London Borough of Camden – Wider Economic Environment and Medium-term Financial Forecasts

7th July 2016

Summary of the Report:

This report provides an update on the impact of the vote to leave the European Union, the government deficit reduction programme and the national economic climate.

The current levels of earmarked reserves are set out alongside future projections for their usage.

Finally, there is a summary of the Council's inflationary assumptions for 2016/17 onwards.

Contact Officer:
Adam Staines
Strategic Finance

Telephone: 020 7974 6014
Email: adam.staines@camden.gov.uk

1 WIDER ECONOMIC ENVIRONMENT

Introduction

1.1 It is too early to say with any confidence what the result of the referendum will mean. However, there is the potential that the turbulence seen in the markets today will lead to a sustained period of uncertainty regarding how and when Britain will leave the EU, and what agreements will be signed in its place. The result may lead to decreased tax revenues and make it more difficult for the government to deliver the current plans on growth. Should this be the case the government could choose to increase borrowing, raise taxes, or reduce public spending over that already planned.

1.2 The Chancellor already announced that the government would abandon the target to eliminate the fiscal deficit by 2019/20. It was stated this is due to expected significant negative shocks to the UK economy following the vote to leave he EU. If the government seeks to only postpone the target, the years of austerity could be extended beyond 2020.

Economic Environment post Brexit

1.3 Prior to the referendum, a number of experts warned of the consequences of Brexit. Ratings agencies Fitch and Standard and Poor's downgraded the country's credit rating, while Moody's warned that Brexit "will weigh on the UK's economic and financial performance".

1.4 In May, the Institute for Fiscal Studies forecast that the UK's budget deficit would grow by between £20-40bn beyond current expectations. If, as the result of Brexit, the UK economy suffers a set-back, this could mean increased pressures on public funding. This could have a twofold impact on local authorities; firstly, reducing grant funding to local government even further than currently expected and a negative impact on businesses and consequent lower receipts from business rates. Secondly, a weaker economy could mean increasing or extending austerity and increased demand on council services and further reductions in benefits.

Four Year Settlement

1.5 The local government finance settlement for 2016/17 confirmed that annual cuts to core government funding will continue year on year for the duration of the parliament up to 2019/20. Our analysis of government-defined 'spending power' shows that between 2010/11 and 2019/20 Camden will suffer the 7th highest cut in funding in the country (measured as £ decrease per household). See appendix A for more detail.

1.6 However, unlike previous years, the settlement includes figures for four years (2016/17 to 2019/20), allowing councils to have more certainty for future years. Due to the four year 'funding offer' and the Council's decision to set a comprehensive medium-term financial strategy we forecast that, subject to council tax decisions and successful delivery of the current programme, the Council is in a strong position to deliver a balanced budget in 2017/18 and 2018/19. We do however expect to have a funding gap beyond 2018/19 – we currently forecast we will have to deliver a further £20m of budget reductions in the two years to 2020/21. It is important to note that these projections may need to be iterated as the impacts of the EU referendum become clearer - in the event of an economic downturn the government could revisit its funding to local government. The decision to leave the EU could also result in higher inflation, which in turn could increase our cost pressures.

1.7 There remains significant uncertainty regarding the latter years of the Settlement. The figures set out are estimates and will change depending on a number of factors. The government noted that they "will need to take account of future events such as the transfer of functions to local government, transfers of responsibility for functions between local authorities, mergers between authorities and any other unforeseen events".

1.8 The chancellor repeated his intention to phase out the core grant by the end of the parliament, and replace it with 100% business rate retention. There remains the potential that unannounced new burdens will be rolled into this funding over the course of the parliament.

1.9 Subsequent to the Spending Review, the government announced it would conduct a departmental efficiency review, which will help deliver additional £3.5 billion of savings from public spending by 2019/20, while maintaining the protections set out at the Spending Review and Autumn Statement. Treasury will lead an efficiency review, which will report in 2018. This will review the efficiency of all departmental spending to inform future expenditure decisions. It is not clear what this will mean for local authorities, but given the protection of spending in a number of departments, it is possible that this may lead to further funding reductions.

Growth, Inflation and Employment

1.10 Change in gross domestic product (GDP) is the main indicator of economic growth. GDP is estimated to have increased by 0.4% in Quarter 1 (Jan to Mar) 2016 compared with growth of 0.6% in Quarter 4 (Oct to Dec) 2015. While the economy is still expanding steadily, sector performance is mixed. Services are growing robustly but manufacturing and construction are struggling.

1.11 The Consumer Prices Index (CPI) rose by 0.3% in the year to April 2016, down from 0.5% in the year to March. From late 2015, the rate began to increase gradually from close to zero. The drop in April 2016 is the first fall since September 2015. Falls in air fares and prices for clothing, vehicles and social housing rent were the main contributors to the decrease in the rate. These downward pressures were partially offset by rising prices for motor fuels and for certain recreational goods and cultural services, and by food prices, which were unchanged between March and April 2016, having fallen between the same two months a year ago.

1.12 Between October to December 2015 and January to March 2016, the number of people in work increased, the number of unemployed people was little changed, but the number of people not working and not seeking or available to work (economically inactive) fell. The employment rate (the proportion of people aged from 16 to 64 who were in work) was 74.2%, the highest since comparable records began in 1971. The unemployment rate was 5.1%, unchanged compared with October to December 2015 but lower than for a year earlier (5.6%).

1.13 The referendum is likely to have a significant impact on how these indicators of economic activity develop in the future. Prior to the referendum, a number of experts warned of the consequences of Brexit – including lower GDP growth and loss of jobs. Additionally, it is expected that weaker sterling will result in higher inflation – indicative consequences of this are set out in a section below.

2 EARMARKED RESERVES

2.1 The Council currently has 18 separate earmarked reserves to support key revenue budget outcomes, the Council's service remodelling programme, on-going capital activity, to mitigate future corporate risk, and to support charitable activities. The opening 2015/16 earmarked reserves balance was £110.660m. The net movement out of earmarked reserves, including the end of year surplus transfer to reserves was £(14.556)m during 2015/16.

2.2 A summary of the impact of these movements is presented in Table 1. A forecast of future year balances can be found at the end of this report in Appendix C.

Table 1 – Earmarked Reserves in Year Movements 2015/16

Earmarked Reserves	Reserves Balances 31.03.15 £m	Movement Out of Reserves £m	Transfer Into Reserves £m	Reserves Balances 31.03.16 £m	2015/16 Net Movement £m
To Support Key Revenue Outcomes	34.355	(9.860)	7.570	32.065	(2.290)
To Support Council's Remodelling Programmes	21.131	(7.833)	0.288	13.586	(7.545)
On-going Capital Activity and asset Management	29.333	(18.688)	17.883	28.528	(0.805)
Mitigation of Future Corporate Risk	25.809	(10.243)	6.325	21.891	(3.918)
Charitable Activity	0.032	0.000	0.002	0.034	0.002
Total Earmarked Reserves	**110.660**	**(46.624)**	**32.068**	**96.104**	**(14.556)**

2.3 The Council also holds General Reserve Balances, Schools Balances and the Housing Revenue Account Reserve, for which forecast in year movements are detailed in Table 2.

Table 2 – Summary of General Reserves 2015/16

General Reserves	Actual Reserves 31.03.15 £m	Movement Out of Reserves £m	Transfer Into Reserves £m	Reserves 31.03.16 £m	2015/16 Net Movement £m
General Balances	13.624	-	-	13.624	-
Housing Revenue Account	40.966	(1.800)	-	39.166	(1.800)
Schools Balances	16.600	(0.230)	-	16.370	(0.230)
Total General Reserves	**71.190**	**(2.030)**	**-**	**69.160**	**(2.030)**

3 London Living Wage

3.1 The Council is working to implement the London Living Wage in all our local contracts. We believe that being accredited as a LLW employer is a positive example of how we are helping to tackle inequality and it is a crucial tool in making work pay in the borough. While it may take us some time to introduce the LLW across all new contracts, subject always to the Council deciding that paying the LLW presents best value for those contracts to the Council, we firmly believe that it is an investment that will improve the quality of services and the daily lives of those who work for Camden. To fund this commitment, we included within the medium term projection a budget of £2.8m in 2017/18, increasing to £2.9m in 2018/19. Additionally, by 2017/18 we will increase budgets by £2.3m to improve terms and conditions in homecare contracts.

4 INFLATION

4.1 Following the contraction of council funding from 2011, the Council has taken active steps to reduce costs by minimising inflation requirements in budget setting.

4.2 The standard indices applied from 2011/12 onwards are set out in Table 3.

Table 3 – Standard Inflation Rates 2011/12 to 2018/19

Type	Description	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Expenditure	Employees	0.00%	0.00%	1.00%	1.00%	1.00%	1.00%	1.00%	1.00%
	Premises	0.00%	0.00%	3.00%	1.00%	1.00%	1.00%	1.00%	1.50%
	Supplies & Services	0.00%	0.00%	3.00%	0.00%	0.00%	1.00%	1.00%	1.50%
	Transport	0.00%	0.00%	3.00%	0.00%	1.00%	1.00%	1.00%	1.50%
	Contracts	3.00%	3.00%	3.00%	1.00%	1.00%	1.00%	1.00%	1.50%
Income	Fees & Charges	1.30%	1.30%	3.00%	3.00%	3.00%	1.50%	1.50%	1.50%
	Sales	1.30%	1.30%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
	Rents	1.30%	1.30%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%

4.3 Significant exceptions to the standard indices listed above are summarised in Table 4, along with the reasons for the adjustment and the resulting additional pressure in 2016/17. In our medium-term modelling, we have continued to apply inflation to the below exceptions at the level stated up to 2018/19, whilst continuing to review regularly with procurement and the relevant services.

Table 4 – Exceptions to Standard Inflation Rates Applied

		Reason	Category	Standard Inflation	Revised Inflation
Expenditure	Electricity	Forecast contracted charges are due to rise.	Premises	1.00%	5.50%
	Gas	Forecast contracted charges are due to rise.	Premises	1.00%	8.00%
	Business Rates	Previous years linked to RPI, however, revaluation of rateable values is taking place in 2017 . Therefore 2017/18 change will not have a link to any index. The change in business rates bills will not be known until around December.	Premises	1.00%	2.00%
	ASC Contracts	Certain ASC contract is set to increase by RPI from 1st April	Third Party Payments (Contracts)	1.00%	1.30%

		Reason	Category	Standard Inflation	Revised Inflation
Income	ASC Contracts	Certain ASC contract is set to increase by RPI from 1st April	Fees & Charges	1.50%	1.30%
	Statutory Fees	Set by statute or to reflect challenging economic conditions.	Reimbursements & Contributions	1.00%	0.00%
	Housing Rents	Ability to increase charges linked by caps in benefits system.	Rents	2.00%	0.00%
	Library Income (F&C)	Income F&C and Sales are currently struggling to meet budget.	Fees & Charges	1.50%	0.00%
	Library Income (Sales)	Income F&C and Sales are currently struggling to meet budget.	Sales	3.00%	0.00%

4.4 Following the outcome of the EU referendum, the uncertainty around inflation has greatly increased. The current medium term financial forecasts, which include balanced budgets up to 2018/19, are based on moderate inflation rates as set out in table 3 (as well as assuming full delivery of savings in the current MTFS). Should there be any dramatic changes in inflation, it could cause pressures on the projected position. As way of illustration, we currently apply 1% inflation to Contracts, should this increase to 4%, we could see additional pressures of £5.6m in 2017/18, increasing to £11.4m in 2018/19, and £17.5m in 2019/20. Should we need to apply 4% across all expenditure (excluding staffing costs), these pressure pressures could be £7.5m in 2017/18, increasing to £15.3m in 2018/9 and £22.9m in 2019/20.

5 UNAVOIDABLE PRESSURES

5.1 While the Council constantly endeavours to limit costs and increase efficiency, there are areas in which demographic, economic or legislative changes mean that the Council has limited or no scope to reduce costs – for example in relation to demographic trends such as an increase in the number of older residents' entitlements. Such costs have tended to rise at rates significantly in excess of inflation in recent years, particularly as the Council has borne down so effectively on its own budgeted inflation allowances. In its medium-term modelling, the Council allows for an additional £5m per annum to respond to these unavoidable pressures.

5.2 The government is planning to introduce an apprenticeship levy which is likely to result in a new pressure in Council's budgets. The levy, which will collected from larger employers (including the Council), will be introduced in April 2017. It will be set at a rate of 0.5% of an employer's paybill. On broad initial estimates, this could mean that the Council will be paying £1.4m in levy per annum across the General Fund, HRA and in schools. While we can theoretically recoup the tax by employing a large number of apprentices, the tax will be an additional cost to the Council. This is because currently, nearly all our apprentice training costs are covered by central government.

5.3 The combination of factors set out above means that the Council continues to operate in a challenging financial environment.

5.4 While the progress towards implementing the £78m strategy has been strong, the Council must be mindful that many projects remain in the planning or implementation stage, and others are subject to the outcomes of public consultation. Furthermore, there remain a number of areas of potential cost pressures, including levies, national insurance rises, changes to adult social care, and business rates appeals.

6 BUSINESS RATES: DEVELOPMENTS IN THE TRANSITION TO 100% RETENTION

6.1 As highlighted in the July Review of Camden Medium Term Financial Strategy (www.camden.gov.uk/mtfs), the impending reform of the business rate system introduces significant uncertainty to Council's funding. The reform will mean that local authorities will be able to retain 100% of all rates collected by 2020. This is a major shift in funding and will mean that local authorities will collect an increasing proportion of their funding from local taxation in exchange for taking over responsibility for funding of services that are currently funded by central government.

6.2 Department for Communities and Local Government (DCLG) has been working with the Local Government Association (LGA), London Councils and sector representatives to ensure that local government shapes the way that this new system will work. A technical steering group and a number of sub-groups have been established to provide information and expert advice to support the LGA and DCLG in providing advice on the setting up and implementation of this new system.

6.3 Camden remains in favour of further localisation of business rates to local authorities. However, the mechanics of the new retention system are yet to be decided. There is currently little detail on how the system will work and therefore it is difficult to determine what it will mean for Camden. The government announced it would carry out a consultation on the 100% retention in the summer. Camden will respond to this consultation and ask that the new system;

- **Recognises need** – the new formula determining funding should account for a full range of pressures, including those that particularly affect Camden, such as quick population growth, daytime population increase, housing pressures and other factors relating to our inner London location.
- **Recognises growth** – councils should be rewarded for all economic growth; both for increase in floorspace and increase in rateable value.
- **Incentives growth** – there is little correlation in the current system between economic growth and increased business rate income. The new system should provide a stronger platform for local authorities to support their local economies by being better able to deal with appeals, allow councils to retain growth at resets, transfer relevant responsibilities to councils, and allow councils a wider control over business rate setting

6.4 As a result of the referendum on the membership of the European Union, the economic outlook is unclear and this is of particular concern in the context of the move to 100% business rate retention, as revenue from of business rates could be reduced in a more volatile economic climate.

Appendix A – Change in spending power per dwelling 2010/11 - 2019/20

The table below shows councils with the highest reduction in spending per dwelling between 2010/11 and 2019/20. It is clear that metropolitan urban areas are facing the largest reductions in their spending power. By 2019/20, Camden will have 7th highest cut in spending per household.

Change in spending power per dwelling 2010/11 - 2019/20

Local Authority	Change in spending power per dwelling (£)
City of London	- 20,474.42
Tower Hamlets	- 1,669.64
Newham	- 1,587.78
Hackney	- 1,546.55
Islington	- 1,377.08
Southwark	- 1,323.38
Camden	- 1,278.40
Knowsley	- 1,226.40
Manchester	- 1,174.00
Birmingham	- 1,169.80
Liverpool	- 1,145.27
Lewisham	- 1,138.42

Although the government's definition of 'spending power' has shifted several times since 2010/11, it remained identical across councils.

In 2010/11, 'revenue spending power' included the following: council tax, formula grant, specific grants (such as Early Intervention Grant, Learning Disability and Health Reform Grant, Preventing Homelessness Grant and Housing and Council Tax Benefits Administration Grant).

The 2019/20 definition of 'core spending power' includes the Settlement Funding Assessment (Business rate baseline and revenue Support Grant) New Homes Bonus, Improved Better Care Fund and Council tax with assumptions of growth.

Household number figures and projections are published by the government and can be found here.

Appendix B – London Borough of Camden – Medium Term Financial Forecast (MTFF) as at July 2016

	2016/17 Budget £m	2017/18 Projection £m	2018/19 Projection £m	2019/20 Projection £m	2019/20 Projection £m
Departmental Expenditure:*					
LAW & GOVERNANCE	4.265	4.290	4.336	4.395	4.455
STRATEGY & ORGANISATION DEVELOPMENT	9.704	7.374	7.464	7.574	7.686
FINANCE	43.227	41.271	40.107	40.653	41.208
CULTURE & ENVIRONMENT	22.656	14.871	15.639	16.569	17.518
CHILDREN, SCHOOLS & FAMILIES	63.849	60.425	60.946	61.760	63.407
HOUSING & ADULT SOCIAL CARE	96.975	90.590	91.540	92.618	93.708
PUBLIC HEALTH	19.125	18.492	18.492	17.795	17.795
DEPARTMENTAL EXPENDITURE	**259.801**	**237.313**	**238.524**	**241.364**	**245.777**
Non Departmental Expenditure:					
Corporate Growth	0.000	3.749	8.749	13.749	18.749
Pressures & Priority Funding	4.654	7.415	12.004	16.104	16.104
HRA Recharge	(9.517)	(9.151)	(8.917)	(8.917)	(8.917)
Revenue Contribution to Capital from Reserves	(17.738)	(10.022)	(10.864)	(9.667)	0.000
Transfers to Reserves	24.946	11.457	12.207	12.293	11.670
Transfers from Reserves	(15.268)	(21.141)	(12.254)	(10.505)	(0.651)
Contribution to Pensions	16.329	32.387	17.463	15.729	15.729
Interest Receivable/Payable	(0.246)	(0.596)	(0.596)	(0.596)	(0.596)
Minimum Revenue Provision	2.000	2.450	2.450	2.450	2.450
Levies	1.859	1.859	1.859	1.859	1.859
Net Other Items	2.478	23.489	14.602	12.145	2.478
Depreciation	(18.266)	(18.266)	(18.266)	(18.266)	(18.266)
Direct Revenue Financing	17.738	10.022	10.864	9.667	0.000
Government Grants	(44.765)	(42.188)	(46.356)	(49.541)	(49.426)
NON-DEPARTMENTAL EXPENDITURE	**(35.796)**	**(8.536)**	**(17.055)**	**(13.496)**	**(8.817)**
TOTAL EXPENDITURE	**224.005**	**228.777**	**221.469**	**227.868**	**236.960**
Funded by:					
Revenue Support Grant (RSG)	(54.814)	(41.114)	(31.874)	(22.318)	(22.318)
Business Rates Retained	(87.929)	(87.918)	(87.918)	(87.918)	(87.918)
Garden Squares	(0.025)	(0.025)	(0.025)	(0.025)	(0.025)
Collection Fund (Surplus)/Deficit	0.096	(1.337)	0.000	0.000	0.000
Business Rates (Surplus)/Deficit	14.004	0.000	0.000	0.000	0.000
Proposed Council Tax	(95.337)	(98.383)	(101.652)	(104.607)	(106.699)
TOTAL FUNDING	(224.005)	(228.777)	(221.469)	(214.868)	(216.960)
Shortfall/(Surplus)	**0.000**	**0.000**	**0.000**	**13.000**	**20.000**
Tax Base	88,000	89,031	90,185	90,987	90,987
Collection Rate (%)	97.80%	97.80%	97.80%	97.80%	97.80%
Council Tax (Camden Element)	£ 1,083.38	£ 1,105.05	£ 1,127.15	£ 1,149.69	£ 1,172.68
Percentage Increase **(For modelling purposes)**	3.99%	2.00%	2.00%	2.00%	2.00%

** The current year budget has been updated to reflect new structure in the Budget Book (www.camden.gov.uk/mtfs), however, work on mapping future years to the new structure is on-going and the MTFF will be presented in the new structure alongside the December Cabinet Report.*

Appendix C - London Borough of Camden – Earmarked Reserves Forecast Balances 2016 to 2020

Earmarked Reserves	Forecast Reserves 31/03/2016 £m	Forecast Reserves 31/03/2017 £m	Forecast Reserves 31/03/2018 £m	Forecast Reserves 31/03/2019 £m	Forecast Reserves 31/03/2020 £m
Reserves to support key revenue budget outcomes					
Dedicated Schools Grant	9.780	7.014	4.848	2.682	0.516
Support for Schools in Difficulty	0.434	0.334	0.234	0.134	0.034
Homes for Older People	1.240	0.990	0.740	-	-
Multi Year Budget Reserve	12.864	5.011	3.150	2.532	2.315
Education Commission	1.181	0.695	0.400	0.400	0.400
Supporting People Specific Reserves	6.566	5.316	3.284	2.034	1.040
Sub Total	**32.065**	**19.360**	**12.656**	**7.782**	**4.305**
Reserves to support the councils service remodelling programme					
Workforce Remodelling/Cost of Change	11.199	5.039	-	-	-
Camden Plan	2.387	1.387	-	-	-
Sub Total	**13.586**	**6.426**	**-**	**-**	**-**
Reserves to support on-going capital activity and asset management					
Future Capital Schemes	20.602	21.769	23.037	24.213	26.672
Commercial and other property	0.776	0.776	0.776	0.776	-
Haverstock PFI Funding Reserve	1.889	1.759	1.629	1.499	1.369
Schools PFI Equalisation Reserve	1.063	1.281	1.499	1.717	1.935
Building Schools for the Future	0.488	0.338	0.188	0.188	0.188
Accommodation Strategy	3.710	1.910	-	-	-
Sub Total	**28.528**	**27.833**	**27.129**	**28.393**	**30.164**
Reserves to mitigate future corporate risk					
Self-Insurance Reserve	6.977	6.477	5.977	5.477	4.977
Contingency Reserve	1.512	1.512	1.512	1.512	1.512
Business Rates Safety Net	13.402	8.017	6.517	6.017	6.017
Sub Total	**21.891**	**16.006**	**14.006**	**13.006**	**12.506**
Reserves to support the Mayors charity					
Mayor's Charity Reserve	0.034	0.034	0.034	0.034	0.034
Total Earmarked Reserves	**96.104**	**69.659**	**53.825**	**49.215**	**47.009**
General Balances	13.624	13.624	13.624	13.624	13.624
Housing Revenue Account	39.166	37.666	36.166	34.666	33.166
Schools Balances	16.370	14.370	11.370	7.370	2.370
Total Reserves	**165.264**	**135.319**	**114.985**	**104.875**	**96.169**

Appendix D – Purpose of Reserves

Reserve	Purpose of Reserve
Dedicated Schools Grant	To hold unspent Dedicated Schools Grant which is reserved for the education budget and which may be carried forward over to future years.
Support for Schools in Difficulty	To provide funding to schools should they find themselves in financial difficulties.
Homes for Older People	To fund preparatory work on the Homes for Older People programme.
Multi Year Budget Reserve	To fund allocations in future years as part of multi-year budgeting.
Education Commission	To provide funding to help implement proposals to guide education in the borough.
People Specific Reserve	Hold various unspent Peoples Services monies that do not have conditions on its use.
Workforce Remodelling/Cost of Change	To fund costs that may arise from workforce remodelling and efficiency projects under the Councils Better and Cheaper agenda.
Camden Plan	To provide funding to implement projects that support the plan's key priorities.
Future Capital Schemes	To provide funding to support the Councils costs associated with various capital schemes.
Commercial and other property	To provide funding to meet the cost associated with dilapidations and other payments in respect of commercial and other property.
Haverstock PFI Funding Reserve	To hold the balance of funding in respect of the Haverstock School PFI project.
Schools PFI Equalisation Reserve	Reserve for the amortisation of the initial payment.
Building Schools for the Future	To provide funding for the preparatory work on the Building Schools for the Future Programme .
Accommodation Strategy	To provide funding to facilitate the office accommodation strategy.
Self-Insurance Reserve	To provide funding to cover insurance risks, this keeps insurance costs to a minimum.
Business Rates Safety Net	To provide funding to cover reduction in retained business rates.
Mayor's Charity Reserve	To hold donations from businesses to be allocated to charity.
General Balances	Unallocated reserves held to resource unpredictable expenditure demands.
Housing Revenue Account	Reserve budgets held by the Council on behalf of the HRA – can only be spent on HRA activities.
Schools Balances	Reserve budgets held by the Council on behalf of its schools – can only be spent by Schools.