SURREY COUNTY COUNCIL

CABINET

DATE: **24 November 2015**

REPORT OF: **MR DAVID HODGE, LEADER OF THE COUNCIL**

LEAD OFFICER: **SHEILA LITTLE, DIRECTOR OF FINANCE**

SUBJECT: **Financial Prospects for the Medium Term Financial Plan (MTFP 2016-21)**

SUMMARY OF ISSUE

Significant work has taken place to up-date the financial prospects for the council for the next Medium Term Financial Plan (MTFP 2016-21), since Cabinet considered the refresh of the Medium Term Financial Plan (MTFP 2015-20) on 29 July 2015. This report updates Members on the latest financial prospects for this period ahead of development of the formal budget for 2016/17 in February 2016.

RECOMMENDATIONS

1. Notes that the Chancellor of the Exchequer will publish his Spending Review on 25 November 2015 and that financial planning assumptions may alter subsequently, meaning development of a formal draft budget is not sensible at this stage [Paragraph 7];
2. Notes the strategic financial challenge that the council faces, specifically:
    - the significant, growing and non-controllable demand for services delivered by county councils (in particular adult and children's social care) [Paragraph 9];
    - that the failure to fund, and therefore protect these services, will lead to very significant cost consequences on the health sector finance pressures [Paragraph 10];
    - that while county councils in two-tier areas have the responsibility for delivering high demographic non-controllable demand services, they do not have the full range of options that are available to unitary local authorities to raise funding through other services (e.g. parking charges) [Paragraph 11];
    - that county councils are further disadvantaged by the Government's apportionment ratios for allocating funds within the local government sector [Paragraph 12];
    - that county councils have to, therefore, put greater reliance on Council Tax to fund services [Paragraph 12];
    - that Surrey County Council has one of the lowest government funding per head of all upper tier local authorities [Paragraph 16];

3. Notes the effectiveness of the strategic actions the council has taken over recent years to manage the financial challenge, in particular:
    - that the loss of Government grants since 2010/11 (£93m) is greater than the increase in Council Tax (£80m) over the same period [Paragraph 17];
    - the successful delivery of £329m of efficiencies since 2010/11 (forecast to rise to £396m by the end of 2015/16) through continual improvement in processes and significant transformational change [Paragraph 19];
    - that the level of efficiencies gained since 2010 effectively off-sets the increased service pressures over the same period (efficiencies total £396m and pressures total £382m between 2010/11 and 2015/16) [Paragraph 20];
    - the improved efficiency across many key services, resulting in reduced unit costs [Paragraph 20];
4. Notes the consequences of the strategic actions taken:
    - that the current level of efficiencies is not sustainable and that, without additional funding, services will have to be cut [Paragraph 21];
    - that the combination of high level demand pressures and Government grant loss has led the council to, reluctantly, adopt the strategy of increasing Council Tax at just below referendum levels for the last four years in order to sustain services to residents of Surrey [Paragraph 23];
5. Notes the council's overall preliminary financial position, in particular:
    - the high level of forecast revenue savings (£28.5m) still to be identified in order to set a balanced and sustainable budget for 2016/17 [Paragraph 31];
    - that the capital programme exceeds that which is affordable in view of the revenue costs of the additional long term borrowing requirement [Paragraph 36];
    - the work that senior officers are progressing to identify further savings to enable a total package of savings can be brought forward for consideration by Scrutiny Boards [Paragraph 32];
6. Notes that, at this point, the council is not clear how it will meet its duty to set a balanced budget and maintain an adequate level of reserves [Paragraph 44];

REASON FOR RECOMMENDATIONS:

In setting the MTFP (2015-20) in February 2015, the council recommended this was reviewed and refreshed in July 2015. Following the refresh, the Cabinet requested a report be submitted to its November 2015 meeting which provided an update on financial prospects for the Council for the next MTFP (2016-21). This will ensure early transparency ahead of the Cabinet meeting on 2 February 2016 that will formally recommend the budget for 2016/17 to full County Council on 9 February 2016, and enable the Cabinet to:

- give full consideration of strategic financial challenge faced by the council and the potential consequences, and;

- consider the views of Scrutiny Boards in relation to the budget changes required to deliver the savings the county council will need to make over the period 2016-21.

Cabinet advises the full County Council how best to meet the challenges the council faces and these proposals will aim to ensure the council continues to maintain its financial resilience and protect its long term financial position.

DETAILS

Introduction

1. This report provides an update to Cabinet on the strategic challenges facing the council in developing its MTFP (2016-21), including the revenue budget and the Capital Programme.

2. The current five-year MTFP (2015-20) was approved by full County Council on 10 February 2015. This included an annual total revenue budget of approximately £1.7bn, and a capital programme of £696m. Since the MTFP was approved, a General Election has taken place and on the 7 May 2015 a new majority Conservative Government was formed. Following the election, Cabinet considered a refresh of the MTFP (2015-20) on the 29 July 2015. The refresh report identified that the council would have to address a shortfall in funding in 2016/17.

3. In light of the significant financial challenge facing the council, Cabinet requested an update on the budget position for the next MTFP (2016- 21) at its 24 November 2015 meeting setting out the financial prospects for the budget for 2016/17 and beyond.

Economic and Public Expenditure Background

4. On 25 November 2015, the Chancellor of the Exchequer is due to announce the 2015 Autumn Statement and publish the 2015 Spending Review. This is expected to set out, at a high level, how the Government intends to eliminate the budget deficit over the period to 2019. In addition, the Chancellor has also announced a review of business rates and its full retention by local government later in this Parliament. This is likely to involve phasing out the Revenue Support Grant and possibly other grants also, and may involve transferring additional responsibilities to local government to be funded from the business rate retention.

5. The November announcements are expected to give an indication of the Government's policy direction and the national quantum of funding available. However, the council will not know with any certainty how much funding it will receive for 2016/17 until the Provisional Local Government Finance Settlement is announced, likely around mid or late December 2015.

6. Further, it is known that Central Government departments have been preparing budgets involving between 25-40% cuts in the last few months and recent media news indicates that some departments have agreed reductions of 30%; including the Department for Local Government and Communities (DCLG), and Department for Transport. Together with other departments who provide funding for council services, such as social care, that the Government have indicated are not protected from expenditure cuts in the

Spending Review, significant reduction in Government support can be anticipated. At the same time, the council faces significant increases in demand for both these services.

7. With the scale of the emerging challenges facing the council and the significant changes to how local government will be funded expected, budget and financial planning work will focus on 2016/17 and include indicative figures for a further four years. Given these uncertainties, a meanful draft budget would not be possible at this time.

Pressures, Funding, and Savings (2016-21)

Strategic challenges facing the County Council

8. Since the Spending Review in 2010, the council has faced unprecedented increases in the demand for key services as a result of non-controllable demographic demand. This has been at the same time as significant reduction in funding from Government grants.

9. While funding has reduced since 2010, county councils in two-tier areas, such as Surrey, are facing significant and growing demographic demand for services, particularly, although not exclusively, adult social care. In Surrey, a growing population as a result of our highest ever birth rate and people living longer is driving demand for services at both ends of the age spectrum – something neither the council nor Government can control. By 2020 there will be 20,000 more older people in Surrey, with older people making up a fifth of our population. Every year in the recent past and looking ahead, this demographic demand for adult social care amounts to an additional pressure to spend £20 million – or the equivalent of uplift in Council Tax by 3.5%. Taking 2010/11 as the baseline, the council's spending pressures increased by £382m over the five years to 2015/16. This is forecast to continue in 2016/17 with the increase in next year's budget reflecting the need to:

   - care for a 4% increase in numbers of vulnerable adults as Surrey's population ages;
   - provide 3,200 school places for Surrey's growing number of children; and
   - maintain and repair Surrey's highways network, one of the most heavily used in the UK.

10. High cost services, such as adult and children's social care that county councils provide have an impact on other public services, especially health. For example, the provision of social care can prevent or delay the health emergencies that lead to increased hospital admissions. Therefore, the failure to fully fund the growth in demand pressures, particularly in social care, will lead to increased costs faced by other public services, particularly health.

11. Further, while county councils in two-tier areas have responsibility for delivering high demand services such as adults and children's social care, they do not have the full range of options that are available to unitary local authorities to raise funding through other services (e.g. parking charges). This makes it more challenging for county councils in two-tier authority areas to manage demand pressures through funding generated from other services.

12. County councils are also disadvantaged by the Government's apportionment ratios for allocating funding streams within the local government sector. This mismatch does not incentivise the infrastructure investment needed to support housing and local economic

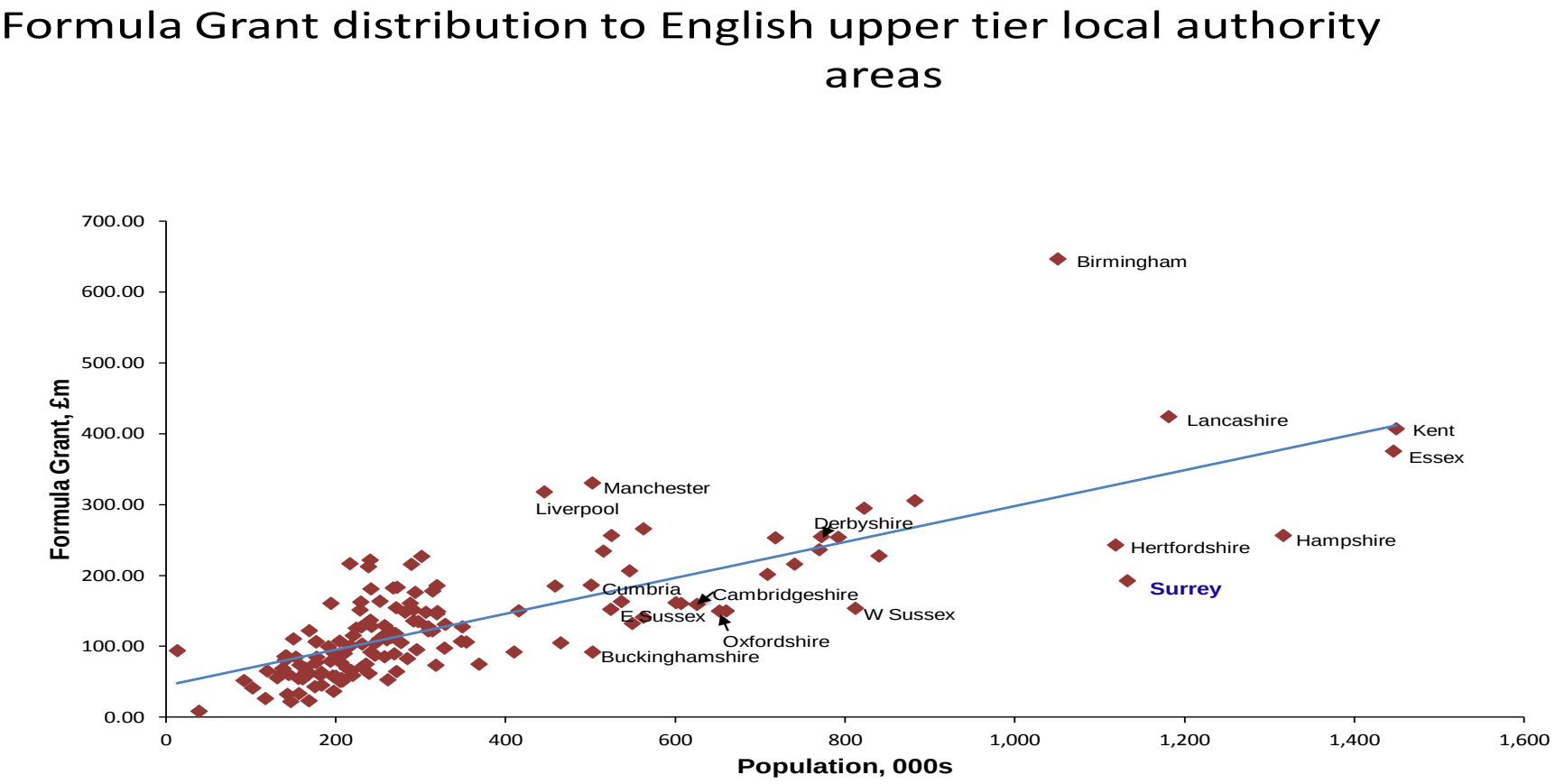
growth (e.g. in highways and school places for which the County has responsibility). Nor does it recognise where demand pressures and responsibilities are greater.

13. The consequence of this is that county councils generally have to put greater reliance on Council Tax to fund services. However, the reduction in Government grants since 2010 exceeds the additional funding raised through Council Tax over the same period meaning that additional Council Tax funding has simply been replacing Government funding, rather than meeting the cost of growing demand for services. This has increased even further the council's already high gearing towards a reliance on Council Tax to fund services. Specifically, over 60% of Surrey County Council's net funding is from Council Tax.

14. The Government have recently announced a review of the Business Rate Retention Scheme. The stated intention is to achieve 100% local authority retention of business rates by the end of this Parliament. However, the details of how this will operate are yet to be developed.

15. Figure 1 below shows the distribution of central grant per head of population for upper tier authorities. The line on the chart indicates that funding reflects the average funding per head, meaning any authority below the line receives less funding. The authority furthest below the line receives the lowest amount of central grant per head of population. Those furthest above the line receive the highest amount of central grant per head of population. Figure 1 uses 2013 data, although the relative amounts have not changed significantly since then and clearly illustrates that Surrey receives the lowest Formula Grant support per head of any county area and the third lowest of all English upper tier areas. As a consequence, Surrey has been disproportionately dependent upon Council Tax funding compared to many councils.

Figure 1: Formula Grant Distribution to Upper Tier Local Authorities (2013)



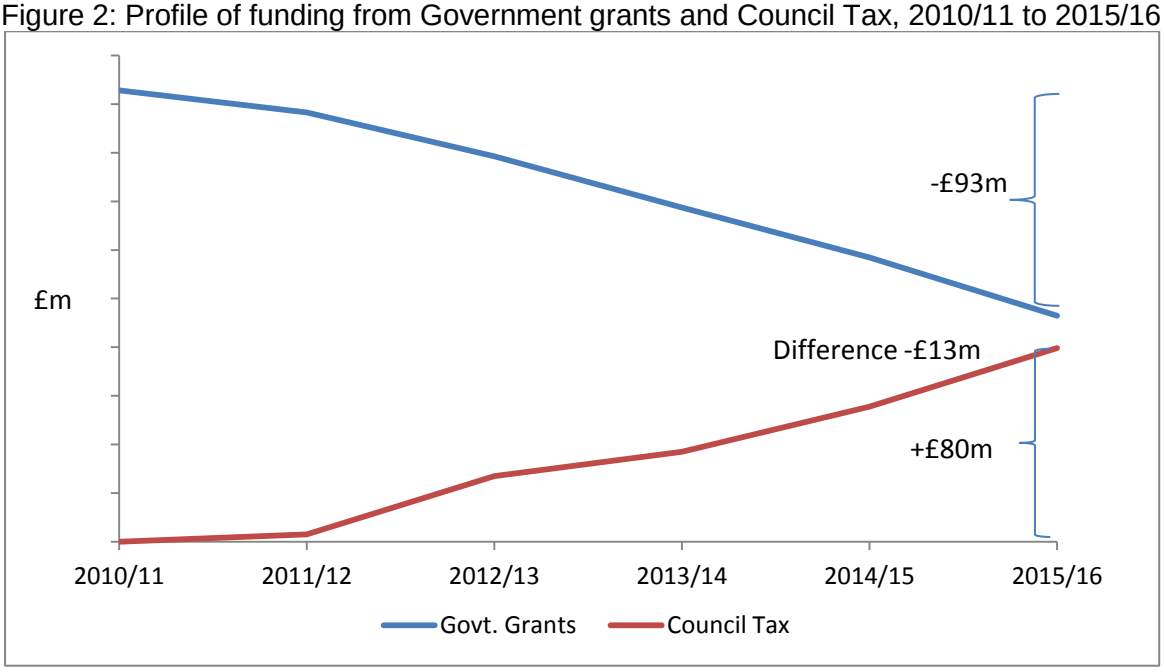
Surrey residents receive the lowest Formula Grant support per head of any county area and the third lowest of all English upper tier areas.

16. Amongst upper tier authorities (county, metropolitan and unitary councils), Surrey County Council receives one of the lowest settlements in central grant when the population of the County is taken into account. That is to say, Surrey County Council is the lowest funded per head of population. The effect of this grant to Council Tax funding gearing ratio means that the council faces much greater pressure on its Council Tax than other upper tier authorities.

Surrey County Council's strategic actions to manage the financial challenges and the consequences

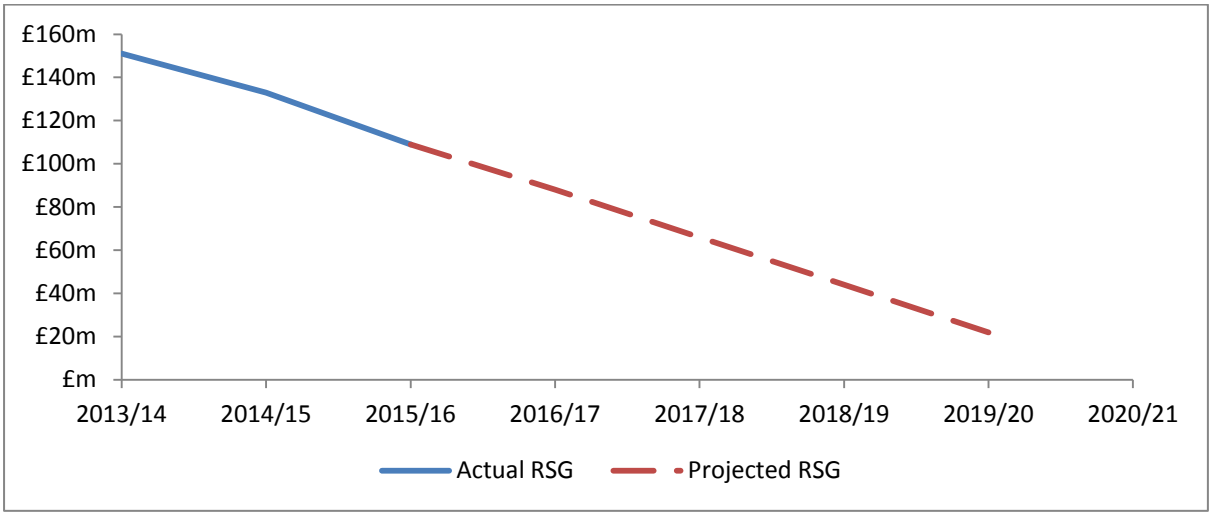
17. Taking 2010/11 as the baseline, the reduction in government grants to 2015/16 totals £93m. Over the same period, Surrey County Council has, reluctantly, adopted a Council Tax strategy that has led to a Council Tax uplift of just under the referendum level. This has been to sustain key services for the residents of Surrey. Figure 2 shows how the profile of funding from government grants and Council Tax has changed over the last five years: i.e. that by 2015/16 £80m more funding comes from Council Tax and £93m less from government grant than did in 2010/11.

Figure 2: Profile of funding from Government grants and Council Tax, 2010/11 to 2015/16



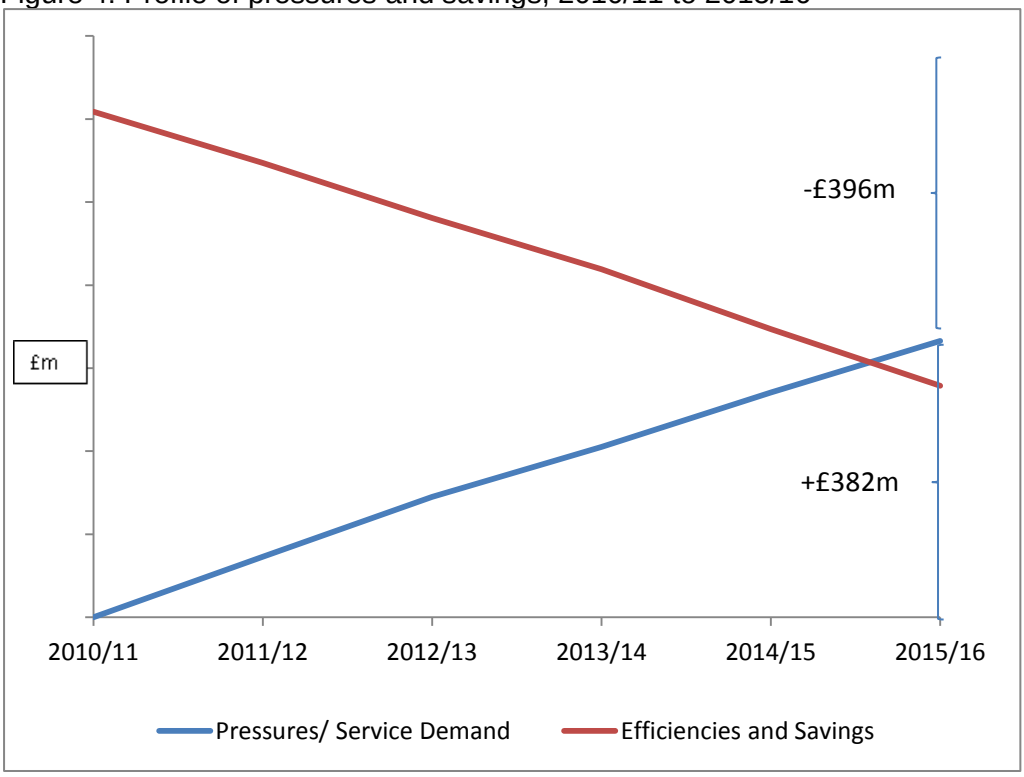
18. Based on the information which has been announced to the media by the Government about its plans for spending and grant funding over the next four years and the 2015 Budget Statement, it is clear that funding will continue to reduce significantly. Figure 3 illustrates the projected future position facing the council in terms of the reduction in central government grant outlined in the March 2015 Budget Statement. This grant is projected to be very small by the end of the MTFP (2016-21) period.

Figure 3: Projected Revenue Support Grant 2015 to 2020



19. Over the five year period that these demand pressures have increased, the council has mitigated these demand pressures through a programme of efficiencies and savings that has reduced the unit cost of many services. Since 2010, the council has reduced its annual value of expenditure by £329m, with an additional £67m planned for 2015/16 bringing the total to £396m. This is an average of £66m every year (or £180,000 every day). Figure 4 below shows that despite an intensive programme of efficiencies and continual improvement initiatives to reduce unit costs, the council has only marginally exceeded the increases in demand across the same period.

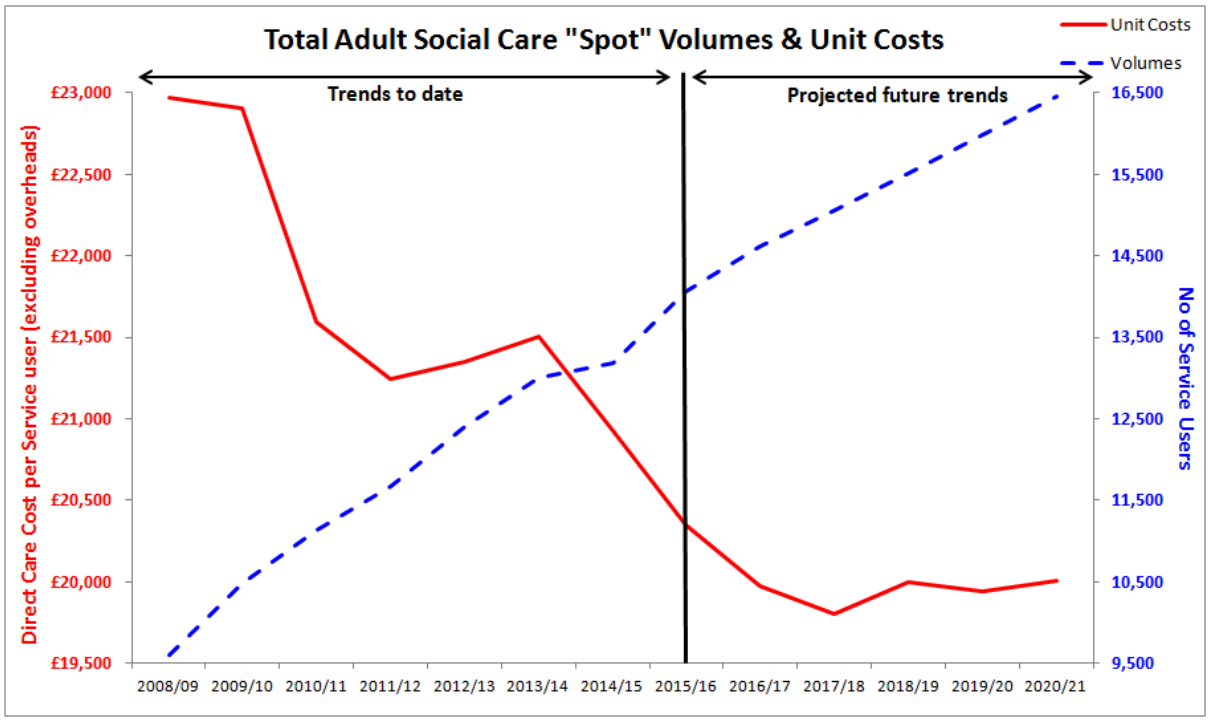
Figure 4: Profile of pressures and savings, 2010/11 to 2015/16



20. To achieve these savings the council has focused on reducing unit costs. An example, shown in Figure 5 below demonstrates that while the council has reduced the unit costs of delivering adult social care up to 2015/16, the gains have been offset by the increase in volumes as a result of demographic changes of an ageing population.

21. Continuing this rate of unit cost reduction is unlikely to be possible, while demand pressures are forecast to continue upwards.

Figure 5: Adult Social Care Unit Costs and Client Volumes (2008/09 to 2020/21)



22. In summary, over the last five years, the council has just managed to meet the service and demographic pressures it has faced (£382m) through delivering an extensive efficiency programme (£396m). Over the same period the council has lost £93m of government grant and has had to adopt a strategy of increasing Council Tax (total £80m) to prepare a balanced budget and sustain services to the residents of Surrey.

23. The outlook for the next few years, where demographic demands are expected to continue to rise and government grants are expected to continue to reduce, is challenging. The council will not be able to sustain the same level of efficiencies in future. Also, the future spending pressures can only continue to be met if some services are cut or if the council is able to increase its Council Tax to sustain funding these services for vulnerable residents.

24. In figure 6 below the scale of the key spending challenges for non-controllable demographic demand in terms of Council Tax equivalent uplift is illustrated. There are also some cost pressures which arise from new measures being introduced in 2016/17 by the Government. A significant example of this is the additional costs anticipated from the introduction of the Unified State Pension which affects the council as the National Insurance increase.

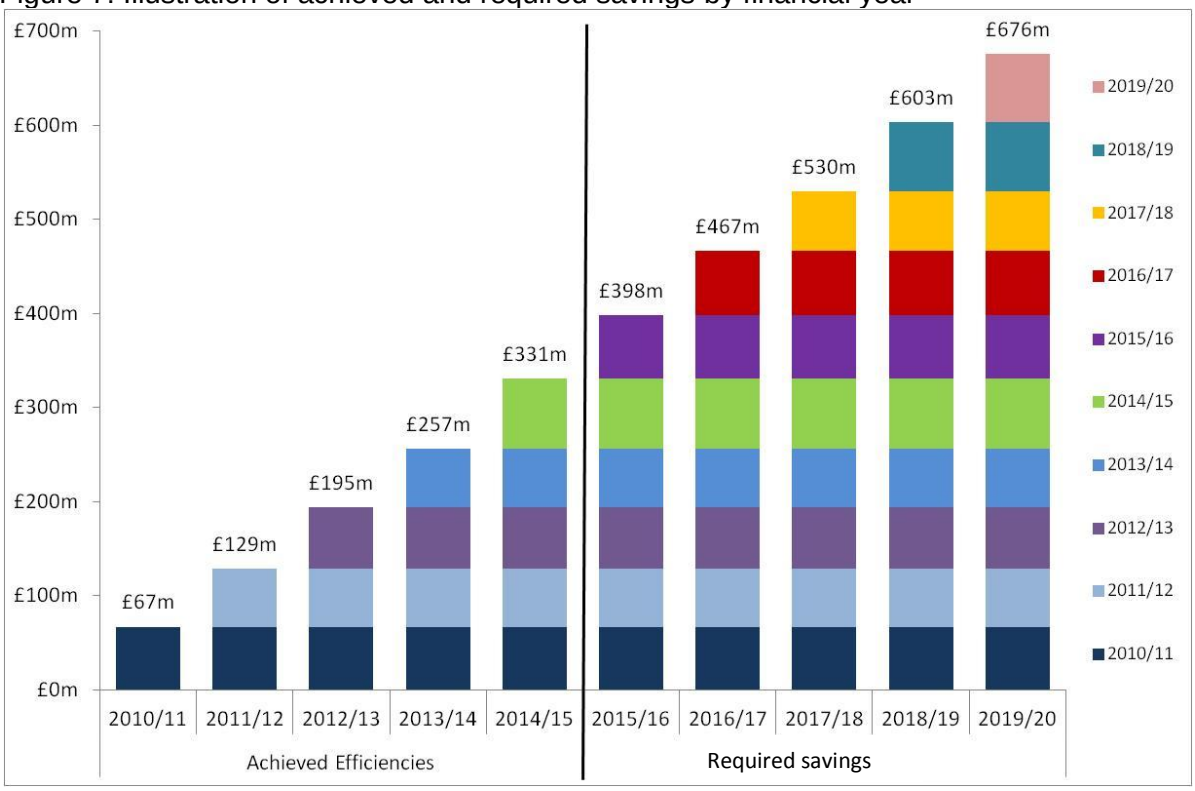
25. A 1% uplift in the Council Tax level yields an additional £6m of funding for the council.

Figure 6: Illustrations of Council Tax equivalents for key demographic demand and other uncontrollable pressures

	Budget Pressure 2016/17 £m	Council Tax Equivalent %
Key demographic demands		
Adult Spot care	20.0	3.5%
Children's services	7.5	1.5%
School Places borrowing (net cost)	2.5	0.5%
	30.0	5.0%
Examples of other non-controllable pressures:		
National Insurance Contributions	6.0	1.0%
Adult Social Care Inflation	6.0	1.0%

26. In summary, despite a five year intensive efficiency programme and continual improvement initiatives to reduce unit costs, the council requires further savings to meet the cost of rising demand for its services. Figure 7 shows efficiencies delivered since 2010/11 and future savings requirements.

Figure 7: Illustration of achieved and required savings by financial year

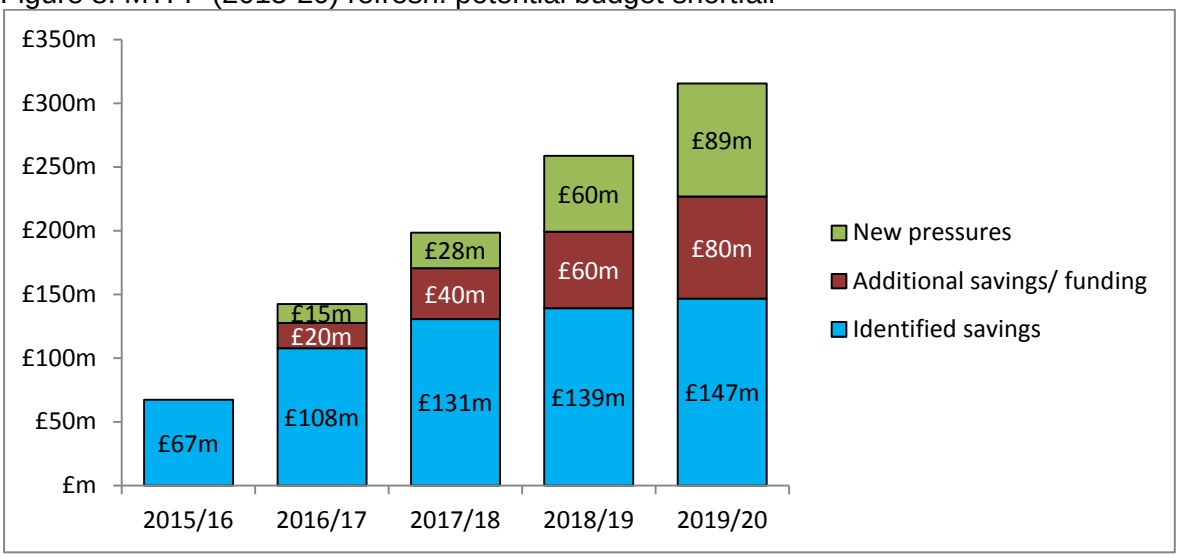


Preliminary financial position for the MTFP (2016 to 2021)

27. Cabinet received a report on 29 July 2015 on MTFP (2015-20) which refreshed the current plan and provided a forecast of expenditure and funding for 2016/17 forward to 2019/20. This was based on the latest information on service spending against 2015/16 budgets which included any budget pressures which had been identified and provided the latest forecast of resources including central funding, specific grants and other income such as fees and charges etc.

28. In July 2015 the refreshed MTFP (2015-20) identified a potential revenue budget shortfall of £35m in 2016/17 arising from new budget pressures of £15m plus a £20m shortfall in resources. Figure 8 below shows how, back in July, the potential revenue budget shortfall was expected to grow over the four years from 2016/17 to 2019/20 to £169m.

Figure 8: MTFP (2015-20) refresh: potential budget shortfall



29. Since 29 July 2015 significant work has been done to update the financial prospects for the council, including Cabinet and senior officers reviewing funding assumptions; the scale of demographic pressures and the efficiency programme. All Members have been kept up to date on progress through regular briefings by the Chief Executive and the Director of Finance.

30. The measures being undertaken to determine a balanced and sustainable medium term budget are based on the current year's budget being delivered within resources and the savings targets for future years being achieved. In addition, new models of delivery for services are being assessed and compared with other similar authorities, while at the same time the council continues to make the case to Central Government on the need for greater resources to meet the rising demographic demand.

31. The current financial position is shown below in figure 9. This takes into account the reductions in government funding, restrictions on Council Tax uplift, the rising demand and the measures undertaken to make further savings.

Figure 9: Draft forecast MTFP 2016/21

MTFP 2016-21	2016/17 £m	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m
MTFP forecast income	-1,658.2	-1,654.4	-1,650.3	-1,647.3	-1,648.7
MTFP forecast expenditure	1,686.7	1,694.7	1,715.4	1,712.2	1,716.2
MTFP 2016-21 shortfall	**28.5**	**40.3**	**65.1**	**64.9**	**67.5**

32. Officers are preparing further savings action plans to develop a balanced and sustainable budget. The complete package of savings will be brought forward in the New Year together with detailed service budgets for submission to Cabinet for approval on 2 February 2016. The budgets will link to services' strategic plans approved by Cabinet. The budget timetable shown in paragraph 57 provides a summary of the key steps in the budget process.

Capital Programme

33. Capital investment in school places has increased from £54m to £75m per year. The current plans are to invest an additional £285m to create 13,000 school places, of which borrowing could be £180m depending on the level of government support through grant funding. The revenue cost of borrowing for this essential capital investment in the 2016/17 budget is £2.5m, which equates to just under 0.5% of Council Tax. The revenue cost of this borrowing on future years' revenue budgets could be up to £7m per year by 2021, which equates to just over 1.0% of projected Council Tax.

34. The council will review demand for school places beyond 2017/18 annually and reflect it in the capital programme. Along with other local authorities, the council is seeking further support from Central Government to meet the increased demand for school places. A key element of this is working with the Government and other interested parties in the creation of free schools that will help to provide the places for the rising number of school aged children.

35. The road network in Surrey has some of the highest traffic volume usage in the country caused by its proximity to London and the need for many travellers to pass through the county. Government allocates capital funding on the basis of road length rather than use or traffic volume. Therefore, this critical factor does not attract Government capital funding.

36. The current capital programme totals £744m over the next five years. The revenue costs of financing the borrowing necessary to fund this programme will be £18.5m by 2019/20. This is the equivalent of 3% of Council Tax, the cost of which is included in the funding shortfall figure contained in Figure 9 above and exceeds that which is currently affordable.

37. An updated Capital Programme (2016-21) with proposals for reductions will be brought forward to Cabinet following the review in the New Year.

Budget Risks and Uncertainties

38. There are significant risks and uncertainties in developing the MTFP 2016-21. These include:

- the details of the Spending Review 2015 and the Local Government Financial Settlement 2015;
- the on-going effectiveness of the efficiencies and savings programme;
- the on-going uncontrollable growth in demographic demands on key services;
- the impact of 100% business rates retention.

Reserves and Balances

39. The uncertainties and risks associated with the next MTFP will require the council to hold adequate reserves and balances to ensure financial stability and sustainability. If the council does not maintain adequate reserves and balances it may expose it to risks of unexpected events and shocks leading to the necessity of identifying budget cuts to services in year to restore council finances.

40. In recent years it has been considered prudent to maintain the council's minimum level of available general balances between 2.0% to 2.5% of the sum of Council Tax plus settlement funding, i.e. £16m to £20m. This is normally sufficient to cover unforeseen circumstances and the risk of higher than expected inflation.

41. An updated forecast of the anticipated level of reserves and balances as at 31 March 2016 will be reported in the budget report to Cabinet on 2 February 2016.

Budget Scrutiny and Consultation

42. A complete package of budget proposals will be brought forward to Cabinet in the New Year which will enable a balanced and sustainable budget to be set for 2016/17. Cabinet will request that Scrutiny Boards scrutinise the proposals from the beginning of December 2015 and provide their comments for Cabinet and Council to consider prior to approval.

43. The Leader, Deputy Leader, Chief Executive and Director of Finance will be meeting during January with key partners and stakeholder groups, including representatives of Surrey's business community, voluntary sector, community groups, faith groups and trade unions. The feedback from these meetings will be incorporated in feedback to Cabinet and Scrutiny Boards in the New Year.

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

44. As a local authority and the steward of public money, the council is required to ensure that the 2016/17 budget is balanced and sustainable in the medium term. As this report shows, further work and decisions are required for this position to be reached.

45. The council must also maintain adequate reserves and balances to ensure that it can meet the financial consequences of unanticipated events and known liabilities.

SECTION 151 OFFICER COMMENTARY

46. This report is a preliminary report setting out the strategic and major financial issues facing the council.

47. As required by the Local Government Act 2003, Section 25, the Director of Finance will provide a separate report in the report to Cabinet on the 2 February 2016 when the Council recommends it budget and Council Tax precept to Council. The report will consider the robustness of the estimates for the budget calculations for 2016/17 and the adequacy of the financial reserves.

LEGAL IMPLICATIONS – MONITORING OFFICER

48. The review of the financial prospects is a part of the development of the MTFP 2016 – 2021 which, in turn, will be incorporated into the final budget setting report which Cabinet will consider on 2 February 2016 in order that Cabinet can recommend the level of Council Tax for 2016/17, the MTFP (2016-21) and Capital Programme (2016-21) to Full County Council for approval on 9 February 2016.

49. The Council has a duty under the Local Government Finance Act 1992, as amended by the Localism Act 2011 to calculate its Council Tax requirement for the following financial year. The Act also permits the Secretary of State to define what level of Council Tax is deemed excessive and requires a local referendum to be held by the Council in the local area if the proposed increase would be excessive. Each year the Secretary of State has to seek approval of the House of Commons to apply the measure for the level of Council Tax in the following year.

EQUALITIES AND DIVERSITY

50. In approving the budget and the Council Tax precept, the Cabinet and Full County Council must comply with the Public Sector Equality Duty in section 149 of the Equality Act 2010 which requires it to have due regard to the need to:

    - “eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Act;
    - advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it; and
    - foster good relations between persons who share a relevant protected characteristic and persons who do not share it.”

51. To inform decision making, an analysis of the potential impact of the proposals set out in the MTFP (2016-21) on Surrey’s residents with one or more of the protected characteristics identified by the Equality Act 2010 will be made available at the meeting of the council’s Cabinet on 23 March 2016. This analysis will also set out the actions that the council is taking, or will undertake, to mitigate any negative impacts that could arise.

52. The equality impact analysis undertaken for the proposed MTFP (2016-21) will build on the analysis of savings in the MTFP (2015-20). It will include full assessments of new

savings proposals and further analysis of proposals where there is a significant change from those presented previously.

53. The analysis will include an overall council wide analysis and a summary of the implications of the proposals for each service. Detailed analysis, undertaken through Equality Impact Assessments, will be made available on the council's website.

54. Where Cabinet is required to take specific decisions about the implementation of savings proposals, additional equalities analysis will be presented at the point where a decision is made. This will be submitted alongside relevant Cabinet reports. Services will continue to monitor the impact of these changes and will take appropriate action to mitigate additional negative impacts that may emerge as part of this ongoing analysis.

WHAT HAPPENS NEXT

55. The following are the key dates in the budget process:

Chancellor announces Autumn Statement	25 November 2015
2015 Spending Review published	25 November 2015
Provisional Local Government Finance Settlement	Mid December 2015
Notification of specific grants	Dec 2015 - Jan 2016
Final Council Tax base information received from districts and boroughs	31 January 2016
Scrutiny of Budget Proposals	From early Dec 2015
Resident Experience Board	
Education Skills Board	
Social Care Services Board	
Economic Prosperity, Environment & Highway Board	
Health & Wellbeing Board	
Council Overview Board	
Final Local Government Finance Settlement	End January 2016
Cabinet considers final budget proposals	2 February 2016
Full Council approves 2016/17 Budget and Capital Programme	9 February 2016

Contact Officer

56. Sheila Little, Director of Finance.
    Tel 020 8541 9223

Consulted

57. Cabinet, Scrutiny Boards, all County Council Members, Chief Executive, Strategic Directors,

Sources and background papers:

- Budget working papers
- Spending Review 2013 (26 June 2013)
