

Cabinet

Meeting to be held on 21 January 2016

Report of the Interim Director of Financial Resources

Electoral Divisions affected:

All

Money Matters – The Financial Strategy for 2016/17 to 2020/21

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

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Executive Summary

This report sets out the impact of the Autumn Statement and the Finance Settlement for 2016/17 that results in a £303.3m reduction in central government support over the period 2016/17 to 2019/20.

This report provides an update of the forecast outturn Financial Position for 2015/16 on revenue and capital, the County Council's updated Medium Term Financial Strategy (MTFS) for the period 2016/17 to 2020/21, reflecting the final settlement for 2016/17, and the position with regard to application of current reserves.

The County Council is facing an unprecedented financial challenge. The Medium Term Financial Strategy reported in November forecast that the council will have a financial shortfall of £262m in 2020/21. This is a combination of reducing resources as a result of the government's extended programme of austerity at the same time as the Council is facing significant increases in both the cost (for example, as a result of inflation and national living wage) and the level of demand for its services. The revised position following the financial settlement for 2016/17 is now for a financial shortfall of £200.5m in 2020/21. This revised gap is after the impact of the settlement, new financial pressures and the £64.8m of savings proposals agreed at Cabinet in November.

Over the five years 2016/17 to 2020/21 the Council is facing the need to make savings of £200.5m on top of those already agreed within previous budget processes.

Financial Position as at 30th November 2015

An overspend is currently forecast on the revenue budget of £9.591m. This is a significant improvement on the forecast position reported to Cabinet at the end of quarter one, which was an over spend of £33.251m, and the £19.666m forecast overspend reported to Cabinet at the end of quarter two. This improvement reflects positive actions taken to stop all non-essential expenditure, tight management of

vacancies and management actions to control and reduce where possible all other areas of expenditure. In addition it is anticipated that the remaining forecast overspend will significantly reduce further by the end of the financial year following approval of a revised minimum revenue provision (MRP) policy at Full Council in February.

The current forecast overspend is due to a base budget pressure from 2014/15 of £24.838m and additional 2015/16 emerging pressures of £10.928m. These are offset by gains of £26.175m. This position is reflected in the Financial Outlook and Medium Term Financial Strategy.

The Financial Outlook and Medium Term Financial Strategy

The previous MTFS presented to Cabinet in November estimated a gap of £262m. This report has further revised the assumptions in the MTFS for expenditure in light of the latest information from the financial settlement for 2016/17. The underlying position resulting directly from the settlement is an additional gap of £10.9m over the full period but £30.4m worse in 2016/17 and 2017/18 before an improved position in later years primarily as a result of the Better Care Fund. Through the identification of £64.8m of savings proposals agreed at Cabinet in November, recommending a 3.99% increase in Council Tax and the use of capital receipts under new flexibilities particularly the funding gap for the period up to 2020/21 is now estimated to be £200.5m.

The County Council's reserves position

The County Council is forecast to have a maximum of £56.613m in reserves remaining at 31 March 2018, primarily within the County Fund, to manage risks after this date. The majority of the £56.613m is contained within the County Fund. This assumes the set-up and application of up to £117.2m of reserves supporting the revenue budget in 2016/17 and 2017/18 which will still leave a residual gap in the revenue budget for 2017/18 of c£28.3m.

The County Council's Capital Programme for 2016/17 and Beyond

The report proposes a Capital Programme for the period 2016/17 to 2018/19 totalling £229.950m funded from a variety of sources but with a total borrowing requirement of £121.987m, the revenue implications of which have been included within the MTFS.

Recommendations

The Cabinet is asked to:

- (i) Note the current forecast overspend of £9.591m on the revenue budget in 2015/16 and ongoing pressure of £35.766m.
- (ii) Note the revised funding gap of £200.5m covering the period 2016/17 to 2020/21 as set out in the revised financial outlook forecast for the Council.

- (iii) Approve the additional budget adjustments for 2016/17, and following years' increases, included in the revised MTFS following the financial settlement.
- (iv) To recommend to Cabinet to make recommendations to Full Council on 11 February 2016 the Band D Council Tax for 2016/17 reflecting a 3.99% increase including 2% to be used for social care as per the new flexibilities.
- (v) Note the contents of the County Council's Reserves position at 30th November 2015.
- (vi) Approve all the proposed changes to the existing use of reserves, linked to creating the Transitional Reserve.
- (vii) In line with the Council's financial strategy agreed at the 26th November Cabinet, approve the establishment of the Council's Transitional Reserve (£107.599m or £117.190m should the County Council deliver a balanced revenue position in 2015/16).
- (viii) Note and approve the use of capital allocations within the 2015/16 capital programme for projects which are now complete or considered not needed as part of the 2016/17 programme funding.
- (ix) Approve the specific capital programme as presented within the body of the report.
- (x) Approve the increase in prudential borrowing identified within the Capital Programme report which is required as a result of utilising revenue and other reserves, previously earmarked for supporting the Capital Programme, to assist in the overall reshaping of the County Council.
- (xi) To note and have regard to the advice of the Interim Director of Financial Resources in relation to the robustness of the budget and the adequacy of reserves.

Background and Advice

The detailed reports at Appendices A, B, C & D present the County Council's revenue position as at 31st December 2015, reserves position as at 30th November 2015, updated financial outlook and Medium Term Financial Strategy for the period 2016/17 to 2020/21, and an update on the Capital Programme.

Impact of the Autumn Statement 2015 and the Financial Statement on the County Council's Financial Position

The Council's MTFS has been forecasting a continuing period of severe austerity and the Autumn Statement and the financial settlement for 2016/16 announced immediately before Christmas has not only confirmed that forecast, but has presented the Council with an even greater reduction in financial resources than previously anticipated.

1) The Rate Support Grant (RSG) and Business Rate Top Up Grant combined is known as the SFA and represents the main funding from central government. The adjusted 2015/16 SFA is £338.466m

This is forecast to reduce from 2015/16 by:

- £46.217m in 2016/17 to £292.294m
- £80.140 m in 2017/18 to £258.326m
- £99.452m in 2018/19 to £239.014m
- £117.719m in 2019/20 to £220.747m

This represents a total reduction in grant support over the 4 years of £343.5m.

2) Reductions in Public Health

The grant is forecast to reduce by:

- £1.6m in 2016/17 to £72.0m
- £3.4m in 2017/18 to £70.2m
- £5.2m in 2018/19 to £68.4m
- £7.0m in 2019/20 to £66.6m

This represents a total reduction in the core Public Health grant support over the 4 years of £17.2m.

3) Adults Social Care – Impact of the National Living Wage

The introduction of the National Living Wage is forecast to have an increase in the cost of social care by:

- £3.3m in 2016/17
- £11.8m in 2017/18
- £19.8m in 2018/19
- £27.4m in 2019/20

This represents a total increase in social care costs over the 4 years of £62.5m.

4) Increased funding for Adults Social Care from the Better Care Fund

- £0.000m in 2016/17
- £3.210m in 2017/18
- £22.656m in 2018/19
- £40.014m in 2019/20

This would represent a total increase in funding over the 4 years to 2019/20 of £65.9m. Note this would only be sufficient to cover just the estimated increase in costs as a result of the National Living Wage (£62.5m).

5) Increase in Council Tax by 2% to fund Adults Social Care

The government has provided councils with responsibility for Adults Social Care with the ability to increase its Council Tax by 2% specifically to fund those services. A 2% increase every year for 4 years has the potential to raise:

- £7.8m in 2016/17
- £15.7m in 2017/18
- £23.8m in 2019/20
- £32.1m in 2019/20

This gives the council the potential to raise a total of £79.6m of additional revenue over 4 years by increasing local taxation. When compared against the reduction in SFA (£343.5m) and other factors within the settlement the resources are lower by £223.7m. Incorporating the Public Health Grant (£17.2m) the net reduction in resources would be £241.0m, even if the council raised council tax every year by 2%.

2016/17 – 2020/21 Budget Strategy and Proposals

As a result the County Council is facing an unprecedented financial challenge. The assumptions made in the MTFs have been reviewed and updated to reflect the latest information available following the financial settlement announced on Thursday 17th December 2015.

The revised forecast funding gap, following the settlement, is now estimated to be £280.8m by 2020/21. This gap will be reduced to £200.5m subject to delivery of the additional savings of £64.8m of savings options approved by Cabinet in November and £15.5m of additional revenue as a result of the proposed 3.99% increase in council tax.

2016/17 and 2017/18 Budget Position

Specific budget options were presented and agreed by Cabinet on November 26th. A number of the proposals will take some lead-in time to deliver and initial estimates of reserve requirements to support the delivery of those savings were identified within the report.

The table below sets out the summary position of budget proposals against the gap identified within the updated MTFs and the overall reserves requirement of £145.5m over the next 2 financial years covering both the revised MTFs funding gap and supporting the savings programme.

	2016/17 £m	2017/18 £m
MTFS Funding Gap	23.3	51.5
Estimated Reserve Requirement	69.7	75.8

The reserves report in Appendix B identifies the total value of existing reserves which could be transferred to a transitional reserve to support the revenue budget as being £107.6m which could increase to £117.2m on the basis that the change in MRP policy is agreed at Full Council in February 2016. This would leave a gap in available reserves against the reserves requirement of £37.9m (£28.3m if the MRP policy is agreed).

The proposed Capital Programme has been based on the agreed principle that prudential borrowing should take place, wherever possible, rather than utilisation of ongoing revenue or reserve funding and therefore support the revenue funding.

The Robustness of the Budget and the Adequacy of Reserves

Section 25 of the Local Government Act 2003 requires that in giving consideration to budget proposals members have regard to the advice of the Council's Chief Finance Officer (in the case of the County Council the Interim Director of Financial Resources) on the robustness of the estimates and the adequacy of the Council's reserves.

Robustness of the Estimates

This section is concerned with the scale of financial risks faced by the Council as a result of the estimates and assumptions which support any budget. The basis of the estimates on which the budget has been prepared, as in previous years, relies on the forecast of activity and the impact of changes in policy previously agreed by the Council. These forecasts are kept under review as part of the budget monitoring process and actions identified to address financial risks arising from changes in the forecast as they occur. A number of specific risks remain within the budget as follows:

- **Government Funding**

The Local Government Settlement on 17th December included the Government offering any council that wishes it to take up a four year funding settlement to provide greater certainty around financial planning. Whilst a longer-term settlement is welcome, it reflects a significantly worsening position with greater reliance on locally raised funding and still the possibility of further reductions in future years should, for example, new responsibilities be given to councils which are not fully funded. Previous reports to Cabinet have clearly identified an impending scenario whereby the County Council will have insufficient resources to meet statutory responsibilities as they are currently provided. It has been recognised previously that the County Council will need to quickly assess and make fundamental changes to the current business model to deliver further savings given the significant funding gap that remains.

There is no guarantee that the changes to the business model, which will need to be necessarily focused on reducing costs, will be sufficient to deliver balanced budgets over the period of this financial strategy and therefore the County Council will need to continuously lobby Central Government and relevant stakeholders regarding the extreme challenges being faced as a result of the local government finance system.

- **Service Demand**

This is a key risk facing the Council in both preparing future budgets and managing budgets during the year. As reported in the budget monitoring reports presented to

Cabinet over the year, demand for both adult and children's social care services continues to see increases despite the impact of demand management measures.

Over the period 2015/16 to 2020/21 £97.4m has been provided for demand pressures of which c70% relates to adult social care and c14% children's social care. This has been identified based on current and historical trends and population projections where appropriate (particularly linked to the ageing population). While this estimate is based on assumptions that have previously been a reasonable prediction of demand there remain a very significant range of risks that might impact on what actually happens.

These include the developing relationship with the NHS including the impact of the Better Care Fund, the interaction between increasingly tightening health and local authority resources as well as other factors such as whether there is a hard winter. While reasonable steps have been taken to estimate future demand and ongoing work is being undertaken with health colleagues it is still possible that demand will exceed budget, although the Council does have a good record of managing demand pressures in previous years. However the flexibility in other parts of the budget which has assisted with this has been very significantly eroded in recent years following the delivery of the savings contained in the previous and current financial strategy.

The pressure resulting from the increasing numbers and complexity of Learning Disability service users, increased demand for direct payments within physical disability services and increased demand for residential care within Mental Health Services continue to be significant issues. This is potentially exacerbated by the Transforming Care (Winterbourne) agenda should there be significant additional costs of moving anyone who is inappropriately in hospital to community-based support.

- Pay

The MTFs makes provision for pay of a 1% increase each year. Most of the pay bill will continue to be driven by the national pay agreement and this assumption will be kept under ongoing review. The County Council is committed to paying its employees as an accredited member of the Living Wage Foundation who have announced a 5% increase in the Living Wage. The impact of this initial increase and further 5% increases in subsequent years for those staff directly impacted has been factored into the MTFs. This does not address maintaining current differentials in pay grades which will need to be considered in future years.

- Inflation

Actual inflation remains relatively low but analysts are anticipating slight increases over coming years. Provision made within the budget is limited to areas where the Council has no choice but to pay increased prices e.g. due to contractual terms. The inflation forecasts used in recent years are based on the future level of inflation implied by yields on interest linked gilts. Historically, this has tended to give a more accurate forecast than the methodology previously used. It is anticipated that the continued use of this methodology will reduce the risk of needing to make catch up additions to the budget for "missed" inflation and the need to absorb additional inflationary costs in year.

A particular issue concerns care markets, primarily residential and homecare, the funding of which is recognised as being a significant issue regionally and nationally. Whilst a significant amount of resource has been included within the MTFs to fund price increases and the estimated impact of the national living wage on care providers, there are significant capacity and sustainability issues within the market which the social care levy will only partly help mitigate given the scale.

The Level of Reserves

The Council holds reserves for a number of reasons:

- To enable the organisation to deal with unexpected events such as flooding or the destruction of a major asset through fire.
- To enable the organisation to manage variations in the demand for services which cause in year budget pressures.
- To fund specific projects or identified demands on the budget.

There is no right answer to the question of the appropriate level of reserves for a local authority; this is a matter of judgement taking into account:

- The level of risk evident within the budget as set out above.
- A judgement on the effectiveness of budgetary control within the organisation.
- The degree to which funds have already been set aside for specific purposes which will reduce the need for general reserves.

Previous reports to Cabinet have clearly identified that the revenue budget will be heavily supported by the reserves that are currently available to the County Council. The value of the Council's reserves is currently significant but are non-recurrent and bar the County Fund are now fully committed over the next 2 years and will not therefore be available in later years to support managing future year budget pressures.

The level of risk evident within the budget is clearly increasing as set out in the analysis above at a time when it is clear that the revenue budget will have to be supported significantly by reserves. The setting up of a transitional reserve to this end is a recognition of this requirement and the effectiveness of budgetary control is a combination of both systems and processes and the risk environment within which the Council is operating. Budgetary control procedures are strong, however based on the evidence of the current year and given the increased level of financial risk there is a greater risk that the processes in place will not be able to bring down a significant overspend over the course of the following years.

In relation to the Council's general reserve (County Fund Balance), the forecast level at 31 March 2016 is £36m.

In overall terms, the Council has an appropriate level of reserves available to manage the overall financial risk it is facing in 2016/17, but not in 2017/18 and therefore it is critical that the zero based budget work identifies and is able to deliver additional savings over the next two years to those already agreed.

Delivery of previously agreed savings plans which now total c£213m (including the current year) following the detailed budget risk assessment and base budget review are critical to ensure the forecast gap does not increase. There are a significant number of factors, both internal and external, which may impact upon delivery and the impact of these will need to be identified and mitigated.

Conclusion

Following the budget risk assessment undertaken early in the year, ongoing detailed budget monitoring, base budget review work and identification of budget proposals and detailed review of the current reserves commitments, a balanced budget for 2016/17 with the use of £69.7m of reserves can be recommended. However, this is clearly dependent on all budget options agreed at Cabinet in November being delivered fully within the timeframes identified, along with the other savings agreed in previous budget cycles. Should any of these budget options ultimately not be taken forward they will need to be replaced with alternative savings to avoid increasing the size of the gap and there also remains £23.256m of savings that will need to be identified relating to the remaining gap in 2016/17 that will need to be delivered by 2017/18. Clearly the reliance on reserves is significant and continuing into 2017/18 and at this point an insufficient value of reserves has been identified to meet the estimated shortfall at this point.

Whilst the principle has been agreed of reviewing each and every continuing service using a zero based approach, with reference to our benchmark unit costs and moving towards the lowest quartile of the most appropriate comparator group, this will need to make early progress during 2016/17 to meet the 2016/17 and 2017/18 shortfalls and consider whether a sustainable financial position will be achievable over a longer period. There is a strong likelihood that the County Council will during the course of this financial strategy period (in 2017/18 at the earliest) be in the position of being unable to set a budget which will meet the cost of the statutory responsibilities.

List of Background Papers

Paper	Date	Contact/Tel
None		
Reason for inclusion in Part II, if appropriate		
N/A		