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

30th November 2018

**Summary of the Report:**

This report provides an overview of the macro-economic environment in which the council is operating. The report notes that there is significant economic uncertainty underlying the forecast £35-40m deficit that is likely to continue into the medium-term, affecting the council's medium term modelling.

The report sets out the effects of rising inflation on costs, discusses the latest position on council funding, and illustrates the overall impact on the council's medium-term financial forecasts.

Finally, there is a summary of the council's inflationary assumptions for 2019/20 onwards.

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## 1 INTRODUCTION

1.1 The council is facing a large degree of uncertainty in the medium term. Our levels of funding may be impacted by the outcomes of a number of upcoming announcements. This includes the Spending Review 2019, which will define the quantum of funding available to local government; and the Fair Funding Review, which re-evaluates the distribution of funding between local authorities. The terms of the London-wide 100% business rates pilot are yet to be confirmed, although latest updates suggest it will continue at a lower retention rate of 75%. It is further unclear how business rates will be treated beyond 2019/20.

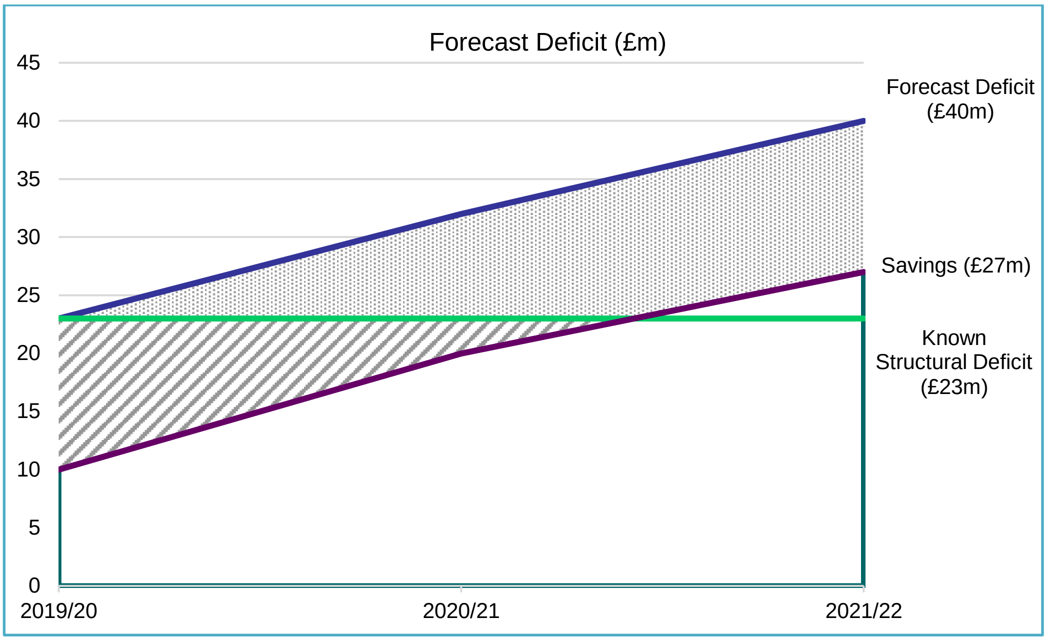
1.2 Simultaneously, the council's spending projections are heavily impacted by assumptions regarding inflationary cost increases, which will be closely linked to the economic outcomes of Brexit negotiations and could therefore change significantly. This makes forecasting of the deficit beyond 2019/20 very difficult.

1.3 Brexit continues to weigh down on the UK's economic outlook. There is a risk that the uncertainty around negotiations of the exit deal, and the final exit deal itself, could result in poorer economic performance and potentially 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.

## 2 OUR FORECAST DEFICIT

2.1 The council was able to set a balanced budget for 2018/19 due to its decision to set a comprehensive medium-term financial strategy. Current council assumptions forecast a £23m deficit in 2019/20, primarily due to known funding decreases as outlined in the multi-year settlement, along with allowances for inflationary increases as detailed in section 4. It is forecast that this deficit will increase to £35-40m by 2021/22 – despite allowing for growth in our council tax base and business rates income. The £27m savings programme set out in the *December 2018 MTFS* lays out how the council intends to begin to address the deficit, as per Chart 1.

**Chart 1 – Forecast against known structural deficit**




2.2 It is likely that further pressures may also arise in that time, particularly due to the borough's changing demographic. In particular, the Office for National Statistics expect the borough's population is set to increase at by 7.5%, 2.2% higher than the average of other London boroughs and 3.5% higher than the rest of England. Furthermore, local government finance is facing historic levels of uncertainty in the medium term, as considered in detail section 3. It is expected that the impacts of this will affect the deficit forecasts in the medium term.

## 3 WIDER ECONOMIC ENVIRONMENT

### Medium term funding forecasts

3.1 The council's current forecast is subject to many unpredictable developments, as with 2019/20 being the final year of the four-year settlement set out in 2016/17, which confirmed that annual cuts to core government funding will continue year on year up to 2019/20. Even if core funding plans remain unchanged, the detail of the latter years of the settlement remain uncertain[1], as material elements of the council's funding were not subject to the multi-year offer. The funding for 2019/20 is expected to be confirmed on 6th December 2018 as part of the provisional local government finance settlement.

### Economic Outlook

3.2 The Office for National Statistics (ONS) revised last year's budget deficit down, relative to estimates made in March and April 2018. Borrowing also fell more sharply than anticipated during the first half of 2018/19. This means the government are forecast to be borrowing £11.9bn less for the 2018/19 financial

[1] The main funding within the 4 year settlement relevant to Camden were revenue support grant and retained business rates multipliers. Excluded were public health grant, new homes bonus and the improved better care fund.

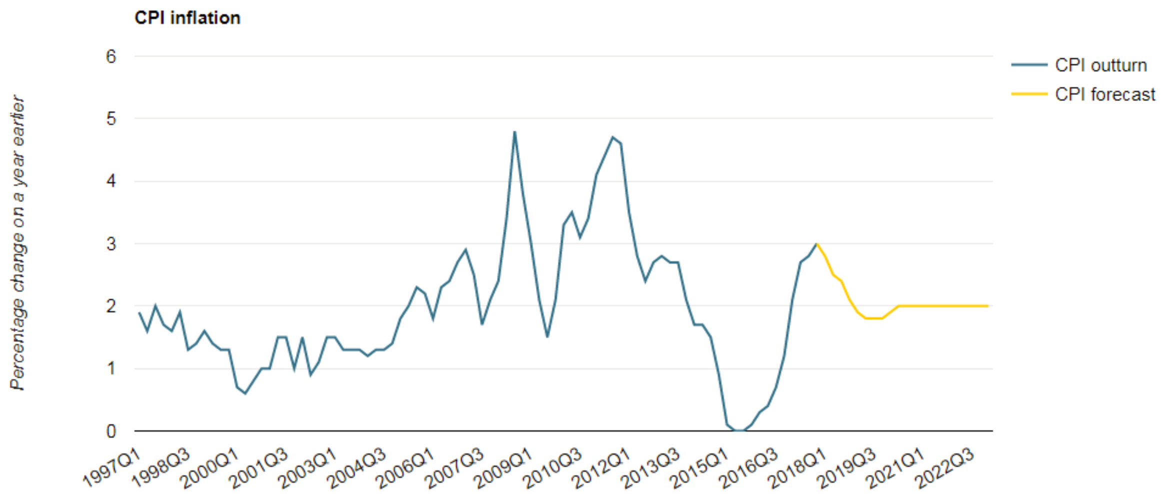
year, suggesting stronger tax revenues and lower spending on welfare and debt interests than expected.

3.3 Gross Domestic Product (GDP) is considered to be an indicator of the strength of the economy. It has been revised downwards from 1.5% to 1.3% in 2018. The Office for Budget Responsibility (OBR) attributes this to the temporary effects on the national economy of the heavy snow in the first quarter of 2018. As such, it is anticipated that the forecast will strengthen by the end of the year, reflecting the continuing downward trend of unemployment. The OBR notes this would reduce net borrowing by a further £6.2bn to £18.1bn by 2022/23 and is the largest favourable forecast revision made since December 2013.

3.4 Although net borrowing has reduced, the subsequent fiscal windfall has essentially been spent under policies submitted in the Autumn Budget (as outlined in sections 3.6 to 3.9). In particular, the Prime Minister's pledge in June 2018 for higher spend for the NHS is expected to cost £7.4bn in 2019/20, rising to £27.6bn by 2023/24 in gross terms. The overall effect of the Budget policies is therefore to increases the national deficit by £1.1bn this year, and £10.9bn next year[2].

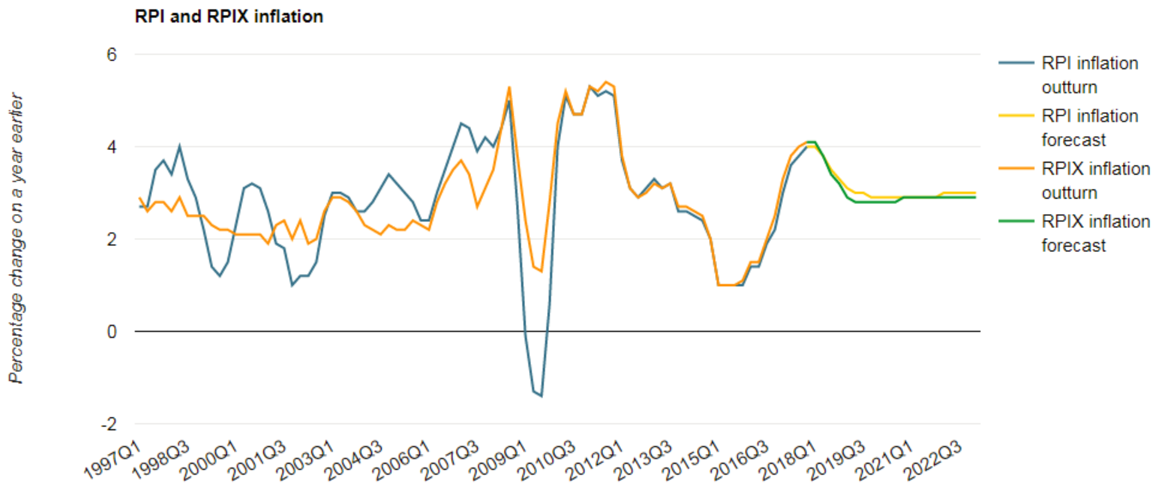
3.5 It should also be noted that CPI inflation has declined in line with March 2018 forecasts. It is expected that higher oil prices and a weaker exchange rate will mean that CPI increases in subsequent quarters to 2.6% by the end of the financial year. CPI is expected to remain a little above the Bank of England's 2% target in the medium term. RPI inflation is currently 3.3%, expected to reduce to 2.8% in 2019 and then steadily increase in the medium term. This is illustrated in Chart 2.

**Chart 2 – OBR CPI and RPI and RPIX Forecasts[3]**




[2] Office for Budget Responsibility: Economic and fiscal outlook – October 2018; https://cdn.obr.uk/EFO_October-2018.pdf

[3] Images courtesy of the Office for Budget Responsibility; https://obr.uk/forecasts-in-depth/the-economy-forecast/inflation/




**Autumn Budget**

3.6 The Chancellor of the Exchequer presented his Autumn 2018 Budget on Monday 29 October 2018. If the current Article 50 deadline remains in place this will be the last Budget before the UK leaves the European Union on 29 March 2019. However, the Chancellor also indicated that the Spring Statement could be upgraded to a full budget dependent on the situation at that time, particularly if the UK faces a ‘no deal’ departure scenario.

3.7 The key fiscal announcements affecting are mostly short-term in nature, and include:

- *Adult Social Care* - In addition to the £40m one-off Adult Social Care relief announced for 2018/19, the Chancellor announced a further £650m of extra social care funding for English local authorities in 2019/20.
- *Universal Credit* - The Chancellor announced £1bn in transition funding over the next 5 years. It is expected that local authorities will benefit from this funding, due to their key role in rolling out Universal Credit.
- *Schools* - £400m capital grant was announced for schools for 2018/19. It is expected that Camden will receive c£390k for its 39 primary schools and £450k for its 9 secondary schools. It is unclear what funding will be made available for our special schools and nurseries.
- *Infrastructure* - £420m will be made available immediately to local authorities for potholes, bridge repairs and other infrastructure maintenance.

3.8 As such, it appears that the council will receive additional funding beyond what has been laid out in the multi-year settlement. Although the additional funding is welcome, particularly in light of emerging demographic pressures, the funding will have strict conditions attached to it, reducing the council’s ability to make locally informed decisions over how to best allocate this resource. This means that meeting the council’s forecast deficit still remains a challenge.

3.9 It is likely that further information will be received in respect of the Autumn Budget announcements when MHCLG release the provisional local government finance settlement (LGFS), scheduled for 6th December 2018.

### Spending Review

3.10 The government had indicated at the 2018 Spring Statement its intention to carry out a Spending Review in 2019.This was assumed to be for the four year period 2020/21 to 2023/24. This was confirmed in the Autumn Budget 2018, and it is expected the Spending Review will occur after Brexit negotiations have completed.

3.11 The government has not yet provided departmental budgets (known as RDEL – Resource Departmental Expenditure Limits) for the period of the spending review as suggested in Spring 2018. Instead, it has shown aggregate departmental resource budgets split between NHS England and all other Departmental spending in the Autumn Budget. Overall funding is shown to increase from £327bn in 2019/20 to £371.6bn in 2023/24; which represents a cash increase of 13.6%. The government adds that from 2019/20 to 2023/24, RDEL spending, including the NHS settlement, will grow at an average of 1.2% per year in real terms. This is assumed to be based on CPI inflation (forecast at 2.1% per annum, rather than RPI inflation (forecast at 3.1% per annum).

3.12 This means that after excluding the increases for NHS England, resources across the rest of government Departments will increase in cash terms by just 8.4% over the 4 year period 2019/20 to 2023/24, which is roughly in line with the increases in CPI for the period set out by the OBR. Therefore, this would suggest that outside of NHS England, all other Departments combined will not see any real terms increase (above inflation) in their funding for the period 2019/20 to 2023/24. In addition, the 8.4% would be the average across the departments; with individual departments likely to be above or below this mark.

3.13 However, the government states that the figures provided do not represent the final envelope for Spending Review 2019, which it indicates will be set in due course, which may mean at the Spring Statement in 2019. Nonetheless, it remains prudent to assume that local government are unlikely to receive a significant increase in real-term funding from the Spending Review.

### Fair Funding Review

3.14 Central government funding for local authorities is based on an assessment of its relative needs and resources. The methodology underpinning those calculations has not be reviewed for over 10 years, is complex and lacks transparency. As such, the government is undertaking the Fair Funding Review to update the formula and set new funding baselines ahead of the new 75% business rates retention scheme expected to be introduced in April 2020.

3.15 Table 1 sets out the expected timeline. At this stage, MHCLG are continuing to review the parameters to be included as part of the Fair Funding review, which will determine how local government funding will be allocated between local authorities across the country.

**Table 1 – Fair Funding Review Timeline**

| Date | Milestones |
|---|---|
| March 2018 | Technical consultation on relative needs closes |
| Spring /Summer 2018 | MHCLG issue series of technical papers on relative need, resources, and transition |
| Summer 2018 | Finalise overall structure and leading options for needs and resources assessments |
| Spring 2019 | Finalise options for needs and resources |
| Summer 2019 | Conclusion of detailed research project into Children's Services |
| Summer 2019 | Indices of deprivation data sets updated |
| December 2019 | Provisionals 2020/21 Local Government Finance Settlement |
| Spring 2020 | 75% business rates retention scheme begins with new funding baselines |

3.16 For London Boroughs, including Camden, the overarching drivers of costs relate to deprivation, area costs in respect of London's unique labour and property markets, and London's changing population.

3.17 At this stage, it appears that the Foundation Formula will be based primarily around population alongside a small number of other indicators. Population is a key driver, particularly for Camden, as a high population means increased pressure on council services. It is unclear whether day-time population (which for Camden is considerably higher than its residential population) will be considered. Inclusion of the most accurate population measurements will therefore have high significance – particularly considering the rate of population increase - and there is general consensus that the latest official population projections such as those provided by the ONS should be used.

3.18 Area Costs Adjustments (ACAs) are expected to cover labour costs and business rates costs, as well as 'access' and 'remoteness'. Accessibility could relate to both downtime related to large distances travelled, such as in rural areas, and congestion associated with high density and inner city areas. Remoteness is considered as this can often create additional costs due to distance from major market providers, resulting in reduced competition for services tendered. Other service specific ACAs will be included and are yet to be confirmed.

3.19 As rurality is likely to be covered through both accessibility and remoteness, it has been proposed that this will not be a cost driver within the Foundation formula.

3.20 The ACAs will be applied at District level geography, with the weighting of different criteria within the ACA to form a key part of the next consultation.

3.21 Deprivation is a key driver of need as it determines demand for many of the services local authorities provide. In particular, this includes Housing, Adult Social Care and Children's Social Care. Existing measures of deprivation do not account for the roll out of Universal Credit, nor the higher costs of housing within London. The government are therefore identifying alternative measures.

3.22 There has been acknowledgment that there will be transitional protection in moving to the new model, however it is expected to be more complex than methods used in the past. It is expected that MHCLG will continue to consult on the parameters and any possible transitional funding. Once confirmed, these parameters will be incorporated into the council's medium term funding projections.

**Business Rates Retention**

3.23 In 2018/19, the council entered into the London-wide 100% Business Rates Retention Pool pilot scheme. Discussions are currently underway between the pool and MHCLG to discuss the future of the pool moving into 2019/20. It is currently expected that the pool will continue but at a lower retention rate of 75% of business rates collected. It is also likely that the no detriment guarantee offered to the London pilot in 2018/19 will not continue, increasing the risk to the council of lower return than expected. As part of the *December 2018 MTFS Report* Cabinet were asked to agree to the pilot in principle, but the final decision will rest with the council Leader further to negotiations.

3.24 Should the pool continue, it is likely that any growth will be shared by the pool, and distributed based on the four agreed objectives. These are based on incentivising growth (by allowing those boroughs with growth to keep some proportion of it), 35% for recognising the contribution of all boroughs (through a per capita allocation), 35% based on recognising need (through the needs assessment formula), with 15% facilitating collective investment with a strategic investment pot.

3.25 Nonetheless in updating our medium-term projections, we have decided to continue to increase our anticipated business rates retained receipts by 1% each year rather than maintained anticipated flat cash balances. This is considered prudent when balancing the opportunities and risks – principally that rates rise by CPI each year but there is the potential for continuing reductions due to appeals.

3.26 The Chancellor made announcements in respect of business rates during the Autumn Budget 2018, including:

- For two years up until the next Revaluation in 2021 all retail premises with an RV below £51,000 will have their bills reduced by one third; on past precedent it would be expected that Local Authorities will be to be compensated for this measure through s31 grant.
- In the Revaluation expected in 2021, rateable values will be adjusted to reflect rental values.
- The Chancellor also confirmed intentions for business rates retention (currently set at 50% for non-pooling authorities) to increase.
- £675m of co-funding will be provided to local authorities through a new "High Streets Fund" to assist with rejuvenation of High Streets and changing unused business and commercial property into residential accommodation. Local authorities will be required to apply to access the funding.

**Brexit**

3.27 The OBR recently noted that the referendum vote to leave the EU appears to have weakened the economy. The fall in sterling has squeezed real household incomes, offset only by a modest boost to net trade. Uncertainty regarding the negotiations has dampened business investment with studies indicating the economy was between 2% to 2.5% smaller in mid-2018 than had the referendum not been called. The growth rate has also slowed, taking the UK from near the top of the G7 growth league table to near the bottom.

3.28 The government has also now issued the Brexit withdrawal agreement, setting out what will happen when the UK leaves the EU on 29 March 2019, including during the transition period set to run until December 2020.

3.29 The agreement notes that during the transition period, the EU's free movement rules still apply, the UK will still have to follow all EU rules and rulings of the European Court of Justice (ECJ). A customs "backstop" will kick in should the UK and EU fail to reach a long term deal in respect of trade or the Irish border. However, the UK will not be able to strike deals to lower tariffs with other countries outside the EU until an EU trade deal is negotiated and the "backstop" ceases.

3.30 It is unclear what will occur beyond the transition period, with many items that will shape the future nature of the UK's relationship with the EU still to be agreed. As such, it remains unclear what the impact of Brexit will be on local authorities.

## 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 2013/14 onwards are set out in Table 3 (including revised rates for 2018/19 and 2019/20 discussed below).

**Table 3 – Standard Inflation Rates 2013/14 onwards**

| Type | Description | 2013/14 | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 onwards |
|---|---|---|---|---|---|---|---|---|
| Expenditure | Employees | 1.00% | 1.00% | 1.00% | 1.00% | 1.00% | 1.00% | 2.00% |
| | Premises | 3.00% | 1.00% | 1.00% | 1.00% | 1.00% | 1.50% | 2.00% |
| | Supplies & Services | 3.00% | 0.00% | 0.00% | 1.00% | 1.00% | 1.50% | 2.00% |
| | Transport | 3.00% | 0.00% | 1.00% | 1.00% | 1.00% | 1.50% | 2.00% |
| | Contracts | 3.00% | 1.00% | 1.00% | 1.00% | 1.00% | 2.00% | 2.50% |
| Income | Fees & Charges | 3.00% | 3.00% | 3.00% | 1.50% | 1.50% | 1.50% | 2.00% |
| | Sales | 3.00% | 3.00% | 3.00% | 3.00% | 3.00% | 1.50% | 2.00% |
| | Rents | 2.00% | 2.00% | 2.00% | 2.00% | 2.00% | 2.00% | 2.00% |

4.3 Exceptions to the standard indices listed above are summarised in Table 4. In our medium-term modelling, we have continued to apply inflation to the below exceptions at the level stated up to 2019/20 and beyond, and are currently undertaking a review with procurement and the relevant services.

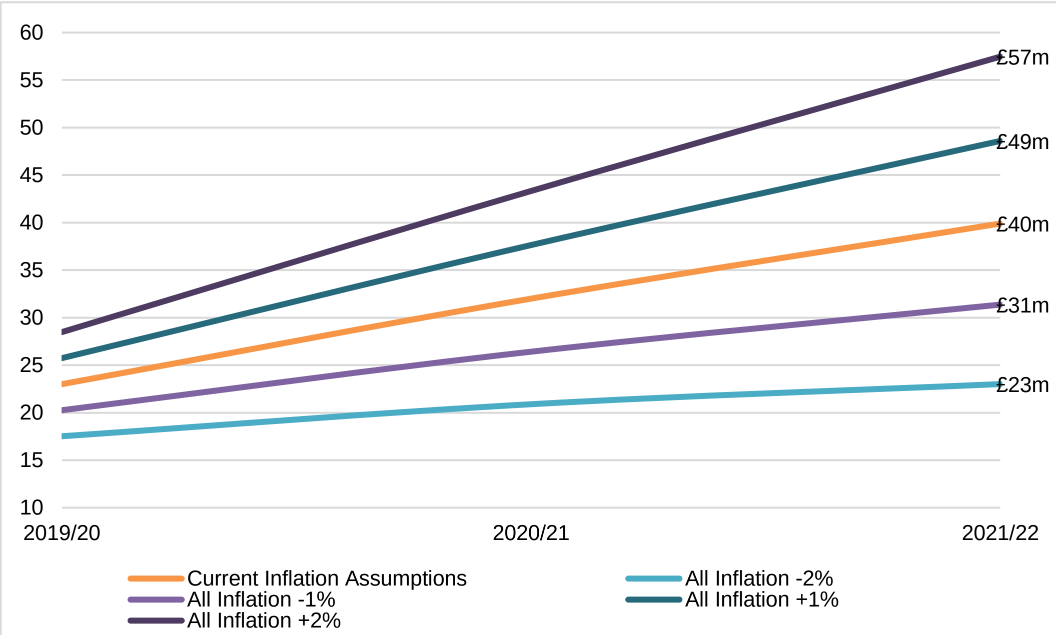
## Table 4 – Exceptions to Standard Inflation Rates Applied

| | Category | Description | Standard Inflation | Exceptional Inflation |
|---|---|---|---|---|
| Expenditure | Saving target to be delivered | Savings entered in budget without allocating to services. Inflating targets adds to in year pressure | 2.0% | 0.0% |
| | Business Rates | CPI inflation rates as indicated by the ONS | 2.0% | 2.3% |
| | Energy Rates - Electricity | CPI inflation rates as indicated by the ONS | 2.0% | 2.0% |
| | Energy Rates - Gas | CPI inflation rates as indicated by the ONS | 2.0% | 2.0% |
| | Highways contract price formula | Highways - contract charges D4250 JX220 charges are based on agreed contract | 2.5% | 3.3% |
| | Levies | Where levies are funded corporately, the do not require additional inflation. | Various | 0.0% |
| Income | Library Income | Income F&C and Sales in are currently only achieving 50% of their budget. | 2.0% | 0.0% |
| | Saving target to be delivered | Savings entered in budget without allocating to services. Inflating targets adds to in year pressure | 2.0% | 0.0% |
| | NHS Funding | Funding grants provided by the NHS do not necessarily increase with our approach to inflation | 2.0% | 0.0% |
| | Statutory Fee | Where fees are determined by central government, inflationary increases do not apply. | 2.0% | 0.0% |
| | DSG and other Schools related funding | Dedicated Schools Grant funding levels are determined by central government and therefore not inflation. | 2.0% | 0.0% |
| | Kings Cross development contribution | This is a historical income target - no longer received (see IRB paper) | 2.0% | 0.0% |
| | Development Management Statutory Planning Fee | Not controlled by the service - set by Central Government, also has a significant pressure | 2.0% | 0.0% |
| | Discretionary Fees | This is a historical income target for Engineering services and the development of Kings Cross, which is now complete. | 2.0% | 0.0% |
| | Events Income | The service is having significant pressures against predetermined income targets | 2.0% | 0.0% |
| | Transport Planning and Parking LIP funded | Agreed Top slice amount from TfL for LIP schemes not being inflated | 2.0% | 0.0% |
| | Tennis Income | Currently only achieving a proportion of budget | 2.0% | 0.0% |
| | Discretionary Fees | The usual grant funded LIP budget allocation received from TfL has been drastically cut across all of London and is likely to be continued to be reduced. D4364 TH072 | 2.0% | 0.0% |
| | Benefits overpayments | Relates to where we've overpaid residents housing benefits and need to recoup. Results from an initial error so shouldn't really be encouraging them to make more | 2.0% | 0.0% |
| | Registrars | Income pressures in service, budgets have been frozen for a number of years as a result | 2.0% | 0.0% |
| | Schools traded income | Income in relation to recharges to schools which is subject to SLAs which can cover multiple years | 2.0% | 0.0% |
| Other | NLWA | The NLWA is a separate entity, therefore does not receive inflation from council budgets | Various | 0.0% |

4.4 Historically, the council has aimed to maintain moderately low inflation rates (below CPI and RPI levels) to encourage efficiencies within the services. However, there is now high uncertainty over inflation, especially since the outcome of the EU referendum. As a result, the current medium term financial forecasts, (which include balanced budgets up to 2018/19 assuming full delivery of savings in the current MTFS), now reflect higher inflation assumptions from 2018/19 onwards. This also reflects current forecasts from the Office of Budget Responsibility, which projects that inflation will exceed 2% in 2017/18 when measured against CPI, and will steadily grow by 2% year-on-year from 2018/19.

4.5 Should there be any dramatic changes in inflation, it could cause pressures on the projected position. As way of illustration, an additional 1% inflation would increase the gap to £49m. Chart 3 illustrates the impact of changes to inflation upon the deficit forecasts.

**Chart 3 – Forecast budget deficit to 2021/22 and impact of different inflation allowances (£m)**




**London Living Wage**

4.6 The council is working to implement London Living Wage (LLW) in all our local contracts, as we believe that being accredited as a LLW employer allows us to contribute to tackling inequality and it is a crucial tool in making work pay in the borough. LLW is being implemented across all new contracts, always subject to the council deciding that paying the LLW presents best value for those contracts to the council. £3m was set aside as part of the previous financial strategy to take contracts on to LLW and to improve conditions in homecare contracts. We firmly believe that investment will improve the quality of services and the daily lives of those who work for Camden and its supplier organisations.

4.7 LLW has increased by 17% since its introduction in November 2011, with annual increases well above CPI inflation each year. In order to better plan for the likely pressures created by funding LLW prior to exploring the granular work set out above, we have increased our inflation allowance on contracts to 2.5% in 2019/20 and beyond.

## 5 CONCLUSIONS – REVISED MEDIUM-TERM FINANCIAL FORECASTS

5.1 The council has proposed a medium-term financial strategy that addresses the known structural deficit whilst ensuring the aims of Our Camden Plan are achieved. As set out above, the outlook for local government finance remains uncertain beyond 2019/20 and are likely to impact upon the council's financial forecasts. As such, Officers will continue to monitor the external environment and update assumptions as required, to ensure the council is able to respond to any changes in demographics and central government financial policy.