Cabinet

16 July 2024

A Financial Framework for the 2025/26 Medium-Term Financial Strategy Refresh

Recommendations

That Cabinet

1) note the emerging financial position within which the 2025/26 budget and 2025-30 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 2025/26 Medium-Term Financial Strategy and Capital Strategy, as set out in Sections 2 and 3;

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

5) approve the timetable for agreeing the 2025/26 budget and Medium-Term Financial Strategy Refresh.

1. Purpose of the Report

1.1. Over the five years to 2028/29 the Medium-Term Financial Strategy (MTFS) approved in February 2024 was balanced, considering likely additional spending need and the expected level of resources. It required the delivery of £64.0m of savings and the use of £15.7m of reserves.

1.2. The 2025/26 MTFS refresh therefore has a strong and robust starting point, assuming that during 2024-25 spending pressures can be contained within available resources and planned savings delivered. 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 (2024/25) financial position looks compared to the planned budget. It will also extend the MTFS into 2029/30 so the commitment to having a balanced five-year rolling MTFS is maintained.

1.3. A five-year MTFS helps align the Council's financial strategy and plans to deliver the Council Plan strategic priorities of thriving economy and places, a sustainable future and safe and healthy communities, as well as managing the risk inherent in providing a diverse range of services to a diverse community funded by numerous income streams. A five-year MTFS allows time to plan and implement changes to deliver financial savings, providing maximum flexibility and supporting the ongoing financial resilience and sustainability of the Council.

1.4. The context in which the 2025/26 refresh is happening includes a number of risks to be monitored, managed and where uncontrollable to be financially underwritten:

- the broader economic environment, such as the impacts of movement in inflation, housing growth, council tax base and interest rates on our day-to-day costs, income and debt repayments;
- significant cost of living pressures on communities and residents which, alongside the high-cost markets WCC operates within, contribute to the significant demand increases impacting key service areas, including the impact of higher interest rates on both mortgage and rental costs;
- sustained inflationary pressures and cost of living increases putting pressure on staff costs, recruitment and retention and impacting on service resilience;
- significant demand and financial pressures on partners, particularly in the NHS, creating additional operational and financial risk for the Council;
- post-election national policy direction and spending priorities will emerge in key areas including Adult Social Care, Children's Social Care, SEND, Planning, Devolution, a possible three-year Comprehensive Spending Review in the Autumn, and potentially a longer-term Local Government Financial Settlement, which itself contains risks around distribution formulas;
- Capital programme pressures from the cost of procuring and delivering projects;
- dependency on locally collected Business Rates, placing greater importance on the need to maintain reserves to manage any volatility;
- the results (financial and social) from our commercial investment activities;
- social and health inequalities and the ability to deliver on our Creating Opportunities (Levelling Up) priorities;
- designing and delivering sustainable Special Educational Needs services within the level of DSG funding, and managing the cumulative deficit position provided for in 2024/25; and
- the Productivity Plan reported elsewhere on the meeting agenda sets out our existing change programmes and priorities as set out in the Council Delivery Plan, and our already stretching savings targets of £64m to balance the MTFS.

1.5. Significant risks remain from rising demand increasing the costs of service delivery which may lead to in-year overspends and challenges delivering planned savings. Further information around the position will be reported to Cabinet as part of 2024/25 Q1 budget monitoring in September, but it is already clear that we are facing significant, ongoing in-year pressures. Any

2024/25 overspend is likely to increase the level of savings required in 2025/26 and future years, and significantly reduce reserves, unless mitigating action is taken. Key risks include the continuing demand growth in SEND, Home to School Transport, children's social care and adult social care.

1.6. The council is focusing on what it can control to mitigate these risks and manage demand, but it further demonstrates the urgent need for national reform, particularly policy solutions for growing DSG deficits, social care reform, changes to home to school transport, and reforming the basis on which local government funding is distributed with multi-year funding settlements to support medium-term planning. All these issues are flagged strongly in the Productivity Plan for submission to Government which is the subject of a separate paper on today's Cabinet agenda. It is critical that the next Government undertakes the necessary reforms to put Councils delivering these services onto a sustainable financial footing.

1.7. As a consequence, like the majority of upper tier councils, our financial situation remains extremely 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.

1.8. The purpose of this report is to bring these strands together and to provide a framework for the 2025/26 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 2025.

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 these components. 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 holistic approach set out in the report seeks to balance 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 Investment Fund (WIF). Driven by the priorities set out in the Council Plan and the Council Delivery Plan, the impact of any proposals on both the MTFS and our balance sheet will be considered together. The 2025/26 MTFS refresh 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 is therefore asked to agree a set of key strategic principles as a starting point within which the 2025/26 MTFS will be developed. The key strategic principles are:

Principle 1: Inflation on prices expected to remain roughly at 2% per annum from April 2024. The MTFS should continue to provide for the Bank of England target inflation rate.

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

Principle 3: The impact of high-cost markets that currently exist in 2024/25 will, as far as possible, be managed in year through robust budget management and, where necessary the use of the reserves.

Principle 4: Given the estimated inflationary, demand and market impacts, there will be a need for long-term policy direction and resources in key areas. Therefore, setting a <u>very</u> 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 existing and new capital projects will mean that we can no longer afford to fund everything currently planned to meet our ambitions. We will be able to afford to do less unless we take out additional borrowing with consequent revenue costs. 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.

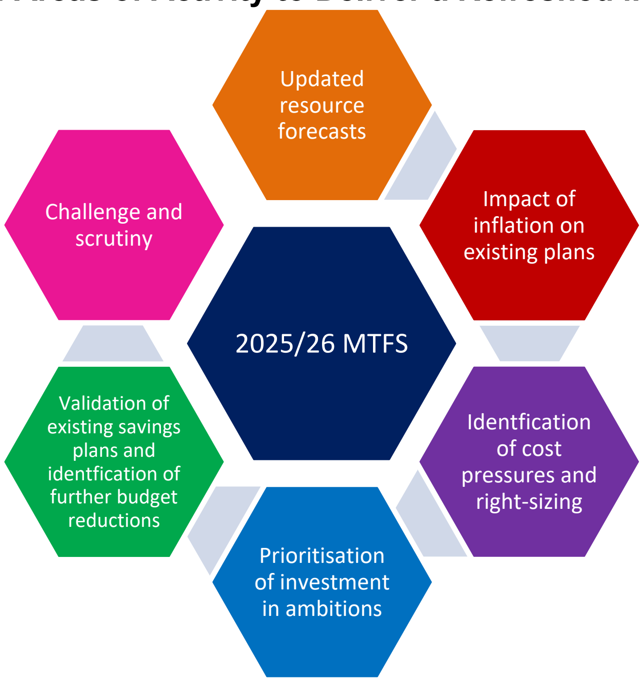
2.5. All of the elements of a sustainable and financially resilient MTFS will require a range of activity, information and intelligence gathering and reports that will need to be brought together before decisions are made over the next six months. The overall objective is to ensure a transparent approach, 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.

2025/26 MTFS Refresh

2.6. The starting assumption for the 2025/26 MTFS refresh is that the impact of pressures in 2024/25 can be managed 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 2024. However, early warning signs suggest the 2024/25 financial position is exhibiting significant pressures. More certainty over the 2024/25 financial position will be achieved through the Quarter 1 budget monitoring process which will be reported to Cabinet in September. If there are significant in-year pressures then the approach to the MTFS set out in this report and the rigour with which it is pursued becomes even more important.

2.7. Diagram 1 shows the areas of activity that will need to be undertaken to deliver a refreshed 2025/26 MTFS, alongside a further review of reserves.

Diagram 1: Areas of Activity to Deliver a Refreshed MTFS



Updated Resource Forecasts

2.8. The basic model of resource forecasting used for the 2025/26 MTFS remains valid. However, the level of uncertainty we continue to face along with the variability in the level of resource 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 medium-term economic position becomes clearer.

2.9. Following analysis of several scenarios, the level of additional budget reductions required is currently estimated to be at least £10 million by 2029/30 in what is considered the most likely scenario at this point, ahead of reporting the Q1 position which could materially impact the position. This scenario is dependent on more clarity emerging from the 2024/25 Quarter 1 financial position but is broadly based on minimal economic growth with inflation stabilising at 2% from April 2024 and interest rates reducing to similar levels by April 2025.

2.10. The key variables in the resource forecasts are the annual growth in the council tax taxbase, inflation assumptions and then the variables over which we have more influence – the level of additional spending allocations and the delivery of the approved savings plan. The most likely scenario assumes an increase in the council tax of 3% per annum from 2025/26, which is the assumption that underpinned the 2024/25 MTFS. A 1% increase/decrease in the council tax increase would increase/decrease the level of savings required by £3.87m. The 2024/25 Local Government Finance Settlement included the flexibility to increase the council tax by up to 5% in 2024/25, 3% for the core council tax and 2% adult social care levy. Permitted increases in Council Tax beyond 2024/25 have not yet been confirmed. OBR projections are based on a future 5% increase in Council Tax but the Council's current planning assumption, as agreed in February 2024, is 3% core council tax and 0% adult social care levy annually over the remaining four years of the current MTFS.

2.11. The 'most likely' scenario assumes an annual increase in the council tax taxbase of 1.65% in 2025/26 and 2026/27, similar to the growth in 2024/25, with the growth rate increasing to 1.75% by 2027/28. A 0.5% reduction in the growth in the taxbase (equating to around 1,100 fewer Band D equivalent properties) will reduce available resources by £2m. The housing market is influenced by economic growth, the cost of living, relatively high interest rates and mortgage availability and increased supply costs reducing the viability of developments. Therefore, as our available resources are partly dependent on the trends in the housing market over the short and medium-term, this will be kept under review.

2.12. 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 2025-30. The 'most likely' scenario is that at least £10m additional savings will be needed by 2029/30 in addition to £64.0m already included in the MTFS approved in February 2024 and the £130m delivered since 2014. Any emerging pressures arising from the 2024/25 Quarter 1 position will need to be factored into the additional savings requirement.

2.13. 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 the potential to increase the Investment Funds and the resources available to invest in the priorities set out in the Council Delivery Plan, including capacity to deliver further savings.

Impact of Inflation on Existing Plans

2.14. Managing the demand and market failure in Children's Social Care, SEND and Home to School Transport services will continue to be the biggest factor to accommodate within the MTFS refresh this year. Persistent demand pressures in these areas and adult social care, compounded by market challenges, represent a fundamental risk to the MTFS. However, maintaining a strategic view of how inflation is impacting on the County Council, and wider partners within the public service delivery system, shows that the inflationary risk is uniform. The assessment of how inflationary pressure is impacting remains complex. It will vary between:

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

2.15. There are no absolutes in forecasting inflation, the approach taken will, of necessity, be a matter of judgement and will need to be continually updated as more information emerges between now and February 2025 when the budget will be agreed.

2.16. The MTFS approved in February 2024 included provision for £89.9m inflationary uplift over the next five years, of which £31.9m relates to 2024/25. 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 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. Any such use of the provision for indicative pressures would be a concern given the sustained increases in demand for Council services and market/inflation-driven increases in unit cost often in the same service areas experiencing sharp increases in demand.

2.17. At this point, it is estimated:

- basic pay inflation, without any wider change to improve the Council's market position in terms of pay and reward, can be contained within the provision set aside within the 2024/25 MTFS;
- forecasts of National Living Wage (NLW) increases and other inflationary costs will require an additional cost for adult social care provider inflation next year; and

- outside of these specific elements the provision for price inflation in the MTFS is sufficient, although there is a risk additional provisions may be required in 2025/26 to supplement the budgets for transport, placement costs and SEND, if costs continue to rise.

2.18. The inflationary outlook has stabilised as CPI has reduced back to the Bank of England target overall, however, inflation remains high in some of our key markets. The position will be kept under close review as work on the 2025/26 MTFS refresh continues, to ensure our financial strategy remains robust.

2.19. The focus of discussion around the impact of inflation would 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. Any decision not to do so will increase the level of savings required. The cost increases assumed to be funded from the income would still need to be funded and we would also need to put in place plans to accommodate the loss of income.

2.20. Furthermore, the existing planned use of reserves and the potential that additional reserves may be needed to meet any additional cost pressures in 2024/25 in excess of the approved budget is likely to mean any further budget reductions would need to be delivered straight away (or those in the current plan brought forward). If the inflationary impact is greater than the 2024/25 approved budget this would also mean 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.

2.21. To counter this, there are also impacts of inflation that are positive from a financial perspective that will need to be assessed. For example, the recent high inflation rate is continuing to drive higher interest rates which in turn is increasing the interest income we are earning on our cash balances. The difficult judgement is the length of time over which these higher interest earnings will continue, with some forecasters suggesting rates will start to fall from August.

Identification of Unavoidable Cost Pressures and Right-Sizing

2.22. The approved MTFS included £10.5m for new cost pressures in 2025/26 and £7.5m per annum over the remaining three years of the MTFS. This is in addition to the £39.4m for known areas of cost pressures already included within the remaining four years of the MTFS.

2.23. 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 nine months.

2.24. 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 and an in-depth review of the 2023/24 outturn.

Prioritisation of Investment in Ambitions and Funding Options

2.25. The Investment Funds are currently secured as sufficient resource has been set aside as part of the Reserves Strategy for the Revenue Investment Funds and through the provision to meet the cost of servicing the borrowing costs that fund the £104.9 million Capital Investment Fund allocation made in the MTFS.

2.26. The approach adopted in 2024/25 and proposed to continue for the 2025/26 MTFS refresh is for a closer alignment of the Investment Funds to proposals in the Council Delivery Plan.

2.27. 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 Capital Investment Fund is insufficient to meet the ambitions of the organisation or deliver the full pipeline of projects. Given the inflationary and demand 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.

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

2.28. Even before the impact of changes to resource forecasts and inflationary and demand pressures the existing MTFS requires the delivery of £47.9m of savings over the next four years. It is therefore essential to validate that the plans and savings being targeted are deliverable. The 2025/26 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. This will build on the work undertaken last year.

2.29. 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 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.

2.30. The need for additional budget reductions will be identified through an approach that ensures they are the most appropriate spending reductions for the organisation over the medium-term. During the year, any decisions with favourable financial implications will be reviewed so that any cost reductions can be incorporated into the MTFS options. Benchmarking and comparative information will continue to be used to identify potential areas where value for money could be enhanced further and to provide strategic insight to potential target areas for reduced spending. The Revenue Investment Funds will be used to invest in sustainable change that will impact towards the end of the MTFS period.

2.31. Alongside this work on identifying budget reductions there will be a review of reserves carried out during the year, to see if we can free up further capacity to allow the lead-in time for any transformation and innovation activity to be delivered. This may also need to include choices about the balance between using reserves for investment and the short-term off-setting of savings not delivered as planned.

Challenge and Scrutiny

2.32. 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 (and beyond) the sector, to provide 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.

3. Capital Strategy

3.1. The approach to future decisions on capital investment and the management of the programme was approved alongside the 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 1-5 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.

3.2. Local authorities are required to approve a Capital Strategy on an annual basis. For 2025/26 the annual refresh will ensure the Strategy is consistent with the priorities and outcomes of the Council Plan and associated Council Delivery Plan. This is consistent with the intention of the Capital Strategy to provide a 20-30 year line of sight and create a more strategic focus to our approach to capital investment.

3.3. The need for prioritisation has been a feature of capital planning over the last few years and became more acute during 2022/23 with the impact of inflation on the capital programme, in addition, the risk to school places with the lack of Basic Need grant funding in 2025/26 and no indication of funding in future years. It is likely there will be another step change this year as part of delivering the capital programme in 2024/25 and the planning for 2025/26. In the simplest of terms, there will be an even 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 without additional borrowing being taken out. The 2025/26 MTFS refresh will therefore also need to consider whether the current balance between revenue and capital is sustainable.

4. The Need for a Balanced Budget

4.1. 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 2025/26 to 2029/30.

4.2. To avoid the risk of setting 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 is better placed to balance the budget. Reserves are a useful option 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 2025-30 will be fully balanced on an ongoing basis.

4.3. This approach is consistent with the Reserves Strategy approved as part of the MTFS in February 2024.

5. Next Steps

5.1. The starting assumption for the 2025/26 MTFS refresh is that the impact of inflationary, cost and demand pressures in 2024/25, in excess of the approved budget, can be managed in year through robust budget management, including early action to tackle emerging areas of overspend, and the use of reserves. If this assumption 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.

5.2. The approach set out in the report is a holistic one which considers and addresses the uncertainty over our medium-term resource levels, inflationary and pay risks, 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 2025/26 MTFS refresh will be complex and is likely to require some difficult choices about priorities.

5.3. 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 align with the integrated planning approach, informed by the work of the Conservative Budget Working Group.

5.4. The next report to Cabinet will be the first 2024/25 Financial Monitoring report in September 2024. This will start to clarify the assumptions made in setting out the forecast resource forecasts that underpin the MTFS.

5.5. The proposed timetable of formal reports through to Council agreeing the 2025/26 budget and MTFS in February 2025 is shown below.

Approach to Agreeing the 2025/26 Budget and 2025-30 MTFS	
Date	**Report**
5 September 2024	• Report to Cabinet on the 2024/25 Q1 Financial Monitoring
14 November 2024	• Report to Cabinet on the 2024/25 Q2 Financial Monitoring
12 December 2024	• Report to Cabinet on the options for the 2025/26 budget proposals, MTFS, capital strategy and review of reserves
December 2024 and January 2025	• Political Groups continue to work on their budget and MTFS proposals
28 January 2025	• Report to Cabinet outlining final information to be used in setting the budget and the Executive Director for Resources reserves risk assessment • Report to Cabinet on the 2024/25 Q3 Financial Monitoring • Cabinet release the Conservative Group's 2025/26 budget resolution(s)
Late January to early February 2025	• Opposition Groups release any amendments to the Conservative Group's proposals
6 February 2025	• Council sets 2025/26 budget and council tax, 2025-30 MTFS, the Capital Strategy and the 2025/26 Treasury Management and Investment Strategies

6. Financial Implications

6.1. 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.

7. Environmental Implications

7.1. There are no direct financial implications as a result of this report. The Council's Council 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 2025/26 budget and 2025-30 MTFS.

8. Background Papers

8.1. None

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