

LGA 2019/20 Budget Assumptions

Purpose of report

For discussion.

Summary

In advance of Leadership Board reviewing the final proposed Budget for 2019/20 at the March 2019 meeting, this report sets out the key assumptions and issues, with an early view of the potential budget for the LG Group over the medium term to 2022/23.

This report forms the basis of the 2019/20 budget-setting process. It identifies the key themes, issues, risks and opportunities for each of the LG Group Companies, and the Group overall, and sets out a proposed Medium Term Financial Plan.

Recommendation

That the Members review and note the 2019/20 Budget key assumptions and issues, and the financial direction of travel over the course of the Medium Term Financial Plan.

Action

As directed by Members

Contact officer: Jonathan Gratte
Position: Strategic Finance Manager
Phone no: 0207 187 7309
Email: jonathan.gratte@local.gov.uk

LGA 2019/20 Budget Assumptions

Background

1. Leadership Board received and agreed a 2019/20 Budget Framework report in November 2018, which set out the main issues to be addressed, including: Pensions Deficit Management; Property Asset Management; Treasury management; Commercial Income Development; and Revenue Budget maximisation.
2. The 2019/20 Budget process is now underway, guided by that Framework, and this report provides an update on the issues and themes, risks and opportunities noted so far, alongside an INDICATIVE view of the potential 2019/20 Budget (the final version will be provided for review and formal sign-off at the March 2019 Leadership Board) and a Medium Term Financial Plan, taking into account the potential future impacts of the current assumptions and plans.
3. The key message for the LG Group's financial position is that it continues to be challenging, due to a combination of:
 - 3.1. downward pressure on the MHCLG Grant (and other grants) expected to continue for the foreseeable future;
 - 3.2. cost inflation pressures for both staff (including the second year of the negotiated pay deal of 2 per cent cost of living increase and increments) and non-staff costs;
 - 3.3. the desire to keep subscription levels at the same level as previous years and the need to keep councils in membership;
 - 3.4. the time lag associated with securing income benefits from current investment programmes, and newly identified business opportunities;
 - 3.5. the ongoing need to service the considerable pension deficits faced by the LGA and the IDeA, plus the new external loan interest costs arising from the investment in our properties; and
 - 3.6. having called on Reserves to fund 2018/19, the need to maintain and replenish Reserves wherever possible.
4. There is also a need to ensure that over the medium term, the LG Group addresses the current Balance Sheet situation where its liabilities exceeded its assets by over £45 million at 31 March 2018 (£71 million at 31 March 2017), due primarily to the current Defined Pension Scheme deficits being larger than the capital values of our assets (including buildings). The plan to address this is set out below.

Headline Assessments

5. Despite the challenging environment described above, the outlook for the medium term remains reasonably positive.
6. In the short term - 2019/20 - it is expected that the Budget will propose a Net Cost position (ie running at a "deficit" overall, as we did in setting the 2018/19 Budget), utilising brought forward Risk and Contingency Reserves created for this purpose. This is to cover the period during our investment property refurbishment programme, where commercial rentals are not being received, and the delay in securing a material income stream from the LG Mutual investment.
7. However, from 2020/21 onwards, we expect to be able to budget a Net Income position (ie creating a "surplus") for the Group overall, with the income generated by the Property and Commercial companies more than offsetting the ongoing difficult conditions facing the Operating companies.
8. A commercial strategy has been developed based on generating additional income from the following four main directions of business development:
 - 8.1. Reviewing all existing business processes so as to explore any opportunities where services could benefit from taking a different approach. This included a review of the LGA Treasury Management policy (considered by Leadership Board in March 2018) which will help improve investment returns in future years;
 - 8.2. 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;
 - 8.3. Developing new areas of business; and
 - 8.4. Exploring opportunities for attracting big projects and innovative partnerships to the organisation.
9. The current plans to reduce our pension scheme deficit and enhance our investment assets should also result in positive Net Assets within the medium term (subject, of course, to the annual vagaries of actuarial assessments of the Pension Scheme).
10. The table below sets out, at a very high level, an early *indicative* view of the expected Net Cost or (Net Income) position possible for each of the LG Group companies over the next four years:

LG Group	2018/19		2019/20 Draft Budget £'m	2020/21 £'m	2021/22 £'m	2022/23 £'m
	Budget £'m	Forecast £'m				
LGA	1.1	1.1	1.1	(0.1)	0.0	(0.2)
IDeA	1.0	0.6	0.7	0.3	(0.0)	0.1
Operating Companies	2.0	1.7	1.8	0.2	(0.0)	(0.0)
LGMB	1.2	0.6	1.1	(1.2)	(1.2)	(1.2)
LGAP	0.5	0.5	(0.1)	(0.1)	(0.1)	(0.1)
Property Companies	1.7	1.1	1.0	(1.3)	(1.3)	(1.4)
LG Group (excl Commercial)	3.8	2.8	2.8	(1.1)	(1.3)	(1.4)
LGCS	0.6	1.0	0.0	(0.1)	(0.1)	(0.0)
Commercial Company	0.6	1.0	0.0	(0.1)	(0.1)	(0.0)
LG Group Total	4.4	3.9	2.8	(1.2)	(1.4)	(1.4)

11. The remainder of this paper reviews the various elements of the 2019/20 Budget and Medium Term Financial Plan, by each Group Company.

Issues, risks and opportunities, by Group Company

LGA

12. The LGA has a relatively high proportion of fixed costs, as it runs the infrastructure of the LG Group, and therefore has a higher sensitivity to inflationary pressures. There may also be less opportunity to share its overheads with other group companies such as IDeA as they reduce in cost base (see below). However, there have been some significant savings secured from current re-procurement programmes (such as IT maintenance spend).

13. There is a desire to have no increase in Subscription cost to Members, which provides no opportunity to increase fee income to meet rising costs. There is the ongoing risk that councils may withdraw from membership in future years, reducing Subscription income.

14. There has been a concerted effort to identify new commercial income opportunities across all departments, which has been built into the forecasts. From 2018/19 onwards, there is no central income target, but rather local areas will be asked to provide details of opportunities to encourage greater ownership of the need to create new income streams.

15. In a similar way, the way the cost of booking rooms and catering in our new Conference Suite was changed last year to be budgeted locally (the budget is being allocated from the central Facilities area) to remind all departments of the opportunity cost of utilising facilities that could otherwise be marketed and generating additional external income. The income stream from the Conference Suite will continue to be recognised in the LGA (rather than LGA(P)) as a new commercial income source.

16. The LGA also has an ongoing requirement to make Pension Deficit Payments, though there is a drop-off in repayments under the current reduction plan after 2020/21. This

situation may change after the next Triennial Valuation, which is due as at 31 March 2019, and which will affect deficit reduction contributions from April 2020 onwards.

17. It is the long term strategy to absorb the two Property Companies into the Incorporated LGA to be more tax efficient – it is likely LGA(P) will move during 2019/20 as the development of 18 Smith Square is complete, but LGMB may wait until 2020/21 to allow the Layden House development to be completed – but for 2019/20 budgeting purposes, they are both still shown, assessed and calculated separately.
18. As a result of all of the above, the expected Budget position for the LGA over the next few years is to be a call from Reserves in 2019/20, followed by future years remaining relatively close to Net £Nil, but with some years showing a small Net Income position.

IDeA

19. The current budget plan for IDeA shows the pension administration remaining with the current provider, as we have initiated the transfer to the same administrator as the LGA Scheme, but expect to effect the move as at 1 April 2020 (this is later than previously anticipated, due to contractual difficulties). Therefore the economic benefits (previously calculated at c.£0.5m saving per annum) will not be achieved until 2020/21 onwards.
20. For budgeting and modelling purposes only, we have assumed that the MHCLG Grant falls by £1 million per year (to £16m in 2022/23 from the current £21 million received in 2017/18), which is a 16 per cent decrease over those four years. It is further assumed that the Welsh CLG Grant reduces from the current £0.3m to £nil over the same period.
21. The IDeA has some flexibility in its cost structure (excluding core permanent staff costs), such that it may be capable of dealing with modestly reduced income streams in the short term without radical restructuring. Some services are procured for individual pieces of work, such that if funding isn't available, the matching cost is not incurred. However, a long-term strategy needs to be developed to cope with further potential reductions in core grant funding.
22. Discussions with MHCLG are continuing about the exact level of funding for 2019/20, and the contents of the Memorandum of Understanding about the use of the main improvement grant. There continues to be a great deal of ongoing planning to manage the funding in the most appropriate way to maximise the outcomes focussed on the LG Group priorities (as set out each year in the Annual Plan) – and significant long term net savings are likely to be required to ensure expenditure does not exceed income.
23. MHCLG funding of the Planning Advisory Service is set to continue at £1 million per annum. The Department of Health and Social Care has agreed a three-year funding package of support for the Care and Health Improvement Programme (CHIP) which amounts to £21.2 million for the period 2017/18 to 2019/20 – with £6.7 million expected in 2019/20.

24. IDeA have already started looking at the core service offering provided, and considering what services could continue to be provided on a commercial basis, if grant funding ceased and they were still considered valuable to Members. An "expert consultancy" service has been trialled in 2017/18 and 2018/19 on a cost recovery plus basis which could be extended to offer further services to Member councils as grant funded opportunities reduce. Where it is not considered feasible to replace grant-funded services with paid-for services, then the resources would be removed.
25. Among other assumptions, it is assumed that any reductions in overall grant will also be reflected with at least similar proportional reductions to Local Partnerships and CfPS, whereas similar dividends and royalties to prior years are expected to be received from the GeoPlace subsidiary. It is also assumed that further Grants are secured through the course of the year (as has been the case for several years from sources such as the Early Years, NHS Digital, Cyber-Security), which allows a certain amount of "over-recovery" of overheads.
26. As a result of all of the above, the expected Budget position for IDeA over the next few years is to draw down from Reserves again in 2019/20, but then to remain relatively close to Net £Nil in future years, however as noted above this is dependent on achieving long term cost savings or the generation of additional commercial income.

LGA(P)

27. Local Government Association (Properties) Limited owns the 18 Smith Square property. The LG Group and some associated partners (such as Local Partnerships) took up residence in October 2017 after a redevelopment exercise. LGAP receives rental income from these internal group organisations.
28. It is intended that three floors are let externally on commercial terms. We secured one tenant (NFU, Floor 1) in 2018/19. It is currently expected that tenants for floors 2 and 3 will be secured in the first half of 2019/20, with the building budgeted to be fully let from the start of 2020/21 onwards. This is slightly later than previously expected. There is a risk that further delays in securing tenants will adversely affect the income projections.
29. As noted above, the income generated by the newly refurbished Conference Suite will be recognised in the LGA.
30. Despite the time lag in gaining external tenants, it is expected that LGA(P) will have modest Net Income for 2019/20 and subsequent years of c.£0.1m (as against the previous Net Cost position for 2018/19), where the combination of internal and external rents exceed costs such as facility management and loan interest payments.
31. As noted above, we expect LGA(P) to be subsumed into the LGA during 2019/20, once its statutory status has been updated to a company limited by shares (from its current

limited by guarantee status), with the share owned by the LGA, which enable tax and VAT groups to be formed, such that the transfer of the assets is undertaken in a tax-efficient manner. For budgeting and modelling purposes, however, it is assumed that LGA(P) will remain as a stand-alone company for 2019/20.

32. The capital value of 18 Smith Square House has significantly risen post-development (as recognised in the 31 March 2018 annual accounts), which will help bring the LG Group to the desired Balance Sheet Net Assets position within the next few years as planned:

Capital Value	Pre-Development Y/e 31 March 2016 (actual) £'000	Mid-Development Y/e 31 March 2017 (actual) £'000	Post – Development Y/e 31 March 2018 (actual) £'000
18 Smith Square	£35,850	£22,970	£53,550

LGMB

33. Local Government Management Board owns the Layden House property, which is currently undergoing redevelopment. The latest estimate is that the building will be completed and returned to us, ready for external rental, in December 2019.
34. New external commercial tenants are therefore only expected to be in place from the final quarter of 2019/20 onwards. While being marketed as a multi-tenanted building, it is hoped that we can secure one lease for the entire building.
35. We expect that there will be an initial 'rent-free' period, but under accounting rules, despite there being no cash inflow for a period of time, there will be some income recognised (through spreading the total income across the life of the lease) in the year.
36. Therefore, while there is some income expected during 2019/20, LGMB will still continue to incur minor upkeep costs (such as facilities management, reduced business rates, etc.) for the full year, such that the budget profile is for a Net Cost position in 2019/20 of more than £1 million – to be covered by Reserves generated over the past couple of years for this specific purpose, before moving to a Net Income position generating more than £1 million per annum (and replenishing Reserves) from 2020/21 onwards.
37. As noted above, we expect LGMB to be subsumed into the LGA in the next few years. We will undertake the same process as LGA(P) (statutory status change, tax/VAT group creation and transfer of the assets), but we expect to wait for the development to be completed first to simplify contract management. For budgeting and modelling purposes, therefore, it is assumed that LGMB will remain as a stand-alone company for 2019/20.

38. Similar to LGA(P), the capital value of Layden House is expected to significantly rise post-development, which will also help bring the LG Group to the desired Balance Sheet Net Assets position within the next few years as planned:

Capital Value	Pre-Development Y/e 31 March 2017 (actual) £'000	Mid-Development Y/e 31 March 2018 (actual) £'000	Post – Development Y/e 31 March 2020 (expected) £'000
Layden House	£28,175	£36,750	£52,500

LGCS

39. Local Government Commercial Services was incorporated in October 2017 with the intention of being an investment vehicle for the LG Group. It was initially created to hold the joint venture (with Regis) providing administration services to the Local Government Insurance Mutual, but it could be used in future years to hold other investments. It is a commercial and taxable entity.
40. LGACS is the most speculative element of the current proposed 2019/20 budget and Medium Term Financial Plan, as its results and cashflows are subject to the widest range of potential outcomes, given the continued uncertainty surrounding the timing, extent and volume of premiums raised by the LG Mutual.
41. It is expected that LGACS will receive a Management Fee, dividends and profit share from the venture, with those income flows starting to be received in a limited way in 2019/20, but increasing in future years as more business is won by the LG Mutual.
42. Therefore it is expected that 2019/20 will be another Net Cost (as was the case for 2018/19) as we continue to invest in the LG Mutual start-up, a flat/break-even 2020/21, before positive cashflows and a Net Income position from 2021/22 onwards. This investment will be funded from the intercompany loan of £2 million approved by Leadership Board and the LGACS Company Board in November 2018.

Implications for Wales

43. 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

44. As above.

Next steps

45. Members are invited to review and note the proposed 2019/20 Budget Assumptions and issues, and the financial direction of travel over the course of the Medium Term Financial Plan.