

ADDENDUM – Transfer of Lewisham Service – Item 9 for M&C 11th January 2017

13 Financial Implications

13.1 Option 1

13.1.1 This option requires the Council to underwrite all the pre-transfer liabilities, to cover the post transfer redundancy costs and any shortfall in the pension fund should the 26% paid in employers' contributions not meet the future costs of the pension liabilities at the end of the contract. Experience has shown these can be considerable.

13.1.2 The Council is being asked to underwrite the following liabilities should the Music Service fail:

At 1.4.2017	Best Case	Worst case
Teacher's Pension Scheme		
Guarantee required to enter the scheme	£34,000	£34,000
Local Government Pension Scheme		
The Redundancy costs of the staff Tupe transferred to the Music Service currently estimated at	£ 247,000	£247,000
The Council's Actuary, Hymans Robertson, were asked to produce a report on the risks associated with entering an Admission Agreement with the Music Service. The report advises the Council to seek a bond from the Music Service to cover liabilities to the pension fund should the Music Service fail. As this is a new venture the Music Service is unable to secure a bond. The Actuary estimated the amount the bond should cover: If there was a 20% chance of failure the cost is estimated at: A 90% to total failure is estimated at:		
Therefore the 'cost the Council is being asked to underwrite is	£169,000	£371,000
	£450,000	£652,000

13.2 Option 2

13.2.1 It is unlikely the trustees will accept this option which will risk the transfer of the music service to Lewisham Music.

13.2.2 This option suggested that if the Council did agree to underwrite the risk it would be for a maximum of 3 years. This ties up with the valuation of the Pension Fund and its Admitted and Scheduled bodies (of which the Music Service would be one) and it also ties in with the ACE funding Grant (£404k) to the Music Service which has not been guaranteed beyond 31.3.2020.

13.2.3 If the Music Service is in operational difficulties during the first three years the Council should be made aware of this immediately, but, the three year revaluation would determine the position of the Music Service, and its pension liabilities, after three years. If the position

is favourable it would no longer be necessary to underwrite the risk as the service should be able to embrace this going forward, if the position is poor, and the liabilities have increased, then a decision on the future position can be made at this point.

- 13.2.4 It should be noted that it is not normal practice, although this was the case exceptionally with the Youth Service for contract specific reasons, for the Council to underwrite liabilities for a transferring service. The expectation when a service voluntarily “spins out” is that it is able to take on all its liabilities from the outset.
- 13.2.5 M&C should be mindful that any decision taken in relation to future ‘spin outs’ should be dealt with on their merits and any decision taken here should not be taken as a precedent.
- 13.2.6 The Council also has a duty to protect the LGPS and ensure it is funded to meet its liabilities and these arrangements are a risk as we would not have any control over the management of the Lewisham Music post transfer.
- 13.2.7 The Music Service is funded by a combination of grant from the Arts Council England (ACE) and fees from both schools and parents for tuition. The grant funding has been guaranteed until March 2020 but after this date the position is unknown. Income from Schools will reduce as schools face significant costs pressures through cash frozen settlements and the implementation of the national funding formula for schools. The total income of the music service is £1.1m, the grant is £0.4m
- 13.2.8 The total legal, consultancy and management costs of the transfer are being met from Lewisham Music Service ring-fenced funds. This has been possible through a budget restructuring in 2015/2016 and 2016/2017 (without any consequent reductions in levels of service) together with a budget surplus built up through rigorous controls of costs and expenditure. The total legal, consultancy and management costs of the transfer are estimated at £50,000.
- 13.2.9 The Music Service’s estimated budget surplus at 31 March 2017 is £135,000. The surplus at the year-end will be transferred to Lewisham Music to provide an opening bank balance of £50,000 and a cash reserve of £85,000 (see Background Paper 9, Appendix 4).
- 13.2.10 The Music Service currently receives the benefit of in-kind corporate services from the Council. These are estimated to cost the Council £95,149 per annum. This covers services such as legal, finance, HR and property costs. In-kind services will be replaced by alternative providers on transfer. As a result these costs will be no longer be incurred by the Council following the transfer.
- 13.2.11 The Music Service’s assets are valued as follows:

Item	Value
Musical instruments	Purchase value: £965,246 Current value (staged depreciation to 40%): £495,500
Sheet music and learning resources	£15,000
Other musical and business equipment	£8,200
Total assets	£518,700

- 13.2.12 Officers propose these assets are transferred to the charity so that they can continue to be made available to schools and users as well as provide a source of earned income for the charity. The assets could be utilised to offset the costs of insolvency if the charity was to default.