LGA Leadership Board

18 October 2017

LGA 2018/19 Budget Framework

Purpose of report

For discussion.

Summary

Leadership Board reviewed the LGA's Financial Strategy for 2017/18 to 2019/20 in January 2017.

This report formed the basis of the 2017/18 budget-setting process. It is proposed that the "Year 2" of the Financial Strategy for 2017/18 to 2019/20 as previously presented provides the core starting point for the 2018/19 budget (and a proposed Medium term financial Plan), with Cost Centres required to demonstrate and explain changes from that original estimate.

A draft memorandum to Budget Holders is also presented for review.

Recommendation

That the Leadership agree the proposed 2018/19 Budget Framework for the LG Group Companies – using the Financial Strategy from January 2017 as the basis, and updated as required, and budget ownership is formalised.

Action
Officers to take any action as directed by Members.

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LGA Leadership Board

18 October 2017

LGA 2018/19 Budget Framework

Background

1. Leadership Board reviewed and agreed the LGA's Financial Strategy for 2017/18 to 2019/20 in January 2017. The paper covered: Pensions Deficit Management; Property Asset Management; Treasury management; Commercial Income Development; and Revenue Budget for the three years under review.

2. The key message was that LGA's financial position continues to be challenging, partly because of uncertainty about the LGA's funding base over the medium term in relation to both members subscriptions and DCLG Grant; but mainly because of the substantial pension deficits faced by the LGA and the IDeA.

3. Although the LGA owns the freehold of two buildings in central London — Local Government House and Layden House — and also has significant cash balances, overall its liabilities exceeded its assets by over £71 million at 31 March 2017 (a significant deterioration from the £43 million reported at 31 March 2016 due to increased Pension Scheme deficits arising from adjusted actuarial valuations).

4. However, the outlook for the short to medium term remains reasonably positive. In spite of their continued overall net Balance Sheet deficit position, the assessment is that the LGA and the IDeA continue to be going concerns (confirmed by the external auditors). This is because for both organisations there is a continuous prospect for the next financial year at least, of a positive cashflow to meet the claims of the pension fund actuaries. Also, it is recognised that the current plans to reduce our pension scheme deficit and enhance our investment assets should result in positive Net Assets within a few years.

5. In terms of annual income and expenditure the January 2017 strategy assumed a gradual reduction in direct government funding of 16% over the 3 years to 2019/20, a standstill for subscription fees (with no inflation increases), the maintenance of current service expenditure levels and increases in income for chargeable services to Councils, and others, and from commercial rents and other sources to be developed via the commercial strategy.

6. For 2018/19, we expect to use the "Year 2" Revenue Budget from the January 2017 Financial Strategy Paper as the basis/starting point, and review the underlying assumptions on all cost lines and for all cost centres to identify risks and opportunities that need to be built into the new budget. As a further step, it is proposed that a Medium Term financial Plan is also developed at the same time to extend the planning horizon and give Members a better view of upcoming issues, pinch points and opportunities.

7. We intend to formalise budget ownership within the organisation through the introduction of Budget Delegation letters.

8. The remainder of this paper reviews the various elements of the Financial Strategy and how it might affect the 2018/19 budget process.

Issues

9. Pensions Deficit Management:

 9.1. The proposed strategy for pension deficit management is to identify the optimal method of funding the LGPS pensions to LGA and IDeA staff. During 2017/18 this has included a review of the potential benefits of transferring the administration of the IDeA fund from Camden to Merseyside management.

 9.2. The pension deficit estimates at 31 March 2017 since the last Triennial valuation at 31 March 2016 show an increase of £3.336 million for the LGA and for the IDeA of £26.904 million. The main causes were due to changes in the actuarial assumptions regarding discount rates, however on a like-for-like basis, the Merseyside fund significantly outperformed (in terms of investment return) the Camden fund.

 9.3. Indications received from Merseyside are that a transfer of the IDeA fund to them would deliver in the medium to long term lower annual payments. Based on current staffing levels this could save a net £0.5 million per annum in reduced employer contributions (with slightly higher initial pension deficit reduction payments), and deliver a NPV saving against the programmed deficit repayments over 17 years of around £5.3 million.

 9.4. To achieve this goal Merseyside required that the fund remains open to new entrants and is backed by the LGA standing behind the pension deficit. This was approved by members at the General Assembly in July 2017.

 9.5. The process for resigning from the Camden Scheme and applying to the Merseyside Scheme is due to be undertaken shortly. The proposed transfer is most likely take place on 1 April 2018, however this may need to be pushed back if agreement cannot be reached in time (probably to 1 April 2019 to align cleanly with the next financial year end and triennial valuation, but it may be possible to make the transfer mid-year).

 9.6. Therefore the 2018/19 Budget for the LGPS Pension contributions will not be based on the estimates of the combined administration of the LGA and IDeA Schemes by Merseyside, as it is more prudent to budget on the more expensive existing scheme administration costs, with an associated opportunity identified if the transfer can be undertaken in time.

10. Property Asset Management:

10.1. The proposed strategy for property asset management is that:

10.1.1. Layden House should be retained as an investment property and with further investment in its refurbishment, to increase both its capital and rental value; and

10.1.2. Local Government House should also be retained with further refurbishment investment to increase both its commercial income as well as its capital value.

10.2. Work on Local Government House (now renamed 18 Smith Square to make it more marketable as a multi-tenant building and conference venue) is almost complete with re-occupation expected on 29 October 2017. We are currently in commercial negotiation with a potential tenant for one of the three tenanted floors, so it is hoped that the "void" period for the building is fairly limited.

10.3. The development work on Layden House is due to commence in November 2017, with the plan to have the work completed and commercial tenants in place by January 2019. We are in the process of procuring a main contractor for the works.

10.4. The above development projects should deliver a net improvement in the LGA Group's Balance Sheet to help offset the estimated pension deficit liabilities, such that the LGA Group Balance Sheet should show a Net Asset position (from the current Net Liability position at 31 March 2017) by the end of 2019/20.

10.5. Based on the most recent estimated post development valuations of the properties (as at 31 March 2017), the forecast is that the individual Group Company Balance Sheets would be improved by £25 million (at a consolidated Group Level, the increase will not be immediately recognised, as under accounting rules Local Government House is partially valued at cost, rather than at investment value, to reflect that it is used by the LGA rather than exclusively by 3rd parties). In the short term this improvement will be reduced by additional borrowing to cover working capital and rent free periods, but it will be offset by the significantly increased net rental income (>£3.5 million per annum across both properties) in future years.

10.6. Commissioned work indicates that the most tax efficient structure for the LGA Group is for the LGA to become an incorporated body, to which the investment properties are transferred, such that the related future net income and expenditure activity in the group is Corporation Tax efficient.

10.7. The General Assembly approved the plan to incorporate the LGA (as an unlimited company) in July 2017. Work is underway to create an incorporated body and transfer members from the current Association to the new unlimited company (to be clear, there is no change in Members' exposure to liabilities and ability to share in assets between the new and old corporate structures). The timetable for the transfer of assets has not yet been set, but is likely to be from 1 April 2019 at the earliest.

10.8. Therefore for 2018/19 it is expected that the two property companies will still be in existence for the entire year, and will be budgeted for separately.

10.8.1. Rental income for 18 Smith Square will be accounted for in line with expert advice from our letting agents (please note that while there may be rent-free periods such that cash inflow is £nil for several months, under accounting conventions rental income is spread evenly over the entire period of the lease, so that some income will be recognised in the current year); and

10.8.2. Likewise for Layden House, with leases expected to be available from January 2019, there will be a small budget for rental income for the final quarter of the year (again – on an accounting rather than cash basis).

11. Treasury Management:

11.1. The proposed strategy for Treasury Management is that:

11.1.1. Refurbishment of Layden House and Local Government House is via additional loan funding obtained from the LGA and IDeA of £15m and from external loan funding of £20m (to be provided by Westminster City Council, with the intention that it is backed by the first bond issued by the Municipal Bonds Agency); and

11.1.2. Group balances are maintained at minimum level of £5m to provide a level of contingency should cash flows fluctuate from expected levels.

11.2. The expected interest payments based on the latest position of the internal and external funding will be built into the 2018/19 budget.

12. Commercial Income Development:

12.1. The commercial strategy of the LGA is based on generating additional income from the following four main directions of business development:

12.1.1. Reviewing all existing business processes so as to explore any opportunities where services could benefit from taking a different approach;

12.1.2. Exploring potential opportunities for expanding the existing services through access to a greater number of customers within the current market and/or for opening new markets for existing services;

12.1.3. Developing new areas of business; and

12.1.4. Exploring opportunities for attracting big projects and innovative partnerships to the organisation.

12.2. The targets for increased income will be reviewed in the light of planned levels of commercial and grant funded activity including any estimates of dividends from investments in joint ventures.

12.3. The development of the proposed Joint Venture (JV) for the Insurance Mutual has resulted in the incorporation of a separate group company - “LGA Commercial Services Ltd” – to manage our new commercial activities. The 2018/19 Budget will include the commercial income targets in this vehicle, rather than the LGA, and will include the latest estimates of the expected revenues and costs of the JV.

13. Revenue Budget:

13.1. Over the three year period from 2017/18 to 2019/20 the January 2017 paper recommended that current strategy continues for the 2 property companies and the 2 service delivery entities (LGA and IDEA) remained the same - the strategy for the property companies should develop the assets to provide capital growth to offset the liabilities arising from our pension funds, as well as reducing costs and / or delivering additional commercial income to maximise the level of support we deliver to our members.

13.2. There is no suggestion that this overarching financial strategy be changed for 2018/19. **Appendix A** sets out the proposed starting point for the 2018/19 Budget (highlighted in Yellow).

13.3. The LGA’s standalone budget per the Financial Strategy indicated a small surplus before making contractual pension deficit payments. Taking into account these payments it was recommended that drawings from the Risk and Contingency Reserve are utilised to balance the budget for the 2 years 2018/19 and 2019/20.

13.3.1. The previously identified budget pressures and risks and opportunities for the LGA are shown in **Appendix B**.

13.4. For the IDeA the forecasts for the 3 years have been based on a possible scenario of a reducing DCLG programme on the basis of reduced grant income year on year, matched by reduced expenditure. The reduced spending requirement shown within the IDeA budget will most likely also impact on the overhead recoveries from the LGA. The detailed calculations will take place each year once the planned grant levels are known within the detailed budget.

13.5. The IDeA's standalone budget per the Financial Strategy also indicated a small surplus in excess of the contractual pension deficit payments. Therefore it is suggested that surpluses driven from commercial activities such as the Geoplace Dividend and the Ordnance Survey Licence fees are allocated to the Risk and Contingency reserve to meet future risks / costs facing the IDeA.

13.5.1. The previously identified budget pressures and risks and opportunities for the IDeA are shown in **Appendix C**.

13.6. The main risks and opportunities for LGA(P) and LGMB centre on the timing of new tenancy agreements.

14. Formalisation of budget ownership:

14.1. Best practice indicates that there should be formal budget ownership within organisations. It is therefore proposed that Budget Holders sign and return Budget Delegation Letters to demonstrate:

14.1.1. They have been involved in the budget setting process;

14.1.2. They understand and take ownership of the budget that has been allocated to them; and

14.1.3. They understand the budget virement process.

14.2. A proposed template letter is included in **Appendix D**.

15. A Memo will be issued to Budget Holders setting out the timetable and detailed processes. A draft version is attached at **Appendix E** for comment.

Implications for Wales

16. IDeA is currently in receipt of a grant from DCLG Wales, which needs to be budgeted and accounted for in line with the principles noted above.

Financial Implications

17. As above.

Next steps

18. Members are invited to discuss:

    18.1. the proposed Budget Framework – using the prior Financial Strategy from January 2017 as the basis for 2018/19 and the new Medium Term Financial Plan;

    18.2. the proposed new Budget Delegation Letter; and

    18.3. the draft Budget Memorandum to Budget Holders.

Local Government Association

LGA Leadership Board

18 October 2017

APPENDIX A – Group Consolidated Summary

The summary below provides an overview of the expected changes to the finances of the group over the three years of the Financial Strategy:

LGA	Current Budget 2016/17	Forecast Outturn 16/17(P7)	Projected Budget 2017/18	Projected Budget 2018/19	Projected Budget 2019/20
	£'000	£'000	£'000	£'000	£'000
Operating entities					
LGA	(115)	(1,210)	(1,262)	(793)	(632)
Contribution to Pensions Deficits	0	0	1,114	1,155	1,198
LGA Total	(115)	(1,210)	(148)	362	566
IDEA	(4,064)	(4,631)	(4,496)	(4,228)	(3,906)
Contribution to Pensions Deficits	2,647	2,647	2,418	2,485	2,553
IDEA Total	(1,417)	(1,984)	(2,078)	(1,743)	(1,353)
Operating entities total (surplus) / deficit	**(1,532)**	**(3,194)**	**(2,226)**	**(1,381)**	**(787)**
Property companies					
LGMB	804	874	1,189	(262)	(1,325)
LGAP	1,369	1,200	563	(174)	(137)
Property companies total (surplus) / deficit	**2,173**	**2,074**	**1,752**	**(436)**	**(1,462)**
Group total(surplus) / deficit	**641**	**(1,120)**	**(474)**	**(1,817)**	**(2,249)**
Funded by:					
Contribution to / (from) specific reserves - Operating entities	1,532	3,194	2,226	1,381	787
Contribution to / (from) General reserves - Property Companies	(2,173)	(2,074)	(1,752)	436	1,462
Total	**(641)**	**1,120**	**474**	**1,817**	**2,249**
Net total	**0**	**0**	**0**	**0**	**0**

APPENDIX B – LGA Pressures and Risks and Opportunities

The Financial Strategy identified a number of budget pressures or opportunities over the three year period. These are identified with the impact shown as the variance from the Strategy baseline (2016/17 forecast outturn):

Budget pressure or (opportunity)	2017/18 £'000	2018/19 £'000	2019/20 £'000
Increments, Pay awards, Pensions Oncosts and Apprenticeship levy adding 4% to costs	363	560	764
Pension Deficit Repayments	1,114	1,155	1,198
Additional Commercial Income targets	(250)	(500)	(500)
ADAS conference hosted biannually by the LGA	(242)	0	(242)
Estimated Reduced DCLG grant towards LGA costs in delivering annual programme	111	191	270
Reduced Income from Treasury Investments	24	24	24
Additional Income from investing in Group property developments.	(651)	(722)	(724)
Estimated Depreciation on technology spend for use in LG House	50	50	50
Additional External Mortgage Interest Costs	494	564	566
Intercompany Tenants rent	288	480	480
Other budget adjustments	(239)	(230)	(110)
Net budget pressure or (opportunity)	**1,062**	**1,572**	**1,776**

Risks and Opportunities

The main risks for LGA are:

- Possible further reductions in grant-funding;
- LGA membership – 9 councils are currently on notice to withdraw from membership in 2018/19. The risk is assessed as being up to a £506k reduction in income; and
- A reduction in current 3rd party clients for back office services could lose up to £350k in contribution to LGA fixed overhead costs.

APPENDIX C – IDeA Pressures and Risks and Opportunities

DCLG Funding

The table below sets out the potential reduction in Grant from DCLG over the lifetime of the strategy. The figures were included in the budget pressures and opportunities for the IDeA:

DCLG Grant assumption	15/16 £m	16/17 £m	17/18 £m	18/19 £m	19/20 £m
Grant - £m	23.4	21.4	20.0	19.0	18.0
Reduction - £m		2.0	1.4	1.0	1.0
Reduction %		8.5%	6.5%	5.0%	5.3%

The Financial Strategy identified a number of budget pressures or opportunities over the three year period. These are identified with the impact shown as the variance from the Strategy baseline (2016/17 forecast outturn):

Budget pressure or (opportunity)	2017/18 £'000	2018/19 £'000	2019/20 £'000
Increments, Pay awards, Pensions Oncosts and Apprenticeship levy adding 4% to costs	296	456	622
Removal of Vacancy Allowance from Budgets	329	329	329
Pension Deficit Repayments	(229)	(162)	(94)
Additional Commercial Income targets	(250)	(500)	(500)
Estimated Reduced DCLG grant to IDeA	1,400	2,400	3,400
Estimated Reduced DCLG from IDeA to LGA	(111)	(191)	(270)
Estimated Reduced DCLG from IDeA to CFPS and Local Partnerships	(92)	(157)	(223)
Reduced Spending on DCLG Grant programmes	(1,197)	(2,052)	(2,907)
Reduced Income from Treasury Investments	57	57	57
Additional Internal Income from investing in Group property developments.	(378)	(378)	(379)
Intercompany Tenants rent	269	475	475
Other budget adjustments	(188)	(36)	121
Net budget pressure or (opportunity)	**(94)**	**241**	**631**

Risks and Opportunities

The main risks for IDeA are:

- A higher reduction in DCLG / Direct Government funding; and
- Inability to generate additional commercial income to replace Government funding.

APPENDIX D – Budget Delegation Letter Template (Draft)

2018/19 Budget Delegation

As you are aware, the LGA Group operates a system of budgetary control over income and expenditure.

This email delegates to you responsibility for the management of income and expenditure for the cost centres you manage. Your delegated authorities for the new financial year are detailed in the attachment, and comprises a monetary budget for income, employment costs and non-employment expenses and a Full Time Equivalent (FTE) budget for your team (with related approved Organisation Chart).

You have responsibility to manage within this budget, subject to your line manager's overall discretion and the following governing policies and procedures:

1. Finance Handbook (link attached)
2. Scheme of Financial Delegation Policy (link attached)

Please note that these documents may be updated from time to time.

It is open to you to sub-delegate your budgetary responsibilities to your direct reports if you wish to do so. If you do wish to do that, you should send the colleagues concerned a formal e-mail setting out the budget and headcount you are delegating and drawing their attention to the associated policies and responsibilities. You should also let your Finance contact know about the delegations in force.

To assist you in managing your budget responsibilities, your Finance contact will continue to provide you with regular variance reporting and analysis.

Please return this mail, copying in the Strategic Finance Manager, Jonathan Gratte, to acknowledge receipt and understanding of this budget delegation.

Sarah Pickup

Deputy Chief Executive

Local Government Association

APPENDIX E – Draft Budget Holder Memo (highlighted references to be finalised)

Draft Memo 2018/19 to all Budget Holders (to issue November 2017)

1. In order to prepare the LGA's budget for consideration by SMT prior to final agreement by the Leadership Board on Wednesday 7 March 2018, SMT have agreed the following key dates:

Budget Managers return working papers	9 Feb 18
Resolution of queries, reallocation of overheads, and preparation of Company and DCLG budget summaries for Initial review by SMT	12 to 20 Feb 18
Initial Review by SMT	21 Feb 18
Chief Executive Final review	22 / 23 Feb 18
Despatch to Leadership Board	28 Feb 18
Review by Leadership Board	7 Mar 18

2. Members reviewed the overall budget framework strategy in October 2017, reflecting the tight financial position faced by the LGA and the Councils we support. In preparing this year's budget I have been asked to help budget holders prepare phased budgets that ensure we utilise our resources to best deliver the overall LGA Business plan.
3. We will also use this opportunity to develop a Medium Term Financial Plan (at a high level) to give Members to the ability to identify upcoming risks and opportunities in future years as a result of current plans.

What is required from you?

4. To meet this timetable budget holders are required by the **midday on Friday 9 February 2018** at the very latest (there can be no slippage on this date) to complete for each cost centre they are responsible for working papers to confirm budget requirements for 2018/19.
5. The template being used this year provides detail around spending in the current year, and sets a base budget for next year (Col Q) based on your last full forecast (Q2, undertaken in October 2017) for this year. You are also asked to phase the budget by month to enable better reporting and analysis during 2018/19.
6. All requested changes to the overall base budget should be identified in the Changes column (Col R). Please round all change figures to £ thousands to make for easier high level reporting.
7. You are requested in Column R to identify changes to the budget that:

   7.1. Will make your budget management easier by moving elements of the budget to the account codes where expenditure or income is most likely to occur. These reallocation movements should net to £nil overall;

   7.2. Identifies savings or additional income that will help improve the LGA's overall financial position; and

7.3. Identifies increased costs or reductions in income that will require additional funding.

8. For those budget managers preparing Staff costs budget, my team will this week issue you with a budget worksheet for next year based on existing posts in place in your cost centres. Please review, where required making adjustments as required to reflect expected joiners, movers (maternity, secondments and promotions), and leavers in 2018/19.

9. The base staffing budgets will include expected increments for next year as well as an allowance for the pay award, known increases in pension contributions and other salary overheads. This worksheet will identify the impact of these items.

10. Once the budget is complete, for items 6.2 and 6.3 above please provide an explanation of the variances in the commentary section (rows 9 to 18) of each cost centres' worksheet.

11. Please complete across the 10 rows in this section the main causes of any variations, using the dropdown selection in column M and an explanation of reasons for your SMT Manager in column M, with the value in column N. As with the detailed budget paper these should relate only to the key items over £1k. The total of column N should equal the Net variance shown in column R of the workings sheet. The key areas we are looking to identify are:

1.	One off savings in the 2017/18 forecast reinstated for 2018/19
2.	Proposed budget movements to another cost centre – note this proposed virement must offset changes to another cost centre or cost centres – include these in the explanation
3.	Unavoidable additional costs
4.	Proposed cost reductions
5.	Reductions in budgets for income or overhead recovery
6.	Increases in budgets for income or overhead recovery
7.	Other

Budget delegation Letters

12. In order to formalise the ownership of budgets, once the budget has been approved by SMT, I will write to you, confirming your final allocated budget (post any adjustments imposed by SMT and/or Leadership, either generally across the organisation or specifically for individual cost centres).

13. I will then require the budget holders to confirm, in writing, that: you have been involved in the budget process; you understand the budget that has been allocated to you; and an acceptance of responsibility to live within that budget (subject to a proper budget virement process during the year).

What we will do for you?

14. We are aware through the staff appraisal process that some colleagues are less confident in managing budgets so I have asked my team to be available to provide support and further training as necessary.

15. The new style working papers and phasing requirement are part of a move to support improved resource management across the LGA. This will allow budget managers (and where required through SMT) to use staff and non-staff resources to deliver the outputs of our overall business plan, and where opportunities exist improve levels of commercial income.
16. We have booked a room to hold short workshops over the coming weeks, please book into one of the diary slots in the [schedule]. My team will answer questions as to how to best prepare your budget for next year. It is important to provide explanations for variances to the base budget to help your SMT representative and SMT as a whole to recommend a budget for approval to the Leadership Board on 7 March.
17. Thank you for taking the time to read this email, myself and the finance team look forward to helping you and your support teams to deliver all budget returns back by the key deadline of **midday on Friday 9 February 2018.**

Regards

Jonathan Gratte

Strategic Financial Manager