Cabinet

14 July 2022

A Financial Framework for the 2023/24 Medium Term Financial Strategy Refresh

Recommendations

Cabinet is recommended to:

1) Note the emerging financial position within which the 2023/24 budget and 2023-28 Medium Term Financial Strategy will be developed;

2) Agree the strategic principles that will form the basis of the Medium Term Financial Strategy, as set out in paragraph 2.4;

3) Subject to the agreement of the principles, approve the proposals for the refresh of the 2023/24 Medium Term Financial Strategy and Capital Strategy, as set out in Sections 3 and 4;

4) Note the requirement for the Authority to set a sustainable balanced budget which shows how income will equal spend over the short- and medium-term; and

5) Approve the timetable for agreeing the 2023/24 budget and Medium Term Financial Strategy Refresh.

1. Purpose of the Report

1.1. Over the five years to 2026/27 the Medium Term Financial Strategy (MTFS) approved in February 2022 was balanced, considering likely additional spending need and the expected level of resources. It required the delivery of £65.7m of savings and the use of £41.1m of reserves.

1.2. The 2023/24 MTFS refresh therefore has a strong and robust starting point. It will update the figures for additional spending need and the resource forecasts based on the latest information available and reflect how the current year's

(2022/23) financial position looks compared to the planned budget. It will also extend the MTFS into 2027/28 so the commitment to having a balanced five-year rolling MTFS is maintained.

1.3. The context in which the 2023/24 refresh is happening has moved on from being dominated by Covid. Instead this has been replaced by a fundamental financial uncertainty around the current inflationary pressures and the consequent impact on both the cost of service we deliver and the demand for services as households and communities struggle with the rising cost of living. These inflationary impacts are not only a short-term issue but are likely to result in a permanent uplift in our cost base.

1.4. Added to this are significant uncertainties around Government policy and the timing of any changes in terms of local government funding reforms, major reforms to Social Care, the opportunities and challenges of Devolution and Levelling Up, the White Paper on Fire Reform and possible reform of the Planning system.

1.5. As a consequence, the economic situation remains hugely challenging, with the direct and indirect impacts of all these factors on the County Council as well as our partners both unknown and highly volatile at this stage.

1.6. The purpose of this report is to bring these strands together and to provide a framework for the 2023/24 MTFS refresh for Cabinet to consider. The recommended approach will enable the Council to respond effectively to changing circumstances while maintaining a longer-term focus on the Council's financial sustainability. It seeks agreement to a set of strategic principles that will form the basis of the MTFS Refresh before going on to set out the key areas of activity and proposed timetable of key dates between now and the budget setting Council meeting in early February 2023.

2. Framework for a Robust, Sustainable and Financially Resilient Warwickshire

2.1. An effective MTFS ensures the Authority has the financial strategies, plans and financial decision-making framework in place that will deliver a financially resilient and sustainable Authority over the short, medium and long-term. The key components are:

- A 5-year Revenue Plan to balance annual funding and expenditure;
- A Capital Strategy and Capital Investment Programme to optimise the way in which we generate, manage and allocate the capital funds at our disposal;
- A Reserves Strategy and an associated programme of reserves reviews to

make sure the money we hold is effectively managed to meet the financial risks and uncertainties; and

- Treasury Management and Investment Strategies that govern how, and to what extent, we can use our cash reserves and balance sheet strength to invest in the Council's priorities and plans.

2.2. The MTFS framework set out in this report will cover all of these issues. It will determine the likely levels of resources and balance sheet capacity available over the medium term, the level of spending priority commitments arising from the Authority's ambitions over the medium term and their subsequent prioritisation and the impact on the Authority's balance sheet and cash resources; and, given that there is likely to be a gap, identify additional options to deliver budget reductions that can be evaluated alongside spending priorities.

2.3. The approach set out in the report is a holistic one which combines the uncertainty over our medium-term resource levels, growing demand and cost pressures and the effect of the use of our balance sheet to invest in the Warwickshire Property and Development Group (WPDG) and the Warwickshire Recovery and Investment Fund (WRIF). Driven by the priorities set out in the Council Plan and the associated Delivery Plan, the impact of any proposals on both the MTFS and our balance sheet will be considered together. These factors, along with the inflationary risk, mean the 2023/24 MTFS refresh will be more complex than usual. It is likely to provide Members, with some difficult choices about priorities and the risk appetite around the potential significance and volatility of our assumptions requiring scenario planning and sensitivity analysis.

2.4. Cabinet are therefore asked to agree a set of key strategic principles as a starting point within which the 2023/24 MTFS will be developed. The key strategic principles are:

Principle 1: The inflationary uplift is not a temporary phenomenon. Prices expected to revert to increasing at roughly 2% per annum after a step change in 2022/23. The MTFS should provide for that step change.

Principle 2: At this stage planned Council Tax increases are likely to be essential to a balanced and sustainable MTFS.

Principle 3: The impact of inflationary pressures in 2022/23 will, as far as possible, be manged in year through robust budget management and, where necessary the use of the reserves specifically set aside for this purpose in the budget agreed in February 2022.

Principle 4: Given the estimated inflationary impacts, there will be a very high bar for new permanent allocations and a clear expectation that existing planned budget reductions will be delivered.

Principle 5: Substantial increases in the cost of capital projects will mean not everything currently on the books or planned to meet our ambitions can go forward. We will be able to afford to do less. This means a greater need for prioritisation, and we will inevitably need to pause/stop/rescope certain projects as our capital budgets will buy much less than originally expected.

Principle 6: The review/prioritisation of the capital programme and pipeline will be based on the return on investment relative to the Areas of Focus in the Delivery Plan, the impact on Levelling up priorities, the overall balance of the programme and deliverability risk.

2.5. All of the elements of a sustainable and financially resilient MTFS will require a range of activity, information and intelligence gathering and reports that will need to be brought together before decisions are made over the next six months. The overall objective is to ensure a transparent approach, taking into account the full risks and implications for services and communities, to meet the overarching aim of being a robust, sustainable and financially resilient Authority well-placed to rise to the challenge of meeting the ambitions set out in the Council Plan in a post-Covid environment.

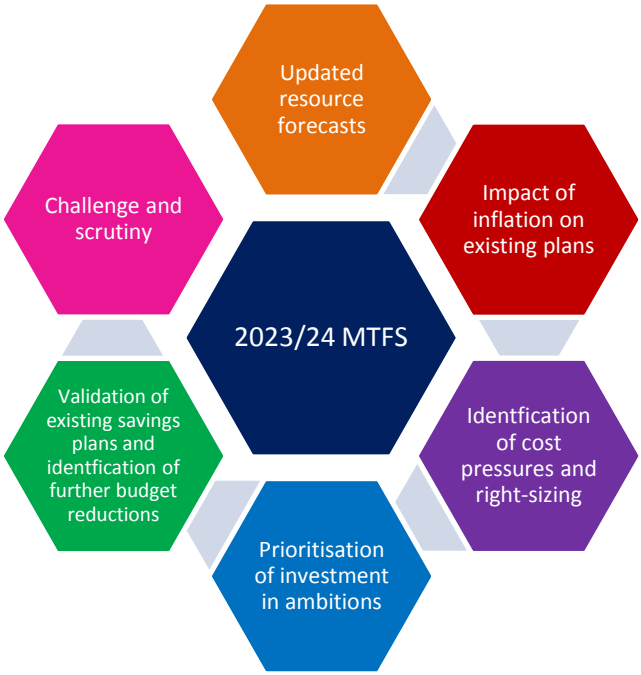
2.6. More details on the proposed activities and how they will contribute to meeting our financial aims are set out in Sections 3 and 4.

3. 2023/24 MTFS Refresh

3.1. The starting assumption for the 2023/24 MTFS refresh is that the impact of inflationary pressures in 2022/23 can be manged in year through robust budget management and, where necessary the use of the reserves specifically set aside for this purpose in the budget agreed in February 2022. If this proves not to be the case, then the approach set out in the report and the rigour with which it is pursued becomes even more important.

3.2. Diagram 1 shows the areas of activity that will need to be undertaken to deliver a refreshed 2023/24 MTFS, alongside a further review of reserves.

Diagram 1: Areas of Activity to Deliver a Refreshed MTFS



3.3. Updated Resource Forecasts

The basic model of resource forecasting used for the 2022/23 MTFS remains valid. However, the level of uncertainty we continue to face means, at least initially, we will need to plan for a range of potential resource scenarios. We will only be able to narrow these down as the economic position and the Government's national approach becomes clearer.

Table 1 summarises the level of additional budget reductions required from 3 broad scenarios. and **Appendix A** outlines the assumptions that underpin them. The scenarios are broadly based on:

- Best Case – economy returns to pre-covid levels of growth and inflation peaks during 2022/23, returning to historic trends by April 2023;
- Most Likely – minimal economic growth, with gradual recovery and stabilisation of inflation to historic trends over the next two years through to mid-2024; and
- Worst Case – medium term recession and stabilisation of inflation to historic trends only from year three onwards.

Table 1: Additional MTFS Budget Reductions Required as part of 2023/24 MTFS Refresh

	Best Case	Most Likely	Worst Case
New savings in 2023/24	£0m	£3m	£18m
New savings over MTFS (including the figures above)	£0m	£15m	£75m

The key variables in all the scenarios are the annual growth in the council tax taxbase, inflation assumptions and then the variables over which we have more influence – the DSG deficit, the level of additional spending allocations whether driven by demand or Council priorities and the delivery of the approved savings plan. All scenarios assume Members' support continuing to increase the council tax by 2% per annum and take the additional 1% adult social care levy increase in 2023/24 and 2024/25. A reduction of 1% in the council tax increase in any one year would increase the level of savings required by £3.5m.

The 'most likely' scenario assumes an annual increase in the council tax taxbase of 2% per annum, in line with recent trends. Currently there is speculation about a potential slowdown in the housing market as a result of the increased cost of living, rising interest rates and increased supply costs reducing the viability of developments. A 0.5% reduction in the growth in the taxbase (equating to around 1,000 fewer Band D equivalent properties) will reduce available resources by £2m. Trends in the housing market over the short and medium term will need to be kept under review.

These resource assumptions will determine the level of further budget reductions or additional income generation the Authority will need to plan for over the period 2023-28. The 'most likely' scenario is that £15m additional savings will be needed in addition to £55.4m already included in the MTFS approved in February 2022 and the £115.3m delivered since 2014.

The need to make the 'right' savings that support the delivery of the Council Plan and do not stifle recovery, increases the on-going importance of effectively managing the Council's spend. Maximising the availability of reserves will be critical to allowing the managed, effective implementation of the necessary changes to services. However, it should be noted that any use of reserves to help balance the MTFS in the early years impacts potential to increase the Investment Funds and the resources available to invest in the delivery of the Areas of Focus in the Council Plan.

3.4. <u>Impact of Inflation on Existing Plans</u>

Managing the impact of inflation is the biggest additional factor to accommodate within the MTFS refresh this year. A strategic view of how inflation may impact on the County Council needs to recognise that neither our type of spending nor the inflationary risk is uniform. As a result the assessment of how inflationary pressure will impact is complex. It will vary between:

- The revenue budget and the capital programme;
- The type of spending/income; and
- The extent and increased cost can be managed without impacting on service delivery and/or capacity.

There are no absolutes in inflation forecasting, the approach taken will, of necessity, be a matter of judgement.

The MTFS approved in February 2022 included provision for £70m inflationary uplift over the next five years, of which £20m relates to 2022/23. Any need to provide for increased inflationary costs, above the level provided for in the MTFS will need to be a first call on the £34.0m (£9m in 2023/24) for future indicative spending pressures, thereby reducing the amount available to meet increases in demand, investment to deliver on the Council's priorities or to alleviate savings targets.

At this point, it is estimated:

- Pay inflation will result in an increased provision of £6m to £8m being needed over the next two years;
- The forecasts of National Living Wage (NLW) increases will require an additional cost of at least £2m a year for adult social care provider inflation in each of the next two years. Although recent speculation about future NLW levels may increase this cost further;
- An additional provision of up to £4m may be required in 2023/24 to re-base the budgets for transport and premises costs; and
- Outside of these specific elements the provision for price inflation in the MTFS is sufficient.

The inflationary outlook is volatile with material changes on a monthly basis. The position will be kept under close review over the coming months as work on the 2023/24 MTFS refresh continues, to ensure our financial strategy and approach remains robust.

The focus of discussion around the impact of inflation will need to extend beyond costs, to the impact on our income. The approved provision for price inflation in the MTFS assumes that Services increase fees and charges at the same rate as the provision for cost increases and council tax is increased in line with the referendum limits set by the Government. Any decision not to do so will increase the level of savings required. The cost increases assumed to be funded from the income will still need to be funded and we will also need to put in place plans to accommodate the loss of income.

In 2023/24 the estimated permanent increase in inflationary provisions needed will use all of the £9m provision in the MTFS for future indicative cost pressures. In addition, a further £6m is likely to be needed in 2024/25 for pay awards and the impact of the NLW. Essentially the working assumption for the MTFS is that any demand/cost pressures as a result of anything other than inflation and not matched by additional resources (e.g. through increases in fees and charges/council tax/government grant), or any non-delivery of the approved

savings plan, will require additional savings to be identified on a £-for-£ basis.

Furthermore, the existing planned use of reserves and the potential that additional reserves may be needed to meet any inflationary impact in 2022/23 in excess of the approved budget is likely to mean any further budget reductions will need to be delivered straight away (or those in the current plan brought forward). There is likely to be insufficient capacity in reserves to enable any additional budget reductions to be delivered 2 or 3 years into the future.

3.5. Identification of Unavoidable Cost Pressures and Right-Sizing

The approved MTFS included between £7.5m and £9.0m a year for new cost pressures. This is in addition to the £41.8m (over £10m a year) for known areas of cost pressure already included within remaining four years of the MTFS.

The identification of unavoidable cost pressures therefore has two elements – a review of those pressures already indicatively approved in the MTFS and identification of any new pressures that have emerged over the last six months.

A robust, evidence-based approach to both elements will be put in place that will cover the cause of the need for an additional budget allocation, the actions the Service has put in place to manage the cost and the implications for service delivery if the allocation is not supported, as well as a detailed calculation of the expected cost and how the funding will be used. This will be accompanied by any further opportunities for right-sizing identified through in-year budget monitoring.

3.6. Prioritisation of Investment in Ambitions and Funding Options

The 2022/23 MTFS retained £10m in the Revenue Investment Funds and included an expanded Capital Investment Fund (CIF) to deliver on the ambitions of the Council Plan. The Investment Funds are currently secured as sufficient resource has been set aside as part of the Reserves Strategy for the Revenue Investment Fund and through the provision to meet the cost of servicing the borrowing costs that fund the CIF made in the MTFS.

The approach adopted this year and proposed for the 2023/24 MTFS refresh is for a closer alignment of the Investment Funds to proposals in the Delivery Plan.

As part of the refreshed MTFS a prioritised pipeline of projects will be developed that is affordable within the level of resources available. Currently, the level of resources available in both the Revenue Investment Fund and CIF is insufficient to meet the ambitions of the organisation or deliver the full pipeline of projects. Given the inflationary pressures on the budget it is unlikely material additional resources will be available in the short-term. Clear prioritisation to ensure best use is made of the scarce resources available will be key.

3.7. Validation of Existing Savings Plans and the Identification of Further Budget Reductions

Even before the impact of changes to resource forecasts and inflationary and demand pressures the existing MTFS requires the delivery of £55.4m of savings over the next four years. It is therefore essential to validate that the plans and savings being targeted are deliverable. The 2023/24 refresh will require action plans for the delivery of planned savings in each of the next two years and outline plans for those in the last two years of the current MTFS.

Any reduction in the level of budget reductions delivered, whether as a result of deliverability or acceptability, will increase the level of new savings that need to be identified. The working assumption is that where, as a result of developing robust delivery plans, the existing MTFS savings cannot be delivered alternative deliverable savings will be brought forward for consideration. These alternative savings would be in addition to the budget reductions needed to balance the MTFS.

The need for additional budget reductions will be identified through an approach that ensures they are the 'right' spending reductions for the organisation over the medium term. This will include the increased use of benchmarking and comparative information to identify potential areas where value for money could be enhanced further and to provide some strategic insight to potential target areas for reduced spending.

Alongside this work on identifying budget reductions there will be a further review of reserves to see if we can free up some capacity to allow the lead-in time for any transformation and innovation activity to be delivered. This may also need to include choices around the balance of using reserves for investment and the short term off-setting of savings.

3.8. Challenge and Scrutiny

The challenge and scrutiny of proposals will include:

- Scrutiny and assessment of spending/savings proposals brought forward for consideration in much the same way as has been put in place for the Investment Funds, providing clear recommendations that supports the balancing of priorities;
- The use of evidence, such as benchmarking information, insight into the relationship between cost and performance and learning from innovative developments across the sector, to provide a more robust assurance about current base budgets, and to support the proactive challenge and validation of spending proposals; and
- Analysing the alignment of spend with the Council Plan objectives and the impact of proposals on performance.

4. Capital Programme

4.1. A new approach to future decisions on capital investment need and the management of the programme was approved alongside the 2020-25 Council Plan and MTFS and consists of three core elements:

- the Capital Strategy;
- the resulting Capital Programme/Pipeline of projects - the content of the capital programme (including schemes to be delivered in 1-3 years); and
- the Capital Framework which demonstrates our compliance with the Prudential Code and sets out the governance and resourcing arrangements needed to deliver and administer the pipeline/programme.

4.2. Local authorities are required to approve a Capital Strategy on an annual basis. For 2023/24 the annual refresh will ensure the Strategy is consistent with the priorities and outcomes of the Council Plan and associated Delivery Plan and aligned to the emerging thinking on long term place-shaping. This is consistent with the intention of the Capital Strategy to shift to a 20-30 year line of sight and create a more strategic focus to our approach to capital investment.

4.3. A fourth area of activity that will form part of the 2023/24 MTFS refresh is the changes to the governance arrangements for the capital programme that have been reported to Cabinet previously, in particular the enhanced focus on monitoring the delivery and impact of the capital programme.

4.4. Any progress on the delivery of the approved programme and the prioritisation of the CIF pipeline will, this year, be driven by the impact of inflation on the capital programme. Capital projects are one-off in nature and by and large the Authority has choice over the level of investment. Therefore, any increase in the cost of projects means we will be able to afford to do less. In the simplest of terms, it means there will be a greater need for prioritisation, with only those projects that are unavoidable (e.g. school places) or deliver the greatest benefits and higher returns on investment being approved.

4.5. Currently the sectors of the economy facing the greatest inflationary pressure – construction and transport - comprise the majority of the Authority's capital programme and therefore it is likely, outside of the impact of the NLW, the area of activity where the effect will be most marked.

4.6. An average 10% increase in the cost of schemes would increase the cost of the approved programme by around £20m to £30m, depending on the extent to which this can be accommodated within project contingencies and/or increases

in third-party funding. This equates to a 20% reduction in the overall CIF funding available for new schemes. However, this would not impact evenly across the years. The majority of the additional cost will impact in the next two years, reducing the investment capacity by up to 40% in each year. If the average inflationary impact is above 10% then the remaining investment capacity will reduce proportionately.

5. The Need for a Balanced Budget

5.1. In putting forward their proposals Members are reminded that local authorities are required by law to have a balanced budget. However, what is meant by 'balanced' is not defined in law. A prudent definition of a sustainable balanced budget is a financial plan based on sound assumptions which shows how income will equal spend over the short- and medium-term. For the purposes of the proposals being developed the medium term has been taken as the five years 2023/24 to 2027/28.

5.2. To avoid an unbalanced budget the Local Authority has to be financially resilient. Setting a clear MTFS helps clarify expected income and expenditure. Awareness of the funding available in the forthcoming years means the Council stands a better chance of balancing the budget. Reserves are a useful option for balancing the budget in the short-term, but they can only be used once. Consequently, proposals will be developed on the basis that reserves should not be used to pay for day-to-day expenditure and that they will be replenished when the short-term need has passed, subject to a risk assessment. This will ensure the MTFS for 2023-28 will be fully balanced on an ongoing basis.

5.3. This approach is consistent with the Reserves Strategy approved as part of the MTFS in February 2022.

6. Next Steps

6.1. The starting assumption for the 2023/24 MTFS refresh is that the impact of the current inflationary pressures in 2022/23, in excess of the approved budget, can be manged in year through robust budget management, including the early tackling of emerging areas of overspend, and the use of reserves. If this proves not to be the case, then the approach set out in the report and the rigour with which it is pursued becomes even more important.

6.2. The approach set out in the report is a holistic one which combines the uncertainty over our medium-term resource levels, growing inflationary risk,

continued high levels of demand and the resourcing of the delivery of the Council Plan, including the use of our balance sheet. This means the 2023/24 MTFS refresh will be more complex than usual and is likely to require some difficult choices about priorities.

6.3. Following Cabinet's approval of the approach outlined in the report Services will begin work identifying and quantifying any costs pressures, the opportunities for investing in the Council's ambitions and options for future budget reductions and invest-to-save proposals. This work will continue to be aligned to the approach to Integrated Planning and informed by the considerations of the Conservative Budget Working Group.

6.4. The next report to Cabinet will be the first 2022/23 Financial Monitoring report in September 2022. This will start to clarify the assumptions made in setting out the forecast resource forecasts that underpin the MTFS.

6.5. The proposed timetable of formal reports through to Council agreeing the 2023/24 budget and MTFS in February 2023 is shown below.

Approach to Agreeing the 2023/24 Budget and 2023-28 MTFS	
Date	**Report**
9 September 2022	• Report to Cabinet on the 2022/23 Quarter 1 Financial Monitoring
25 November 2022	• Report to Cabinet on the 2022/23 Quarter 2 Financial Monitoring
15 December 2022	• Report to Cabinet on the draft 2023/24 budget proposals, MTFS, capital strategy and review of reserves
December and January	• Political Groups continue to work on their budget and MTFS proposals
27 January 2023	• Report to Cabinet outlining final information to be used in setting the budget and the Strategic Director for Resources reserves risk assessment • Report to Cabinet on the 2022/23 Quarter 3 Financial Monitoring • Cabinet release the Conservative Group's 2023/24 budget resolution(s)
Late January 2023 to early February 2023	• Opposition Groups release any amendments to the Conservative Group's proposals
7 February 2023	• Council sets 2023/24 budget and council tax, 2023-28 MTFS, the Capital Strategy and the 2023/24 Treasury Management and Investment Strategies

7. Financial Implications

7.1. There are no direct financial implications as a result of this report. The report sets out the proposed approach to ensuring the Authority remains financially resilient and sustainable going forward.

8. Environmental Implications

8.1. There are no direct financial implications as a result of this report. The Council's Delivery Plan will set out the actions and activity planned to address climate change and environmental issues. These in turn will inform the allocations made as part of agreeing the 2023/24 Budget and 2023-28 MTFS.

9. Background Papers

9.1. None

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Elected Members have not been consulted in the preparation of this report.

Appendix A

Resource Scenarios and Underlying Assumptions

	Best Case	Most Likely	Worst Case
New savings in 2023/24	£0m	£3m	£18m
New savings over MTFS, including extra in 2023/24	£0m	£15m	£75m
Assumptions			
Core BCF/iBCF funding	All social care grants continue for MTFS period with Public Health Grant increase by 2%	All social care grants continue for MTFS period cash flat	1% annual reduction in core government grants
Council Tax Collection Fund Deficit	£2m a year surplus	Nil across the period of the MTFS	£2m a year deficit
Council tax taxbase	3% a year	2% a year	1% a year
Council tax increase	2% per annum plus 1% adult social care levy in 2023/24 and 2024/25	2% per annum plus 1% adult social care levy in 2023/24 and 2024/25	2% per annum plus 1% adult social care levy in 2023/24 and 2024/25
Business rates income	Annual 1% growth in taxbase, 2% inflationary uplift	Flat taxbase as reliefs drop out, 2% inflationary uplift	5% reduction in taxbase in 2023/24 and 2024/25 as reliefs drop out, flat thereafter, 2% inflationary uplift
High Needs DSG deficit	High Needs DSG brought into balance by 2025/26 reserve provision remains unchanged	50% reduction in the High Needs DSG deficit from 2025/26 onwards as a result of additional Government funding and the success of the transformation projects	As per current DSG recovery plan
Additional permanent spending pressures	No spending pressures beyond the available provision in the MTFS, £9m in 2027/28 including £3.2m for capital financing and £4m for adult social care demography	£5m a year in 2023/24 and 2024/25. Thereafter revert to available MTFS provision plus £15m in 2027/28 including £3.2m for capital financing and £4m for adult social care demography	Increase provision from to £10m a year plus £3.2m for capital financing and £4m for adult social care demography in 2027/28
Price/Income Inflation	Maintained at 2% per annum plus £4m for transport and utilities in 2023/24 and £2m for the NLW in 2023/24 and 2024/25	Maintained at 2% per annum plus £4m for transport and utilities in 2023/24 and £2m for the NLW in 2023/24 and 2024/25	Increased to 3% per annum plus £4m for transport and utilities in 2023/24 and £2m for the NLW in 2023/24 and 2024/25
Pay Inflation	4% in 2023/24 and 2024/25, 2% per annum thereafter	4% in 2023/24 and 2024/25, 2% per annum thereafter	5% in 2023/24, 4% 2024/25, 3% per annum thereafter
Non-delivery of existing savings plan	Current savings plans delivered in full, or alternatives identified	Current savings plans delivered in full, or alternatives identified	20% non-delivery of current savings and no alternatives identified