Leicestershire County Council

CABINET – 20 NOVEMBER 2020

FINANCIAL RESILIENCE

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

PART A

Purpose of the Report

1. The purpose of this report is to present an overview of the County Council's current level of financial resilience, considering the significant increase in financial pressure created by Covid-19.

2. The latest position on the County Council's earmarked funds is set out in Appendix A to this report.

3. An extract of the CIPFA Financial Resilience index, for the measures relating to the County Council is included in Appendix B.

Recommendations

4. It is recommended that the Cabinet notes the update on the County Council's financial resilience.

Reasons for Recommendation

5. To support the Cabinet in making arrangements for the proper administration of the financial affairs of the County Council. This report is presented to provide an overview of the County Council's financial resilience.

Timetable for Decisions (including Scrutiny)

6. The Scrutiny Commission received a report on 4 November and its comments will be reported to the Cabinet. [Now attached as Appendix C].

Policy Framework and Previous Decisions

7. The Medium Term Financial Strategy (MTFS) for 2020/21 to 2023/24 was approved by the County Council on 19th February 2020. The Strategy incorporates a commentary on the adequacy of earmarked funds and robustness of budget estimates, including mitigating actions.

8. The Earmarked Funds Policy and Treasury Management Strategy Statement and Annual Investment Strategy gained approval as part of the MTFS. The Earmarked Funds Policy has been revised to reflect the acute financial constraints resulting from the Covid-19 pandemic and the need to place greater control on earmarked reserves to rationalise and help to ensure the General Fund balance can be maintained at an appropriate level. The revised policy will be presented to the County Council in February 2021 as part of the updated MTFS 2021-25.

9. The MTFS will be reviewed and updated over the next few months. The 'Medium Term Financial Strategy – Latest Position' report to the September Cabinet meeting outlined the approach.

Resource Implications

10. The financial position faced by the County Council is extremely serious and challenging. The current MTFS anticipated a funding gap of £39m by 2023/24 but on-going service demand and the additional pressures from Covid-19 will increase that gap significantly. This is a particularly difficult situation for a low-funded authority such as Leicestershire as room for further savings is limited.

11. The financial impact of Covid-19 is particularly difficult to predict. It will fluctuate depending upon the required response to the virus and the level of Government support offered. The uncertainty is significantly higher than experienced in a normal year and is expected to continue for the foreseeable future. In future financial years government focus will change from what level support is appropriate to how do they pay for the support given.

12. The greater the uncertainty the more important it is that the County Council pays heed to not just performance of the revenue budget but also the strength of its balance sheet. A good asset base and reasonable level of liabilities is vital in ensuring issues can be dealt with in a sensible thought through manner and the Council is not forced into knee-jerk decisions.

13. The Director of Law and Governance has been consulted on the content of this report.

Circulation under the Local Issues Alert Procedure

14. None.

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PART B

Background

15. The County Council has been operating in an extremely challenging financial environment caused by the ten years of austerity and more recently significant service demand pressures, particularly from social care. Despite continued Government announcements that austerity has come to an end, it is unclear how realistic this position will be due to the detrimental financial impact of Covid-19, and hence the impact upon Local Government funding in the medium term. It was hoped that the Comprehensive Spending Review, due later this year, would provide an indication of funding over the next three to four years. However, with the worsening of the financial crisis, the Government's ability to provide a medium term view is questionable. The Government reviews on Fair Funding and the Business Rates Retention Scheme have also been postponed, perhaps indefinitely.

16. Delivery of the current MTFS requires savings of £80m to be made from 2020/21 to 2023/24. £39m of this target does not have identified savings initiatives, meaning that it represents a funding gap in 2023/24. Whilst this position is not ideal a balanced budget in the first two years and an investment in resources to close the financial gap make it a manageable position and comparatively better than many authorities.

17. The speed and severity of Covid-19 has severely disrupted the normal working of the County Council. This disruption has inevitably impacted the delivery of savings and the generation of new initiatives.

18. Given the starting point of a challenging financial position, a reduced ability to react and a growing financial problem, the Covid crisis has the potential to push even well-run organisations to breaking point.

Key Risks

19. The risks facing the County Council are well documented and reflect the circumstances of most councils. The Latest Corporate Risk Register highlights 23 risks, more than two thirds of which have the potential to create an immediate and significant financial issue for the Authority. For example, an increase in the number of children in care, the infrastructure investment required to support districts' local plans and the impact of climate change. The remaining risks are likely to require financial investment to resolve the issues, should they come to pass.

20. Whilst mitigations for individual risks are continually being developed the fact that there are so many that could have a material detrimental financial impact makes it virtually inevitable that some negative impact will be felt over the MTFS period.

21. A theme running through a significant number of risks is the interdependence with other public sector organisations. Key examples are set out below and highlight the adverse impact that would be felt by the County Council if a partner organisation struggles financially and reduces their services unilaterally.

    a. **Covid-19 response.** Working with local and national organisations across Leicester, Leicestershire and Rutland.
    b. **MTFS delivery**. Dependency on district councils to collect local taxes. Significant trading income received from schools and academies.
    c. **SEND (Special Educational Needs and Disabilities) response**. Education pupils in a mainstream setting is cheaper than independent schools.
    d. **Infrastructure investment.** Section 106 funding secured via district councils.
    e. **Better Care Fund and Health transformation.** Significant funding passed directly to the County Council and support of common service users.
    f. **Service Delivery.** A range of partnership arrangements exist supporting front-line and back office services.
    g. **Other.** The interconnectedness of the public sector is not always obvious, but the impacts can be significant, the Local Government Pension Scheme being a prime example. In common with most schemes most employing organisations' funds are in deficit. If one of these organisations were to default on its obligations the other scheme employers become liable. Local Government organisations hold most of the deficit and have minimal risk due to the established regime of successor organisations. However, the Government has made it clear that it does not consider such arrangements relevant for Universities and Further Education colleges which have cumulative deficits of approximately £50 million. Whilst the risk to the County Council is low it is not negligible.

22. For completeness the key financial risks are set out below:

    a. Non-achievement of savings and income targets. When the MTFS is refreshed the 4-year requirement is likely to be higher than the current £80m. Successful delivery of savings is dependent upon a range of factors, not all of which are in the control of the County Council.
    b. Additional service pressures including demand-led, primarily social care and SEN placements, and discretionary such as highways improvement and support for public bus services.
    c. Changes in pay legislation, such as faster increases in the National Living Wage, or exceptional increases for key workers.
    d. Council tax and business rate income are directly affected by the state of the economy.
    e. Lasting impacts of Covid-19, such as on the care provider market.
    f. Government funding changes. Although delayed there is still the potential for some positive reform, but the state of national finances makes reductions just as likely.
    g. Legislative changes. These could be positive, for example the promised SEND reforms, but outcome of changes can also drive additional costs.

Adequacy of Financial Arrangements

23. Section 25 of the Local Government Act 2003 requires Chief Financial Officers (CFOs) to report to their authorities about the robustness of estimates and the adequacy of reserves when determining their budget and level of council tax. This is good practice and should ensure authorities have put in place adequate measures to deal with future uncertainties in advance of a crisis hitting. Adequate risk management arrangements, such as demand management, should be the primary approach, but contingencies have a vital role.

24. Contingency measures tend to take 2 forms:

    a. Explicit contingencies in the revenue budget that can be drawn upon when overspends occur.
    b. Flexibility, within regulations and resources, outside of the revenue budget (balance sheet) to temporarily provide funding to deal with issues.

25. The County Council uses both approaches. A range of explicit contingencies are held and reassessed every time the MTFS is refreshed, to avoid over providing and trapping resources that could be used for service provision. Holding these has allowed the County Council to prepare well, e.g. targeting savings at the right level, by minimising the impact of unforeseen events. In summary these are:

    a. Inflation contingency – which it is known will incur but it is difficult to determine the individual service impact in advance.
    b. Corporate growth – it is impossible to determine all growth that will be encountered over the 4-year MTFS. The Council will use historic experience to estimate the level.
    c. Potential funding losses – these are estimated based upon prior experience and Government indications.
    d. MTFS risks contingency – this fund is primarily to provide for the risk of non-achievement of savings and the investment required. The level varies depending upon certainty of expenditure plans and funding.

26. The balance sheet contingencies are covered by this report. By their one-off nature as balances (can only spend once) rather than a recurring revenue budget they play a vital, but less useful role. Repaying the balances increases the saving requirement sometimes significantly if external borrowing is undertaken.

27. If the overall level of contingency is set too low and does not provide enough time to fix the underlying problem a downward spiral can ensue. This is the situation witnessed in Northamptonshire where temporary measures had to be repaid, compounding the immediate financial pressure, forcing the authority to reduce services to the statutory minimum. This is clearly not good for residents, who benefit from services, or for the council's ability to return to financial strength. When cutting back to the minimum there is no flexibility to

deal with new risks and mistakes are liable to be made in the battle to find financial stability.

28. Having an adequate level of contingency is not something that can be put in place overnight. It is a hard-earned position that takes several years and a strong commitment to planning for the long term; not waiting for a crisis to adopt good financial disciplines.

29. Throughout the years of austerity numerous authorities have adopted policies that have delayed the requirement to make savings. At the heart of these policies the common theme tends to be borrowing from the future. So whilst these may be alluring in the short term there is a price to pay, a weakened balance sheet (resources spent) and a greater future savings requirement (resources repaid plus interest).

30. Delaying savings in this way had the illusion of being a good strategy until Northamptonshire became the first authority for almost 20 years to fail to meet its legal obligation to balance its budget. After Government indicated abolition rather than bail-out was its preferred approach in such circumstances most councils sought to strengthen their financial standing.

31. The impact of Covid-19 has started to highlight those that were not successful in this strengthening. Five authorities (Croydon, Peterborough, Birmingham, Oxford City and Woking) have approached the Government for permission to borrow to fund revenue expenditure. Several councils (including Leeds, Nottingham and Trafford) have opened mass voluntary redundancy schemes. Numerous authorities (including Exeter, Newcastle, Kent, Luton and Ipswich) have enacted emergency budgets.

32. The councils named above are a wide range of sizes and types but the common theme is that there has been an expectation that financial problems will be solved locally. This reinforces the importance of having a good understanding of the financial position of Local Government organisations, enabling sound rather than populist decisions to be made. However, the multifaceted nature of councils and the associated statutory reporting requirement can make determination of financial strength difficult for those outside the organisation in question to understand.

33. There is a well-established External Audit regime for Local Government, which can help to untangle some of the complexity and provide independent insight. However, by their nature audits are historic and warnings can come too late, a position compounded by authorities in trouble often delaying delivery of their accounts. This is exemplified by the recent history of auditor reporting:

    a. Only five Public Interest Reports have been produced in the past 5 years. In the current year reports have been issued for Croydon Council and Nottingham City Council. Both reports were issues when problems were well established. Nottingham City Council’s management of Robin Hood Energy in August 2020 came 16 months after the financial year-end after the Authority had incurred losses of almost £40m. Croydon's report coincided with an admission that a section 114 notice would have been required if the guidance had not changed due to Covid-19.

b. Only one advisory notice has been issued in the past 5 years; to Northamptonshire *after* a section 114 notice (imposing immediate spending restrictions) had been issued.

34. In these unusual times even the prospect of a section 114 notice is not the warning it once was. Local authorities have legal duties to set balanced annual revenue budgets. CFOs have a duty to issue a section 114 notice if it appears that an authority might spend more in a financial year than the resources available. This notice prevents the authority from engaging in further spending for a set period. Government, supported by CIPFA, have watered down the CFOs' duty removing the requirement to issue a notice whilst in 'discussions' with Government. This can make it difficult to differentiate between an authority that is keeping its Members informed and aware of the risks being faced compared to one that is in dire trouble and avoiding the inevitable.

CIPFA Resilience Index

35. Last year CIPFA launched its Financial Resilience Index, which uses key indicators of the financial position of local authorities. The Index received a mixed reception from the Local Government sector and its impact is reduced by the historic nature of the information. That said it is a reasonable attempt at simplifying the financial appraisal of a complex sector and prompts questions to be asked in key areas that are often overlooked. The Index has not yet been updated for 2019/20 financial statements due to the delayed deadlines but is still useful in the context of this report.

36. The Index contains sixteen financial measures that can be broadly grouped into three categories:

a. Levels of reserves, with higher values considered good.
b. Hard to reduce expenditure, for example social care, with lower levels good.
c. Certainty of income, with higher levels good.

37. This broadly mirrors the National Audit Office's 2018 report that highlighted areas of concern including "spending more concentrated on Social Care" and an increasing number of authorities "have relied on reserves to balance their books".

38. The main weakness of the Index is the use of comparisons to similar organisations to define risk levels rather than absolute measures.

39. An extract of the Index showing this Council compared to other County Councils is included in Appendix B. Overall the results are very good, showing the County Council in the lower risk range across the board. Only two indicators suggesting anything other than a low risk level:

a. Growth Above Baseline – High Risk. The County Council's value of 6% represents £3m and is provided for in the MTFS, hence is not of concern. The measure is targeted at district councils where the highest value is 287%.
b. Unallocated Reserves – Medium Risk. The County Council included in the current MTFS plans to increase its General Fund. This measure had already increased by the end of 2019/20.

40. The fact that the Government's Fair Funding review has now been put on hold is extremely disappointing. The County Council's low funded position means that it has much less scope, compared to other councils, for dealing with unforeseen events. With significant control of funding held by Government, including caps on Council Tax, it is essential that the County Council makes the most of the areas that can be controlled locally.

General Fund

41. The General Fund balance is available for unforeseen risks that require short term funding. The balance on the General Fund (non-earmarked fund) at the end of 2019/20 was £23m, which represents 5.9% of the net budget (excluding schools' delegated budgets). Further increases are planned to reflect increasing uncertainty and risks over the medium term. These risks come in a variety of forms:

- Legal challenges such as judicial reviews that require a change in savings approach.
- Legislative changes that come with a financial penalty, for example General Data Protection Regulations (GDPR).
- Service provision issues that require investment, for example the capital investment to support the High Needs Block Development Plan.
- Variability in income, particularly from asset investments.

42. To put the level of resources into context, with the exclusion of schools, the County Council spends nearly £60m a month.

43. If the General Fund is spent a reasonable plan must be in place to replenish it so that the next unforeseeable risk can be dealt with. This makes use of the General Fund very much a last resort. If replenishment needs to take place before the issue is resolved the size of the task can become unmanageable. The County Council's preferred approach when facing material overspends is to reprioritise activity, so that it continues to only spend within its means. This approach worked for the 2019/20 full year overspend and, so far, in tackling the Covid-19 issues where investment in capital schemes has been reduced.

44. As part of the MTFS refresh process now being undertaken, provision will be made within each years' expenditure requirement to ensure that the General Fund balance is maintained at an appropriate level in light of the risks highlighted above and any further risks that emerge.

Earmarked Funds

45. Earmarked funds are held for four main reasons and the various rationale are set out below:

Rational	Benefit
Insurance	
Meet the cost of future claims not covered by insurance policies.	Smooth the volatile timing of claims, avoiding in-year shocks. Allow greater risk retention, through higher excesses, reducing premiums.
Renewals	
Meet the cost of future replacement of equipment, vehicles and systems.	Spread budget impact to allow replacement to be timed based upon need and avoid leasing costs.
Projects	
Support transformational and departmental change.	Align commitments to available funding. Scope to reprioritise if unforeseen events. Ensure funding for efficiency initiatives. Save for schemes, avoiding borrowing.
Commitments	
Meet known commitments that are expected to be paid in the future.	Hold funds on behalf of partnerships. Reserve funding for specified objectives, e.g. Section 106 (developer) or grant distribution awaiting fulfilment of conditions.

46. The benefits included in the above table have a deliberate focus on financial robustness. In summary, earmarked funds held at the right level can:

a. Reduce costs by allowing tolerance of risks that are unlikely to pass and the avoidance of financing costs.
b. Act as a shock absorber allowing exception costs to be managed over several years or reprioritised when circumstances change.

47. Holding funds at too high a level is not necessarily a good use of resources. It can encourage inaction in dealing with issues and create a mismatch between the raising of tax income and the benefit to tax payers.

48. Grant Thornton, the County Council's external auditor, has reviewed the level of earmarked funds held by the County Council as part of its Value for Money review of the 2019-23 MTFS and reported no issues: 'Based on the work carried out we are satisfied that the Council had proper arrangements for securing economy, efficiency and effectiveness in its use of resources.'

49. The latest position on the County Council's earmarked funds is set out in Appendix A. In common with previous reports a declining level of balances is forecast. Historically the balances have been replenished as new funding is

received, for example temporary social care grants, or contingencies not used. The Covid-19 crisis could change the situation if less funding is available reducing the value of balances held. Providing the County Council's financial management approach does not change fundamentally financial resource will still be directed towards earmarked funds reflecting priorities.

Cash Holdings

50. By their nature earmarked funds and the General Fund are backed by cash. There are a range of other situations that can contribute to the County Council holding cash for an extended period. The most common are set out in the table below.

Category	**Typical Value**	**Reason**
Earmarked Funds – Revenue	£25m - £50m	See section above for main examples.
Earmarked Funds – Capital	£25m - £85m	Hold cash to support Capital Programme commitments.
Earmarked Funds – Partnerships	£5m - £15m	Segregate funds that other organisations have an interest in from County Council resources.
General Fund	£15m - £40m	Contingency for unforeseen events.
Government policy – SEND	(£25m) - £0m	Grant insufficient to cover expenditure. DfE not fully committed to repay.
Statutory requirement – Minimum Revenue Provision	£0m - £50m	Build a balance to repay debt when it becomes due.
Debtors vs. Creditors	£25m - £50m	Difference in amount the council owes versus what is owed (excluding loans). Skewed to a positive cash value due to tendency for Government to forward fund.

51. A good cash position is beneficial to any organisation. In terms of financial resilience, it plays an important role allowing financial resources to be redirected quickly and at relatively low cost providing repayment is very likely and before the original purpose becomes due.

52. Recent examples of the benefit of the County Council's strong cash position include:

   a. Provide interest free cash-flow advances to adult social care providers during the Covid-19 crisis, without service rationing elsewhere.
   b. Longer term investment in Property and Private Debt to improve yield.
   c. Planned forward funding of the Capital Programme to avoid external borrowing costs.

53. The growing Minimum Revenue Provision (MRP) balance, due to the annual revenue charge, is well suited to the purposes above due to the extended period before loans become due. In the case of forward funding of the capital programme the MRP regime also acts as a safeguard by requiring regular repayment.

54. The benefits of using cash in this way can be significant. For example, the £160m of forward funding in the MTFS (per September updated programme) saves between £3.5m and £4m per year of interest costs. This is likely to be offset by the opportunity cost of interest received on treasury management activities, although for the foreseeable future, with interest rates at historic low levels, the impact is likely to be minimal.

Other Assets

55. The County Council's main category of asset relates to land, buildings and infrastructure. The value is significant due to the range of assets held for service delivery. The benefit of holding assets is the avoidance of rental/lease costs. Sale of assets is of limited benefit due to the on-going service requirement and the restrictions on using receipts from asset sales for capital purposes.

56. The exception is the Corporate Asset Investment Fund (CAIF). The decision to build CAIF without incurring debt means that the sale leaves the County Council in a no worse revenue position than if CAIF had never existed. An immediate revenue pressure would be created from lost income but the net detriment from having to repay loans would not be felt.

Liabilities

57. A review of financial resilience would not be complete without considering the level of liabilities held. The dominant categories are the County Council's share of the Pension Fund deficit (£607m) and Long-Term Borrowing (£265m).

58. Pension Fund deficits are a common situation for organisations with Defined Benefit schemes. The strong financial covenant of public sector organisations allows an extended deficit recovery period, 17 years in the County Council's case. Recovery of the deficit is through a combination of additional contributions by the County Council and return on financial investments. The recovery period allows the impact of volatile investment markets to be managed with minimal impact upon the County Council's budget. The approach to deficit recovery is agreed with a firm of actuaries and is subject to oversight by the Pension Regulator.

59. The County Council's Long-Term Borrowing relates to the previous acquisition of capital assets. Despite not undertaking any new borrowing since 2009 the level of debt is £265m. The loans are all effectively fixed interest, avoiding volatility in the revenue budget. Avoiding loans for the past decade has reduced the capital financing burden on the revenue budget from 8.7% to 4.9%. This significant decline has been hugely beneficial in supporting the County

Council through austerity and allows a greater portion of funding to be directed toward service delivery. If borrowing had kept pace with growth in the County Council's revenue budget additional costs of £15m would be incurred equivalent to an entire years expenditure on ASC home care services.

60. Although ultimately costly a short term cash boost could be received if the County Council's capital financing policy switched from revenue funding to borrowing. Maintaining a good capacity to borrow acts as a contingency, for example:

  a. The General Fund can be kept at a lower level than would be the case if the Capital Programme was fully funded by debt.
  b. Using cash to forward fund the capital programme can be undertaken knowing there is an alternative.

61. Undertaking too much borrowing has the potential to put an organisation under significant pressure. The table below, based upon CIPFA's index, shows some of the authorities referred to earlier in the report that are reporting some of the biggest impacts of Covid-19, with this County Council as a comparator.

Council	Debt	Interest / Net Budget
Leeds	£2,700 million	13.4%
Croydon	£1,400 million	8.4%
Nottingham	£1,200 million	22.3%
Kent	£1,200 million	6.1%
Peterborough	£507 million	9.9%
Leicestershire	£265 million	3.9%
Derbyshire	£382 million	4.3%
Nottinghamshire	£599 million	4.6%

62. It is worth noting that except for Leicestershire a significant portion of the other councils' debt will have been raised in a low interest rate environment. The Covid-19 crisis has aided some authorities by keeping debt servicing cost low for an extended period.

63. If this County Council had followed others and had been ready to borrow the impact on the revenue budget would be an additional cost in the region of £40m per annum.

64. Derbyshire and Nottinghamshire have been added to the table, as local comparators. Even against these authorities the County Council's cost of servicing debt compares favourably.

Conclusion

65. The future financial position is uncertain and complex and made increasingly so due to Covid-19. The prudent approach taken by the County Council to managing its finances, including ensuring sufficient contingencies are maintained and external borrowing is kept to a minimum, have ensured the County Council is, as demonstrated by the CIPFA resilience index, comparatively well placed to deal with future financial challenges.

66. Nonetheless, the low funded position that the Council still finds itself, coupled with the ongoing delays to implementing the fair funding review, does mean that it needs to be mindful that its financial resilience will likely be adversely affected, and the steps outlined in this report are key to ensuring this is mitigated as much as possible.

Equality and Human Rights Implications

67. There are no equality or human rights implications arising from the recommendation in this report. Public authorities are required by law to have due regard to the need to:

- Eliminate unlawful discrimination, harassment and victimisation.;
- Advance equality of opportunity between people who share protected characteristics and those who do not; and
- Foster good relations between people who share protected characteristics and those who do not.

68. Many aspects of the County Council's MTFS may affect service users who have a protected characteristic under equalities legislation. An assessment of the impact of the proposals on the protected groups must be undertaken at a formative stage prior to any final decisions being made. Such assessments will be undertaken in light of the potential impact of proposals and the timing of any proposed changes. Those assessments will be revised as the proposals are developed to ensure that decision-makers have information to understand the effect of any service change, policy or practice on people who have a protected characteristic.

69. Proposals in relation to savings arising out of a reduction in posts will be subject to the County Council's Organisational Change policy which requires an Equality Impact Assessment to be undertaken as part of the Action Plan.

Risk Assessment

70. As this report states, risks and uncertainties surrounding the financial outlook are significant. The risks are included in the Corporate Risk Register which is regularly updated and reported to the Corporate Governance Committee.

Background Papers

Report to Cabinet – 18th September 2020 - Medium Term Financial Strategy Latest Position
http://politics.leics.gov.uk/documents/s155524/MTFS%20Latest%20Position%20FINAL.pdf

Report to County Council -19 February 2020 – Medium Term Financial Strategy 2020/21 to 2023/24 https://bit.ly/339lJfp

Appendices

Appendix A:	Earmarked Reserves
Appendix B:	CIPFA Resilience Index
Appendix C:	Draft minute of Scrutiny Commission meeting on 4 November