as, for example, the resources available to the County Council have yet to be confirmed for future years. However, indications from previous base budget review tied in with the outturn position delivered in 2015/16 suggest that there will be insufficient resources to cover statutory services from 2018/19.

The County Council, in redesigning the services it provides to the public, faces the challenge of doing so whilst delivering savings over and above those already agreed of an estimated £148m over the next 4 years.

As part of the process of redesigning its services the County Council has previously explicitly recognised that it will need to utilise its reserves. Details on the reserves are detailed in the Money Matters report Appendix B. In this report it is noted that as at 1 April 2016 the County Council had £314.647m of reserves, some of which are already committed. Including the Funding Gap identified in this report, it has been identified that there is an estimated reserves requirement of £47.978m to support the revenue budget in 2017/18. Consequently, by 31st March 2018 it is anticipated that there will only be the £36.000m County Fund and a residual £35.058m of service reserves which includes £8.355m school PFI expenditure and £4.931m which is not LCC money, meaning in effect an available balance of £21.772m. This position is a forecast dependent upon a number of key factors that are detailed within Appendix B.

2. Resources

The MTFS includes government funding based on the Secretary of State's proposed allocations up to 2019/20.

Following decisions on Council Tax and the application of capital receipts taken in setting the 2016/17 budget by Full Council in February 2016 the estimated resources built into the current MTFS are as follows:

	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m
Revenue Support Grant	81.508	56.979	32.894	26.928
Business Rates	179.418	185.508	190.480	195.569
Council Tax	412.182	413.196	414.215	415.237
New Homes Bonus	5.530	3.475	3.334	3.334
Better Care Fund	3.210	22.656	40.014	40.014
Transitional Grant	1.154	0.000	0.000	0.000
Capital receipts	12.500	5.000	0.000	0.000
Total	**695.502**	**686.814**	**680.937**	**681.082**

These were based on a number of assumptions which have revisited as part of this report.

2.1 Settlement Funding Assessment (SFA)

The Secretary of State announces a Settlement Funding Assessment (SFA) for each authority. This is an indication of the level of resources required by an authority which is to be met from business rates and RSG. In 2016/17 the Secretary of State announced details of proposed support for the next 3 years, i.e. up to 2019/20 and the MTFS has been based on this Settlement. These were:

	2017/18 £m	2018/19 £m	2019/20 £m
Settlement Funding Assessment (SFA)	258.326	239.014	220.747
Funded by:			
Revenue Support Grant	81.508	56.979	32.894
Business Rate Baseline	176.818	182.035	187.853
Total	**258.326**	**239.014**	**220.747**
Reduction in SFA	-33.923	-19.312	-18.267

The Settlement for 2017/18 to 2019/20 were indicative but the Secretary of State offered local authorities the opportunity to apply for a four year finance settlement covering the Revenue Support Grant, Rural Services Delivery Grant and Transitional Grant. Authorities have until 14th October 2016 to accept the offer which is subject to being supported by a published efficiency plan and needs to be considered in the context of the identified gap in funding and the fact that based on current assumptions the funding covered under the offer represents c12% of the Council's assumed core funding in 2017/18 and is already assumed to reduce further each year until ultimately Revenue Support Grant is phased out completely by April 2021 at the latest.

The indicative figures that have been provided remain the best available forecast of Central Government's funding intentions. They have therefore been retained as the basis of this MTFS.

However, there is still significant risk associated with the figures include in the table above. At the time of the final settlement in February 2016 the forecast of economic growth was in the region of 2% per annum. Since then economic conditions and uncertainty both at home and in the world economy have worsened, particularly following the United Kingdom's decision to leave the European Union. Most estimates of UK economic growth over the lifetime of this MTFS are now lower. This will have an impact on Government finances and could potentially result in further public sector expenditure reductions although the Chancellor has announced that the aim to generate a surplus by the end of parliament is no longer sustainable. Further clarity of the Government's intentions are unlikely to be known until the Autumn Statement when some indication of public sector expenditure will be given.

Business Rates

The business rates budget consists of:

- Business rate top up grant
- Business rate income from District Councils
- Section 31 grants

As shown in the table above detailing the SFA the business rate income is a significant portion of funding to local authorities. The baseline is an assessment of the business rate income required to meet service needs. For the County Council the amount anticipated to be received from the business rates collected in the area is less than its assessed need therefore it receives a top up grant.

The MTFS that was reported to Full Council consisted of:

	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m
Top Up grant	142.827	147.041	151.741	156.441
Funding from Districts at baseline	33.991	34.994	36.112	36.542
S31 Grants	2.600	3.473	2.627	2.586
Total	**179.418**	**185.508**	**190.480**	**195.569**

Note: 2020/21 does not form part of the indicative settlement announced by the Secretary of State.

Unless there is change in the SFA due to the economic uncertainties referred to above; the level of the top up grant between 2017/18 and 2019/20 is the best basis of the forecast available for business rates figures in the MTFS. There is however some degree of discretion over the locally raised amounts.

Under the business rates system a proportion of growth above the baseline accrues to the local authorities. As an example in 2016/17 it is estimated that the County Council will receive £0.500m above the baseline amount.

It is also possible that business rate income could fall, although there is a safety net within the business rates retention system which ensures that no authority's income will fall by more than a set percentage of their original baseline funding level (and this level will be increased by RPI every year). The Safety Net percentage has been set at -7.5%.

In terms of the MTFS, whether or not to add additional income is difficult to assess. There is little local information and much will depend on the general economic performance of local areas. In addition, there are valuation appeals outstanding, some of which are on large value properties. If successful these will have a negative impact on the ability to generate business rates.

The baseline data already assumes an increase in income derived from local business rates. Therefore given the economic uncertainty forecast income has been maintained at the baseline funding level.

In 2015/16 the Government compensated authorities for the cost of a number of measures introduced by the Government. These were the multiplier cap, the temporary doubling of small business rates relief, the temporary maintenance of small business rate relief when a second property is occupied, relief given to newly built properties whilst they are empty (herein after referred to as “new empty” property relief), relief given to long-term empty property brought into occupation (“long-term empty relief”), retail relief, flooding relief and payments made in lieu of transitional relief. Compensation is provided by means of a grant paid under Section 31 of the Local Government Act 2003 and the County Council has been notified that its S31 grant in 2016/17 is £3.992m. There is no information in respect of future years but the main elements of the grant relate to the multiplier cap and the doubling of the small business rate relief.

Assuming that the reliefs continue the impact of the multiplier cap is likely to rise with inflation as without the cap the income would have increased. Other reliefs are more likely to relate to the change in the business rate base. It has been assumed that the level of S31 grants is maintained at the current level.

Overall the increase in forecasted income from business rates is as follows:

	£m	Year on Year change (£m)
2017/18	1.443	1.443
2018/19	0.633	-0.810
2019/20	1.558	0.925
2020/21	1.686	0.128

The final aspect of the business rate forecast is the pooling arrangement. The 2016/17 budget includes an additional £0.400m due from the pooling arrangement. The pool is a one year arrangement. Clearly, it is possible that it could be extended for future year(s). This will largely depend on the willingness of the District Councils to continue to participate. A key risk for District Councils is the possibility of losing the safety net as a result of being in a pool. The current MTFS currently excludes the impact of the pool but will be reviewed and updated once the position on the continuation of pooling arrangements beyond 2016/17 is known.

Council Tax

The MTFS previously did not include any provision for an increase in Council Tax for 2017/18 and beyond. With respect to the Council Tax the position now built into the MTFS is that, due to the size of the funding gap, an assumption that Council Tax would increase by 3.99% per annum which is the current referendum limit; although it is important to note that this has not been confirmed for future years.

The MTFS last presented to Cabinet assumed a small percentage increase in the tax base of between 0.25% and 0.56% per annum.

The tax base growth will increase in relation to the number of new properties but any growth will also be offset by the reliefs and assumed collection rates. So like the business rates the overall economic picture would have an impact on the forecast. Recent tax base data are:

	Tax base	% change
2010/11	382,201	
2011/12	383,227	0.27
2012/13	383,703	0.12
2013/14	331,648	-13.57
2014/15	336,050	1.33
2015/16	342,636	1.96
2016/17	348,980	1.85

The financial year 2013/14 saw the introduction of a new system whereby local authorities were responsible for Council Tax support with the abolition of the national council tax benefits scheme. The year on year change in the tax base are not comparable.

Ignoring 2013/14 the council tax base has grown each year. The growth rate does exceed the rate provided for in the MTFS by up to 1.7%. These recent years are data from a time when the economy was growing and it would be reasonable to expect growth. Whether or not this trend continues is one which needs to be kept under review. Before the introduction of the technical changes in April 2013 the national average annual increase was approximately 0.6%. If the Council Tax was kept the same yet the council tax base was assumed to increase by 1% per annum the impact would be:

	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m
Increase in income	1.921	5.048	8.211	11.414
Impact on Funding Gap	1.921	3.127	3.163	3.203

The MTFS now presented assumes a 3.99% increase in Council Tax along with a 1% increase in the tax-base. This has the following impact:

	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m
Increase in Income	18.444	39.092	60.821	83.695
Impact on the Funding Gap	18.444	20.647	21.729	22.874

New Homes Bonus

The 2016/17 Local Government Finance Settlement included an actual New Homes Bonus figure for 2016/17 and indicative allocation for 2017/18 to 2019/20. These future years' form the basis of the MTFS. They are lower in later years to reflect a reduction in the total funding allocated. However, the New Homes Bonus System (NHB) is subject to change and actual allocations will depend upon the outcome of the consultation that was undertaken earlier in 2016 and also the impact of future local growth. At this stage it is still the best information available for NHB allocations.

Better Care Fund/ Transitional Grant

The MTFS is based on indicative data in the last Settlement and therefore represent the best estimate available.

Capital Receipts

As part of the Autumn Statement the Chancellor of the Exchequer announced that the rules for the use of capital receipts, which is the income received from the sale of the County Council's fixed assets, were to be amended to help local authorities deliver more efficient and sustainable services. Previously the use of capital receipts has been restricted to the funding of capital expenditure or the repayment of debt. From 1 April 2016 capital receipts can be used to fund revenue expenditure which meets qualifying criteria, which is that the revenue expenditure needs to be on any project which is designed to generate ongoing revenue savings or to transform the service so as to make savings or improve the quality of service provision.

Local authorities will only be able to use capital receipts from the sale of property, plant and equipment received in the years in which this flexibility is offered. They may not use their existing stock of capital receipts to finance the revenue costs of reform.

Current estimates of the capital receipts to be generated are:

	2016/17 £m	2017/18 £m	2018/19 £m
Capital receipts generated	5.000	12.500	5.000

An estimated £22.500m has previously been agreed to be applied to the revenue budget. It should be noted that the receipts are one-off resources and there is a possibility that the level of receipts to be generated from the sale of assets will not be maintained at these levels for a sustained period of time. The actual receipts received in any one year will fluctuate in line with local property markets and the type of asset available for sale. Therefore, there is a risk that in any given year the receipts actually received will be less than assumed and therefore the situation will be monitored closely.

The funding gap shown in section 1.1 already assumes the use of these receipts. This is subject to the approval of the recommendation that the capital receipts are applied to revenue as outlined above.

Based on the potential increases outlined above the funding gap would be reduced by £85.781m from changes in resourcing. This is primarily due to the assumed increase in Council Tax. The breakdown is shown below:

	2017/18 £m	**2018/19 £m**	**2019/20 £m**	**2020/21 £m**	**Total £m**
S31 grants	1.444	-0.810	0.925	0.128	**1.687**
Council tax increase	18.444	20.647	21.729	22.874	**83.694**
Total	**19.888**	**19.837**	**22.654**	**23.002**	**85.381**

3. 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**.**

3.1 Pay

In the July 2015 Budget the Chancellor announced a 4 year restriction on public sector pay increases at 1% per year. This assumption was built into the current MTFS and remains unchanged, however a full review of the current staffing cohort and future savings that may impact on staffing has been included. This also incorporates a separate calculation for the National Living Wage which the County Council is committed to paying its employees as an accredited member of the Living Wage Foundation.

As part of the review of the MTFS a resource requirement has been built in to fund the cost of increments that will be paid to staff as they progress up their respective grades. The staffing budgets have undergone a full realignment in 2016/17 with budgets being allocated on specific grade points at the start of 2016/17, therefore additional budget will be required to fund increments over future years and this has not previously been built into the MTFS.

The table below presents the amounts already built into the MTFS for pay and the impact of the revised calculation:

	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m	Total £m
Pay – Previous MTFS	**4.149**	**3.289**	**3.368**	**3.428**	**14.234**
Pay requirement (1% increase and Living Wage)	3.107	2.970	3.448	4.360	**13.885**
Incremental Pressure	2.339	2.160	1.684	1.329	**7.512**
Revised Pay Budget Requirement	**5.446**	**5.130**	**5.132**	**5.689**	**21.397**
Impact on Financial Gap	**1.297**	**1.841**	**1.764**	**2.261**	**7.163**

It is important to note that the figures detailed above do not include the impact of any additional adjustments to salary scales to maintain wage differentials and this represents a significant risk in terms of the potential additional cost.

3.2 Price Inflation and Cost Changes

Contractual price increases represent a significant cost pressure to the County Council. The assumptions have been subject to regular review by services with an increase of £3.111m identified over the 4 year period.

	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m	Total £m
Total price inflation	16.698	16.894	17.813	19.731	**71.136**
Revised price inflation requirements	20.037	13.652	15.855	18.481	**68.025**
Impact on Financial Gap	**3.339**	**-3.242**	**-1.958**	**-1.250**	**3.111**

Some of the key areas of price pressure are:

- An estimated £48m over the MTFS 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 based on the application of relevant inflation rates to a costing model. This figure also incorporates recent fee increases of £5.2m that were agreed by the Cabinet Member which is the main reason behind the additional requirement in 2017/18.

- The overall additional budget requirement for the provision of waste disposal over the period of the MTFS is £7.262m. The requirement within the previous MTFS was £11.005m with the revised position incorporating assumptions surrounding waste transport in relation to a new contract from 2018/19 onwards.

- The overall additional budget requirement for children's social care including agency payments, residence orders, foster and other allowances and payments to health is £6.086m. In the previous MTFS the requirement was £4.621m. The increased inflationary pressure is linked to the increased demand that will have an inflationary pressure applied to it.

3.3 Demand Pressures

All services have reviewed the demand pressures faced by the County 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 now £85.141m. This is an increase of £25.843 from the previous MTFS over this time period.

	2017/18 £m	**2018/19 £m**	**2019/20 £m**	**2020/21 £m**	**Total £m**
Total Demand	14.027	13.512	14.623	17.136	**59.298**
Revised Demand Requirements	29.981	15.448	18.498	21.214	**85.141**
Impact on Financial Gap	**15.954**	**1.936**	**3.875**	**4.078**	**25.843**

Adult Social Care represents a large proportion 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.

	2017/18	2018/19	2019/20	2020/21
Total Older People Population Projection Growth	1.92%	2.52%	3.07%	3.57%

These have been updated from the previous MTFS resulting in an £5.6m increase in the budget requirement, primarily from 2019/20 onwards.

All other demand assumptions contained within this revised MTFS regarding Adult Social Care have remained the same as those used in the MTFS and funding gap reported to Full Council in February 2016.

- The cost of Children's Social Care demand has significantly increased as part of this revised MTFS (and can be linked to the budget monitoring positon for Children's Social Care). An amount of £6.807m including £5.000m to meet additional costs, primarily social worker capacity post Ofsted inspection were previously included in the MTFS for the 4 year period.

  The forecast is based on available financial and activity information and assumes that placements will increase over the next 12 months by 0.8% per month and then after that will increase as per child population increases. Work is underway to review the underlying reasons for increases in numbers of placements and is an area that is being kept closely under review.

  The additional budget requirement of £12.234m in 2017/18 for Children's Social is included within the revised MTFS. This reflects the overspend that is being reported as part of budget monitoring in 2016/17 and continues to anticipate a growing population of children looked after in 2017/18 and beyond with an overall additional £13.238m included from 2017/18 – 2020/21.

- The revised MTFS for 2017/18 includes an additional £5.240m for Waste Services. This includes £1.241m which had incorrectly double counted a saving in the previous MTFS. In addition demand assumptions made in the previous MTFS are estimated to be too low, therefore an additional £0.600m has been included to rectify the overspend position reported. The remaining requirement is due to an increase in residual waste arisings with 4% now being forecast (compared to a previously assumed 1%) and some additional green waste costs.

3.4 Other

This section contains adjustments that are required that do not predominantly fall into any of the categories noted above. The total reduction of £1.186m is comprised of the following:

- A reduction in the budget required for of £1.140m in the Public and Integrated Transport due to charges being made to the schools block in relation to non-maintained special schools.
- Re-phasing of the income expected from Working Together with Families Grant.

3.5 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 2 above. The County Council was subject to an in-year reduction to the Public Health Grant of £4.3m in 2015/16 with a further reduction now confirmed in 2016/17 and reported as part of budget monitoring. It is anticipated that this will be a continuing reduction and has been revised for this MTFS.

3.6 Savings and Cabinet Decisions

The savings to be achieved are constantly under review. This has resulted in some savings plans being identified as now not being fully deliverable, most significantly public and Integrated Transport whereby £0.493m of the £2.499m agreed saving for transport to day centres cannot be delivered.

4. Future Risks

In addition to the economic uncertainty post-Brexit outlined earlier in the report, the following are key future risks, the full impact of which is not yet known at this stage:

4.1 Agreed Savings Plans Delivery

The scale of agreed savings is hugely significant given both the scale and areas covered, and there are inherent risks in their delivery. Any significant under-delivery of agreed savings will create an additional funding gap and impact on the ongoing and longer-term financial health of the Council. This has been identified as one of the highest level risks in the Risk and Opportunity Register. There are comprehensive arrangements in place to track delivery of financial savings and take corrective actions where required.

4.2 Identification of Further Savings Opportunities

Cabinet has agreed a financial strategy based on:

- Setting an expenditure target for service expenditure levels to move in line with the lower quartile of the most appropriate group of local authorities for individual services.

- Stage 3 of the base budget review being the zero base with a fundamental review of all expenditure within services to ensure the best value for money. Work is progressing on identifying the scope for further savings opportunities.

- External consultants have been appointed to assist the council in scoping and undertaking the review of its operating model. A key element of this is the development of a public services operating model for the County Council to enable it to be sustainable within its forecast financial resource envelope by 2020/21.

- Transformational work across Adult Social Care aimed at both improving systems and processes and delivering significant financial savings. Work is well progressed on identifying the overall scale and phasing of benefits from the review.

4.3 Business Rates Retention / Changes to Funding Formula

In 2015 the Chancellor announced that local government as a whole would be able to keep 100% of business rates by 2020. Using Office for Budget Responsibility (OBR) forecasts the Government has estimated that additional business rates kept by councils will be c£13bn by 2020/21 with the intention to transfer new responsibilities to local government to ensure cost neutrality overall of the funding changes. There is currently a system of redistribution (top-ups and tariffs) to reflect there are councils with relatively higher needs but lower income from business rates and vice versa. The Secretary of State for Communities and Local Government has also announced a full review of needs and redistribution which will be use as the starting point for the new system when it comes into force. The County Council currently receives a top-up grant, primarily as a result of having Adult Social Care responsibilities, and there is insufficient information currently, although work is progressing nationally with a consultation regarding the changes underway, to model what the financial impact of the changes will be and the financial impact on the County Council.

4.4 STP

Since 2015 the County Council has been a partner organisation in the Better Care Fund planning and pooled budget arrangements with Clinical Commissioning Groups (CCG's). Building on this is the requirement for every part of the NHS to have a locally led Sustainability and Transformation Plan (STP) in place by 2017. This is within the context of the substantial financial challenges for the health and social care system in Lancashire and will necessarily involve the development of new delivery models and ways of working to minimise the impact of funding reductions and provide a better offer for patients and service users.