

Report to the Cabinet

Meeting to be held on Thursday, 18 January 2018

Report of the Interim Chief Executive and Director of Resources

Part I

Electoral Divisions affected:
All

Money Matters – The Financial Strategy for 2018/19 to 2021/22

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

Contact for further information:

Angie Ridgwell, (01772) 536260, Interim Chief Executive and Director of Resources,
angie.ridgwell@lancashire.gov.uk

Executive Summary

This report sets out an overview of the Council's financial position from 2017/18 to 2021/22. It includes an update on the current year's financial position and a revised Medium Term Financial Strategy (MTFS) reflecting the provisional settlement for 2018/19 announced on 19th December 2017 as well as updated financial assumptions based on the latest evidence.

Like all councils, Lancashire County Council is facing significant financial pressures, and while good progress has been made in addressing the forecast financial shortfall over the strategy period, further work is required to ensure the council can achieve a financially sustainable position.

In summary:

- The 2017/18 revenue forecast outturn is £709.064m, an underspend of £15.758m (c2%) on the original budget.
- The MTFS indicates a financial deficit of £144.492m in 2021/22 and a cumulative deficit of £381.796m after allowing for savings of £135m, including £81m of new savings proposals included in reports to Cabinet during 2017/18.
- The Council is forecast to hold a General Reserve against unforeseen issues of £23.627m representing c3% of net budget.
- The Council is forecast to hold £122.801m of uncommitted transitional reserve (including the forecast underspend in the current financial year), which is sufficient to meet the deficit in 2018/19 and could also support the 2019/20 deficit, however in order to set a legal budget in future years further savings will need to be made.

- The in-year agreed capital programme is £171.611m with a forecast spend of £155.271m and therefore a delivery variance of £16.340m.
- A capital programme for the period 2018/19 – 2020/21 of £226.117m, is proposed, reflecting additions to the programme agreed by Cabinet including revenue savings linked to capital. Prudential borrowing totalling £200.428m covering the period 2017/18 to 2020/21 is required to fund the proposed programme.
- Council Tax is assumed to increase by 5.99% in 2018/19, including 3% for adult social care. This maximises the flexibilities set out in the latest provisional settlement without the need for a referendum.

Recommendations

The Cabinet is asked to:

- (i) **Note** the current forecast underspend of £15.758m on the revenue budget in 2017/18 and **agree** the transfer of the final underspend at year end into the transitional reserve.
- (ii) **Note** the revised funding gap of £144.492m covering the period 2018/19 to 2021/22 as set out in the revised financial outlook forecast for the Council.
- (iii) **Approve** the additional budget adjustments for 2018/19, and following years' increases, included in the revised MTFS following the financial settlement.
- (iv) **Approve** for purposes of consultation the budget proposals set out in Appendix C, the outcomes of the consultation to be reported back to Cabinet for consideration in due course.
- (v) **Approve** the budget proposals set out in Appendix D, authorise officers to proceed with their implementation and agree that the 2018/19 budget is based upon these revenue decisions
- (vi) **Agree to make recommendations to Full Council** on 8th February 2018 a Band D Council Tax for 2018/19 reflecting a 5.99% increase including 3% to be used for social care as per the new flexibilities.
- (vii) **Note** the contents of the County Council's Reserves position at 31st December 2017 forecast at 190.285m at the end of 2019/20, and approve the transfers between reserves contained within the report.
- (viii) **Approve** the specific capital programme estimated at £226.117m for 2018/19 – 2020/21 as presented within the body of the report.
- (ix) **Approve** prudential borrowing totalling £200.428m over the period 2017/18 to 2020/21 as identified within the Capital Programme report.

(x) To **note and have regard to** the advice of the Interim Chief Executive and Director of Resources in relation to the robustness of the budget and the adequacy of reserves.

1. Background and Advice

The detailed reports at Appendices A to E present the following:

- County Council's 2017/18 forecast revenue position as at Quarter 3 (Appendix A).
- Revised Medium Term Financial Strategy for the period 2018/19 to 2021/22 as at Quarter 3, including reserves position (Appendix B).
- Additional proposed revenue budget savings (Appendix C and D).
- Update on the Capital Programme as at Quarter 3, and the Capital Programme for future years (Appendix E).

Financial Position as at 31st December 2017 (Appendix A)

A revenue underspend is forecast for the County Council of £15.758m and represents a variance of c2.0% against the overall County Council budget of £724.822m. This is subject to a number of assumptions around the anticipated profile of expenditure for the rest of the year which is difficult to predict in some demand led budget areas. The report identifies those areas where forecast pressures exist and will be subject to ongoing detailed review with a focus on controlling and reducing costs and the delivery of an improved financial position by year-end.

The 2017/18 budget of £724.822m included a savings requirement of c£54m (some of which will be achieved across 2018/19 – 2020/21). A number of savings agreed as part of the 2016/17 budget were to be implemented by 2018/19 and it was agreed that these would be covered by the use of reserves to facilitate the transformation of services.

Delivery of the savings programme has been identified as a key risk area and the savings plans are subject to detailed and regular scrutiny by the Programme Office and Finance.

The level of reserves that were approved to be applied from the transitional reserve in 2017/18 to support the delivery of savings was £24.2m. The amount that is now forecast to be required is £16.5m reflecting early delivery of some agreed savings, noting this is partially offset by some budget savings that are delayed and will require longer reserve funding than expected. (The report provides details as to progress on the achievement and delivery of the savings relating to each Head of Service).

The Medium Term Financial Strategy (MTFS) and Reserves Position (Appendix B)

A revised MTFS was presented to Cabinet in December with a reported funding gap of £157.786m in 2021/22 and a cumulative gap of £442.976m.

This report provides an updated position for the period 2018/19 - 2021/22 and a review of the existing assumptions to reflect the most current information available. As a result of these reviews, increases to the council tax levels (both as a result of a rise in council tax base and a 2% uplift using flexibilities offered in the recent Settlement), increases in the level of capital receipts and the identification of £11.140m of new savings, the funding gap has reduced to £144.492m. This reduced gap is net of new demand and inflationary pressures, particularly in relation to the recently announced increase in pay levels of 2% and further demand pressures within Children's Social Care.

The reserves section of the report shows that the forecast value of the uncommitted Transitional Reserve is currently £122.801m (assuming that the 2017/18 underspend is included as recommended). Whilst it is anticipated that further revenue savings for 2018/19 and beyond will be identified, the impact of utilising the transitional reserve to fund the 2018/19 gap of £48.886m, would leave £73.915m available for use in 2019/20 and beyond based on current forecasts. The value of the current forecast gap for 2019/20 is £69.885m. Table 2 within the report demonstrates that that this reserve is sufficient to support the budget gap in 2018/19 and 2019/20. However, further savings will need to be made and fully implemented by 2020/21 to deliver a sustainable financial position and better protect the Council and its services from economic shocks or other unforeseen events.

Additional Savings 2018/19 – 2020/21 (Appendices 'C' and 'D')

As the County Council continues to have a significant and increasing financial gap over future financial years a detailed review has been completed of service budgets. This resulted in savings of £51.304m being included and agreed as part of the MTFs at Quarter 1, savings of £11.534m agreed at Quarter 2 and a further £7.112m agreed at December Cabinet. The total agreed savings to date is therefore £69.950m, an increase in total savings of £11.140m (over the next 3 years) as set out in Appendices C and D.

The new figures presented within the revised MTFs from 2018/19 onwards are presented on the assumption that these budget proposals are agreed by Cabinet, subject in the case of the budget proposals set out in Appendix C to appropriate consultation, the outcomes to be reported back to Cabinet for a final decision in due course.

It is anticipated that further savings proposals will be presented at future Cabinet meetings, reflecting the funding gap of £144.492m (2021/22) reported in the MTFs, should all savings in this report be agreed and delivered. This continued focus on maximising the Council's ability to secure a sustainable financial position is absolutely essential.

Capital Monitoring and Financing Position as at 31st December 2017 and Capital Programme for 2018/19 to 2020/21 (Appendix E)

This report sets out the capital monitoring forecast for 2017/18 based on the position at December 2017 against the agreed in-year capital programme approved by Cabinet. The in-year agreed programme is £171.611m with a forecast spend of £155.271m and therefore a variance of £16.340m.

The capital programme for the period 2018/19 – 2020/21, reflecting additions to the programme agreed by Cabinet including revenue savings linked to capital, totals £226.117m. The overall size of the Capital Programme for the period 2017/18 to 2020/21 has increased by £134.13m with an associated forecast increase to prudential borrowing of c£94m, the revenue cost of this will be funded through interest charges and the annual minimum revenue provision (MRP) charge, the impacts of both have been reflected in the MTFs position.

2. 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 must have regard to the advice of the Council's Chief Finance Officer (in the case of the County Council the Chief Executive and Director of 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.

The table below demonstrates the scale of just a small variance in the assumptions made in the MTFs, showing the potential impact of both a positive and negative movement of 1% across the main areas within the MTFs and the potential impact of a further 0.25% variation on interest rates:

	Potential Full-Year Impact (£m)
Funding (1%)	+/- 4.768
Pay (1%)	+/- 3.226
Price Inflation (1%)	+/- 5.952
Demand (1%)	+/- 6.323
Interest Rates (0.25%)	+/- 1.250

A number of specific risks remain within the budget as follows:

- **Government Funding**

The Council did not take up the offer in 2016 of a multi-year finance settlement covering Revenue Support Grant, Rural Services Delivery Grant and Transitional Grant. However, there were no changes to the 2018/19 allocations, announced in the Local Government Settlement on 19th December 2017, previously reported to Cabinet. Revenue Support Grant is expected to end in 2019/20 and the impact on the Council

of the Business Rate Retention Scheme and Fair Funding Review from 2020/21 is not yet known. For the purpose of the budget and MTFs a neutral position has been assumed including no Revenue Support Grant from 2019/20 and will be updated when further information is known.

No additional funding was announced for either adult social care or children's services, nor to cover the proposed 2% two year pay offer for local government workers. These additional cost pressures have been included in the strategy.

The settlement has given the Council scope to increase council tax by an additional 1% in both 2018/19 and 2019/20 on the grounds that it keeps pace with inflation, CPI is currently running at 3%. Adult social care precept arrangements also remain unchanged for Councils with adult social care responsibilities able to add up to a 3% increase in council tax up to a maximum of 6% over the period 2017/18 to 2019/20. These flexibilities have now been included in the strategy as part of this report.

- **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 and waste services continue to see increases despite the impact of demand management measures.

Over the period 2018/19 to 2021/22 £85m has been provided in the MTFs for demand pressures of which £55.7m relates to adult social care and £22m children's social care. These have been identified based on current and historical trends and population projections where appropriate (particularly linked to the ageing population in respect of Adult Social Care). Whilst for Adult Social Care the estimates are based on assumptions that have previously been a reasonable prediction of demand, during the current financial year significant and unanticipated increased costs in relation to Children's Social care have occurred and have been reported to Cabinet in revenue monitoring reports.

Detailed work continues to be undertaken focused on a better understanding of the causes of increasing demand and what steps can be taken to mitigate the financial impact, which, along with grant funding reductions, is a major contributing factor towards the funding gap reported in the MTFs.

- **Pay**

The previous MTFs has made provision for a pay award of 1% each year. Most of the pay bill is driven by the national pay agreement and the announcement of the 2% 2 year pay offer represents a significant additional cost pressure reflected in the updated MTFs. The County Council also remains committed to paying its employees as an accredited member of the Living Wage Foundation who have announced a 3.6% increase in the Living Wage. The impact of this initial increase and further 3.6% increases in subsequent years for those staff directly impacted has been factored into the MTFs.

- **Inflation**

The Monetary Policy Committee (MPC) of the Bank of England has been set an inflation target by the Government of 2%. However, in September 2017 the CPI inflation increased to 3% and rose again to 3.1% in November. It is considered that inflation has been pushed above the target by the increase in import prices that resulted from the depreciation of sterling. The MPC has stated that it judges that inflation is likely to be close to its peak, and will decline towards the 2% target in the medium term.

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 or the need to absorb additional inflationary costs in year.

A particularly significant area is the care market, primarily residential, nursing and homecare, the funding of which is recognised as a significant issue regionally and nationally. 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.

- **Interest Rates**

The MPC has also raised the base interest rate for the first time in a decade. At its meeting on 1 November 2017, the MPC voted by a majority of 7-2 to increase the Bank Rate by 0.25 percentage points, to 0.5%. Reasons cited for the increase were concern over inflation and the reduction of slack in the economy.

Despite the increase in the base rate the short term interest rates continue to be at historically low levels. It is not anticipated that the increase in November is the start of a period of large increases. All indications are that any future increase will be at a very gradual pace. Indeed, the County Council's Treasury advisors predict no further changes in the base rate for this financial year due to the uncertainty for the UK economy arising from the Brexit negotiations and the fall in real wages.

- **Savings Programme Delivery**

The Council is committed to the delivery of a significant savings programme (c£135m over the period 2018/19 to 2021/22) including £70m of new savings already agreed by Cabinet during 2017/18 and an additional £11m of proposals for consideration at this meeting. There are inherent risks with saving plans of this scale and scope and any significant under-delivery of agreed savings will further increase the funding gap. This has been identified as one of the highest level risks in the Council's Risk and Opportunity Register and there are comprehensive arrangements in place to track delivery of financial savings and take corrective actions as required.

Adequacy of Reserves

The Council holds reserves for a number of reasons:

- To enable the Council to deal with unexpected events such as flooding or the destruction of a major asset through fire.
- To enable the Council 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.

In relation to the Council's general reserve (County Fund Balance), the forecast level at 31 March 2018 is £23.627m. This is after £10m is transferred to a formal treasury management reserve to reflect that, whilst the Council's Treasury Management performance (covering both investment activity and financing costs) has been positive over an extended period, the outlook post-Brexit is particularly uncertain and volatile. The reserve will therefore help to manage quickly responding to that volatility, including interest rate changes and associated risks, over the short-term without directly impacting the revenue account.

The revenue budget has been heavily supported in recent years by the reserves that have been available to the County Council and their value has therefore reduced significantly. The value of the Council's uncommitted transitional reserve by the end of the financial year is currently forecast to be £122.801m (including the 2017/18 forecast underspend). Assuming all of the savings proposals up for consideration at this meeting are agreed there still remains a gap between available funding and forecast expenditure of £48.886m in 2018/19, which will further reduce reserves.

The level of risk evident within the budget has been significant in recent years and remains so at a time when it is clear that the revenue budget for 2018/19 will also need to be supported significantly by reserves. The Council acknowledges that it needs to move to a sustainable financial position and also that this will take time to implement. The transitional reserve allows decisions to be made in a more measured and considered way but does not of itself negate the need for a sustainable budget to be achieved. While the Council's budgetary control procedures are strong in terms of managing in year expenditure, the effectiveness of budgetary control is a combination of systems and processes as well as the risk environment within which the Council is operating. It therefore remains an essential requirement that the Council continue to ensure that processes are effective in maintaining a grip on in year expenditure and also that there is a clear focus on delivering a balanced and sustainable budget.

Overall, the Council has an appropriate level of reserves available to manage the financial risks it is facing in 2018/19, but this is highly unlikely to be the case in future years. It is critical that a significant level of additional savings are identified to be

delivered and fully implemented by 2020/21 to bring the Council to a financially sustainable position. Any utilisation of remaining reserves should support, wherever possible, activities which reduce ongoing revenue costs. One of the priority areas for new savings will be in seeking to implement the aim within the current financial strategy of seeking to move to lower quartile cost, of the most appropriate comparator group of local authorities, for all services.

Conclusion

Following the ongoing detailed budget monitoring, identification of £81m of further budget proposals and a detailed review of the current reserves commitments, a balanced budget for 2018/19 with the use of £48.886m of reserves can be recommended. However, this is clearly dependent on all the budget options being agreed and 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 financial gap.

While it is possible to confirm the robustness of budgets using £48.886m of reserves for 2018/19, the position for 2019/20 is critical to addressing the issue of financial sustainability as there remains a funding gap of £69.885m. Urgent work is required to identify proposals for additional savings early in 2018/19 that can be delivered in 2019/20 and for the remaining MTFS period.

Consultations

Cabinet is recommended to approve the budget proposals set out in Appendix C for the purposes of appropriate consultation with individuals and parties potentially affected as set out in the budget option templates. The outcomes of the consultation will be reported back to Cabinet in due course and will be incorporated in Equality Analysis reports as necessary for Cabinet to consider.

Implications

This item has the following implications, as indicated:

Equality and Cohesion

Cabinet must ensure that they comply with the requirements of the Public Sector Equality Duty as set out in s.149 of the Equality Act 2010.

The budget proposals are set out in Appendices 'C' and 'D'. A number of them may have a negative impact on persons with protected characteristics and initial Equality Analysis reports are included where required. The proposals included in Appendix 'C' have been identified as requiring specific consultations and the outcomes of these will be reported back to Cabinet in due course for final consideration.

Risk management and Financial Implications

The County Council's overall approach to managing financial risks continues to be to identify and acknowledge risks early and build their impact into financial plans while continuing to develop strategies which will minimise their impact. This approach operates in parallel with the identification and setting aside of sufficient resources to manage the financial impact of the change risks facing the organisation.

The financial risks that could affect the position outlined in the report primarily cover the following:

- *Level of Future Resources from Central Government*
Risks remain in relation to the level of resources the Council receives from the government in terms of Revenue Support Grant and the impact of the statement by the Chancellor of the Exchequer regarding the retention of 100% business rates and the ending of RSG by the end of this Parliament. At this point in time there is insufficient detailed information regarding the changes to amend the funding assumptions within the MTFS.
- *Demand*
There is continued pressure on the Council's budget, particularly around Adults and Children's social care, and the most up to date demand forecasts have been included. However any increase in demand above the current forecast will add additional pressure to future years.
- *Inflation*
A significant level of additional resource has been included in the MTFS, primarily on contractual price increases and particularly on social care where there are nationally recognised funding issues in the residential and domiciliary care markets. In addition, the MTFS includes estimates of the cost of increases that would enable independent sector providers to meet the additional costs of meeting new national living wage levels for their employees.
- *Delivery*
The MTFS assumes that c£54m of existing agreed savings (aside from those agreed as part of 2017/18 reports to Cabinet) will be delivered in the period 2017/18 to 2020/21 to ensure the current 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 on new and existing budget proposals being taken forward will need to be clearly identified and minimised.

The financial implications of Cabinet agreeing to the budget proposals are set out in the report and the individual budget option templates.

Legal Implications

The immediate legal implications of the budget proposals to be considered by Cabinet are set out in the budget option templates and Equality Analysis reports at Appendices C and D

List of Background Papers

Paper	Date	Contact/Tel
Money Matters – Updated Medium Term Financial Strategy (2018/19 – 2021/22)	7 December 2017	Neil Kissock/(01772) 536154
Money Matters 2017/18 Position and Medium Term Financial Strategy	9 November 2017	Neil Kissock/(01772) 536154

Reason for inclusion in Part II, if appropriate

N/A