**Appendix 'A'**

## The Financial Strategy 2015/16 - 2017/18

## 1. Introduction

Over the period 2014/2018 the Council is facing the huge challenge of reducing its costs by £300m as a result of the government's austerity measures. To put it in context, since austerity bit in 2010, the Council will have taken half a billion pounds out of its revenue costs – with the consequent impact on services, staff, communities and the economy.

When the Council set the revenue budget for 2014/15, it looked ahead to the level of resources available for 2017/18, and that the Council would have a net budget available of £664m of resources to invest in services, compared to the 2014/15 level of £758m. At the same time, the Council is facing increases in both costs (for example, as a result of inflation) and the level of demand for its services. In total, over the four years 2014/15 to 2017/18 the Council was facing the need to make savings of £300m.

The Council has met this challenge robustly – at the heart of this is the recognition that to be sustainable and deliver for our communities the Council will need to change. Management and organisational structures will need to be streamlined and the Council will have to work differently. Given the scale of the challenge it is impossible to make the level of savings required by a series of piecemeal cuts and changes; a more fundamental approach is required.

The work to deliver this further challenge began with the 2014/15 budget, and in February 2014 the Council set a balanced budget which agreed savings of £142m over the 4 years 2014/15 to 2017/18. At the time it was recognised that despite this excellent start, a further £161m of savings remained to be identified, and that this would mean very difficult decisions in relation to services, as taking this level of resources out of services would have a significant impact.

## 2. Forecast Revenue Requirements 2015/16 to 2017/18

### *2.1 The Starting Point*

After Full Council set the 2014/15 revenue budget in February 2014, the position for 2015/16 to 2017/18 was as set out in Table 1 below:

| | 2015/16<br><br>£m | 2016/17<br><br>£m | 2017/18<br><br>£m | Total<br><br>£m |
|---|---|---|---|---|
| Gap between spending and resources | 72.946 | 44.794 | 43.748 | 161.488 |

Table 1.

In essence, if no further savings were made, the Council's forecast revenue spending by 2017/18 would be £161.488m higher than the level of resources available to invest in services.

As set out to Full Council at the time, this took into account anticipated increases in costs as a result of inflation, changes in the level of demand for services, increases in the level of employers' contribution to the pension fund, and provision for pay awards. In addition, the forecast level of resources took into account forecast changes in level of government resources, changes to the New Homes bonus and council tax.

*2.2 Changes to the Forecast of Spending and Resources*

In order to ensure that the Council is on a sustainable financial footing, it is important to keep the forecast of both costs and resources under review. Over late summer and early autumn, a detailed of review of both cost and resource projections and risks has been undertaken, the results of which are set out below.

*2.2.1 Review of Spending Pressures*

The Council's future costs are driven by both demand and inflation, and the report on the 2014/15 financial position elsewhere on the agenda sets out the pressures being experienced in 2014/15 above that forecast. These pressures, whilst being contained within the overall financial position for 2014/15, will continue in 2015/16 and beyond. In addition, there are "legacy" pressures arising as a result of savings falling out of the current financial strategy. The figures are set out to show the increases which fall in each financial year – however, the impact is cumulative. For example, whilst the increase in demand will cost the Council £8.185m, by 2017/18 this will be £9.357m, due to further increases in 2016/17 and 2017/18.

In relation to demand, the service specific increases in demand are shown in Table 2 with further details set out below:

| Service Demand Pressures | 2015/16 £m | 2016/17 £m | 2017/18 £m | Total £m |
|---|---|---|---|---|
| Adult Social Care | 2.959 | 0.732 | 0.094 | 3.785 |
| Children's Social Care | 4.510 | 0.063 | 0.094 | 4.667 |
| Environment (landfill tax and waste transport) | 0.616 | -0.224 | 0.213 | 0.605 |
| Land not in operational use | 0.100 | 0.100 | 0.100 | 0.300 |
| **Total** | **8.185** | **0.671** | **0.501** | **9.357** |

Table 2

- The most significant elements of the changes in areas of demand were reported to Cabinet in July and are principally around Adult Social Care (£3.8m over the period) and Children's Social Care (£4.7m over the period), which reflects the latest budget monitoring information.
- There is a forecast increase in relation to landfill tax, however the largest increase in relation to Environment is an increase in the costs of waste disposal in 2017/18 due to the need to begin transporting residual waste to landfill sites in the East of the County.
- The need for further significant reductions in the scale of the County Council estate mean that the previously forecast phased reduction in the land not in operational use budget is not realistic in the medium term.

However, there are further potential demand pressures which may represent a risk position for the Council if they crystallise:

- It has been assumed that the costs of the first phase of implementing the Care Act will equate to the resource that will be made available through the settlement. At this stage based on the information available locally this appears a not unreasonable position. However, as at present there is no indication of the resources to be made available in future year's no further increase in costs has been assumed as otherwise there is the potential for the scale of pressure to be materially overstated.
- In addition, we are continuing to assume that any costs associated with the Deprivation of Liberty Safeguards (estimated at £2.9m) are funded through the new burdens mechanism, which may be a risk position.

*2.2.2 Inflationary Pressures and Changes in Costs*

The Council is also facing changes to the forecast of future costs as a result of inflationary pressures and changes in costs, as set out in Table 3 with further detail below:

| Inflation and Cost Changes | 2015/16 £m | 2016/17 £m | 2017/18 £m | Total £m |
|---|---|---|---|---|
| Pay | -0.715 | -0.256 | 0.248 | -0.723 |
| Education Services Grant | -0.305 | -1.427 | -1.558 | -3.290 |
| **Total** | **-1.020** | **-1.683** | **-1.310** | **-4.013** |

Table 3

- Pay – The assumption in relation to increases in the Living Wage has been set at 2.5% each year in line with the assumption for RPI inflation. For other pay the forecast is for a 1% increase in 2015/16 and 2% in the following years.
- The pressure previously forecast as a result of the reduction in Education Services Grant is now less than previously forecast as a result of the Department for Education providing clarity on their proposals and of factoring in the current rate of academy conversion.

*2.2.3 Legacy Financial Pressures*

The legacy financial pressures comprise two elements and are shown in Table 4 with further detail below:

| Legacy Financial Pressures | 2015/16 £m | 2016/17 £m | 2017/18 £m | Total £m |
|---|---|---|---|---|
| Capital Financing Charges | 0.954 | 5.076 | 0.246 | 6.276 |
| Pension costs | 0.987 | 0.499 | 2.342 | 3.828 |
| Energy and other inflation | 2.881 | 1.679 | -0.140 | 4.420 |
| **Total** | **4.822** | **7.254** | **2.448** | **14.524** |

Table 4

- There is an increase in capital financing costs of £6.3m over the period as a result of forecast changes in the interest rate environment, which is forecasting an increase in short term rates over the strategy period. As a result, the savings in the 2011 financial strategy from short term interest rates will fall out and the Council will need to lock in what will be lower long term interest rates.
- The previous forecast understated the impact of inflation on the centralised elements of pension costs, in particular historic added years and also assumed that there would be no further increase in the deficit contribution arising from the next actuarial valuation. A more prudent assumption has now been made on this latter point, given recent movements in the liability position of the Fund.

- Further changes in forecast inflation have added further costs of which energy prices amount to £3.3m – again, this is reflected in the 2014/15 budget monitoring. It was anticipated that increases in energy costs would be managed and mitigated by arrangements with an energy buying company; however, this arrangement has not been successful.

*2.2.4 Changes in Resources*

In addition to considering changes to the forecast of spending, the forecast for the Council's resources has also been updated which results in the additional resources set out in Table 5 with further details set out below:

| Resources | 2015/16 £m | 2016/17 £m | 2017/18 £m | Total £m |
|---|---|---|---|---|
| Business Rates Top Up and Local Share | 6.418 | -1.583 | -0.134 | 4.701 |
| Council Tax Base | -0.507 | nil | nil | -0.507 |
| New Homes Bonus | -0.568 | 1.058 | nil | 0.490 |
| **Total** | **5.343** | **-0.525** | **-0.134** | **4.684** |

Table 5

- Business Rates – we are now able to firm up our forecast of our share of the local business rates for 2015/16. 2014/15 was the first year of operation and much of the data from district councils and the valuation office has not previously been available. Whilst our share of business rates will be increased with RPI each year, we also need to take into account the potential impact of appeals, which are extremely significant in some districts.
- Council Tax - There is an assumption of a 0.27% per annum increase in the tax base, which is in line with the long term average, with some continuing impact from the Single Person Discount Review in 2015/16, although not as much as previously forecast.
- New Homes Bonus – The forecast here is based on the most recent Council Tax Base returns and reflects the impact of the arrangements for New Homes Bonus within the City Deal on the County Council. This forecast will need to be updated following the next set of returns to be produced by the billing authorities.

However, there is a further risk in relation to the resources the Council receives from the government in terms of Revenue Support Grant. When setting the 2014/15 to 2017/18 forecast the projections in 2016/17 reflected the continuation of the average reductions the Council had experienced since 2010 at 7.0%. However, both the LGA and commercial consultancies have produced forecasts which indicate this may be a risk position to take. The mid-point of the LGA and other forecasts is a reduction of 9% in both 2016/17 and 2017/18. A 2% change in this assumption makes a difference of about £6.6m to the forecast resources available in 2016/17 and £6.1m in 2017/18. A 2% change over both years would amount to £12.7m in total.

*2.3 Overall Impact*

The overall impact of these changes to the forecast of the Council's spending and resources on the level of savings required for 2015/16 to 2017/18 is set out in Table 6 below. This table shows the position for the Council if no action is taken to reduce costs (or alternatively, increase resources).

| | 2015/16 £m | 2016/17 £m | 2017/18 £m |
|---|---|---|---|
| Forecast of spending if no action is taken | 778.933 | 802.612 | 825.668 |
| Add :Service Demand Pressures | 8.185 | 8.856 | 9.357 |
| Add : Inflationary Pressures | -1.020 | -2.703 | -4.013 |
| Add: Legacy Pressures | 4.822 | 12.076 | 14.524 |
| **Revised forecast of spending** | **790.920** | **820.841** | **845.536** |

Less: Resources

| | | | |
|---|---|---|---|
| Original Resource Forecast | 705.986 | 684.872 | 664.181 |
| Changes in Resources | 5.343 | 4.818 | 4.684 |
| **Revised forecast of resources** | **711.329** | **689.690** | **668.865** |
| **Gap Between Spending and Resources if no action is taken** | **79.591** | **131.151** | **176.671** |

| | | | |
|---|---|---|---|
| **The Gap for Each Financial Year** | **79.591** | **51.560** | **45.520** |

Table 6

## 3. Bridging the Gap

It can be seen from the table above that the increase in savings required over the three years 2015/16 to 2017/18 has increased from £161.488m to £176.671m as a result of changes to the estimate of the Council's spending and resources. Of this, £79.591m falls into 2015/16, which must be bridged in order for the Council to set a balanced budget in February 2015.

However, within this there are a number of risks, particularly in relation to the Care Act, the Deprivation of Liberty Safeguards and the level of the Council's government resources in 2016/17 and 2017/18. It is important to highlight that industry commentators are suggesting the potential for a greater reduction in resources overall than included above; although we have seen a degree of protection afforded previously to social care authorities.

The level of future resources will be tied to the next Spending Review, the precise timing of which will not be known until after the 2015 general election. Clearly, the result of the general election will impact upon the Spending Review, and ultimately the level of resources for local government, but at this point it is not possible to model the potential financial outcome for the Council. However, it is important to note that in terms of the policy announcements from the political parties, there would appear to be no indications of additional resources for local government.

Set within the context of total reductions of £0.5bn between 2010 and 2018, the challenge facing the County Council is unprecedented. Delivering this level of saving whilst seeking to deliver effective services for our communities cannot be achieved without a radically different approach which focuses on service delivery within a budget envelope of £669m by 2017/18. Reshaping public services across Lancashire will require innovative thinking and leadership to secure effective services for our communities and ensure a sustainable future.