Cabinet

A Financial Framework for the 2021/22 MTFS and Managing the Covid-19 Financial Impact

9 July 2020

Recommendations

Cabinet are recommended to:

1) Note the emerging financial position within which the 2020/21 budget and 2020-25 Medium Term Financial Strategy will be developed;

2) Agree the approach to the funding of the financial impact of Covid-19 in 2020/21 as set out in paragraph 3.4;

3) Agree the proposals for the refresh of the 2021/22 MTFS and Capital Strategy, as set out in Sections 4 and 5;

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 2021/22 budget.

1. Purpose of the Report

1.1. Summer is when key financial information is coming forward on:
- The initial forecasts for how the current year's (2020/21) financial position looks compared to the planned budget; and
- The resource forecasts and key issues that will need to be considered in the 2021/22 MTFS refresh.

1.2. This year the context in which this is happening is that there are significant uncertainties around Government policy in terms of the Comprehensive Spending Review, Local Government Finance Settlement, the Fairer Funding review, Business Rates, commercial policy and potentially major reforms with Green papers on Social Care and White Papers on Devolution and possible Planning reform. The economic situation is hugely challenging, and we continue to be faced with rising demand for services. The direct and indirect impacts on the County Council as well as our partners are both unknown and highly volatile at this stage.

1.3. Added to the mix, we have the financial impact of our immediate response to Covid-19 and delivering on the Authority's ambition to invest in recovery.

1.4. The purpose of this report is to bring these strands together and to provide a framework for Cabinet to consider. The approach will enable the Council to respond effectively to changing circumstances while maintaining a longer-term focus on the Council's financial sustainability. The report then goes on to outline the key issues which will need to be considered as part of development the MTFS, setting out the key points and proposed timetable of key dates between now and the budget setting Council meeting in early February 2021.

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

2.1. The strength of the Authority's balance sheet has traditionally meant we have been in a position to develop the future years budget and MTFS as a largely standalone exercise with only material demand pressures arising through budget monitoring impacting on planning for future years. The uncertainty and financial commitment created by Covid-19 means for 2021/22 this is no longer the case. Instead the different dimensions need to be considered together to ensure the County Council remains a robust, sustainable and financially resilient Authority. **Appendix A** shows a diagram of the proposed framework within which this can be delivered.

2.2. Each of the dimensions will have a different purpose and provide different intelligence to input into the refresh of the Council Plan and the development of the Authority's Change Portfolio as the drivers of recovery:

- The 2019/20 outturn, reported to Cabinet in June:
    - Determined the level of the Authority's reserves; and
    - Identified any requirement to, or opportunities for, right-sizing.

- The forecast 2020/21 outturn position and rephased capital programme will determine the level of resources required in 2020/21 in light of Covid-19, compared to the approved budget and revised levels of funding now available alongside identifying the level of resources available to support recovery and the change portfolio; and

- The 2021/22 MTFS refresh will:
    - Determine the likely levels of resources available over the medium term;
    - Determine the level of spending priority commitments arising from the Covid-19 recovery plan and the Authority's ambitions over the medium term; 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 latter two dimensions will result in 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 refreshed Council Plan in a post-Covid environment.

2.4. More detail on the proposed activities and how they will contribute to meeting our financial aims is set out in Sections 3 and 4.

3. 2020/21 Forecast Spend

3.1. There are five inter-related elements that will impact on the 2020/21 outturn position. These are:

- The forecast 2020/21 revenue spend;
- A rephased capital programme;
- Progress on the delivery of planned savings;
- Covid-19 additional costs; and
- Covid-19 in-year impact on resources.

3.2. As 2020/21 progresses and we look to manage the impact of Covid-19 on the Authority it is essential these pieces of work are brought together into a single position statement. This will start with the first quarter's monitoring report to Cabinet in September.

3.3. Outside of ensuring we have an agreed approach to consolidated reporting, the key decision for 2020/21 is how the additional Covid-19 funding from the Government is used. At the time of writing, it is uncertain that the Government will fully fund the impact of Covid-19 and we therefore need to plan on the basis that some level of internal funding is likely to be required to meet the unfunded impacts. It is proposed that a set of strategic financial principles for managing the costs of Covid-19 are put in place that will allow final decisions on how the grant is to be used to be seen as part of a robust approach to budget monitoring, rather than as a separate exercise, and wider impacts picked up as part of the refreshed 2021/22 MTFS.

3.4. The recommended approach to the financial management in light of Covid-19 in 2020/21 is:

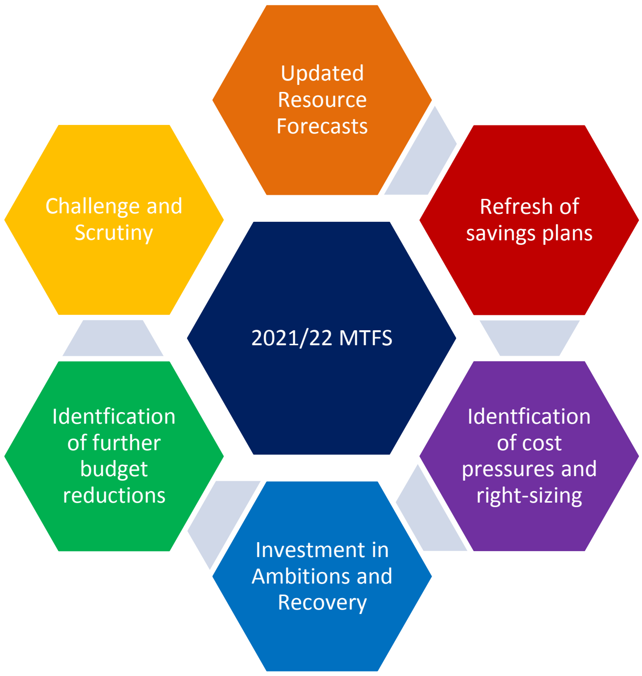
- We will continue to spend where we need on the Covid-19 response, with all decisions being taken in line with existing governance frameworks and with a focus on value for money;
- We will seek to maintain services as far as possible, so minimising the loss of income;
- We will maximise the delivery of planned savings;
- We will continue to focus on the biggest pre-existing structural budget risks e.g. Education and services for children;
- We will seek, as far as possible, to maintain the investment funds quantum (recognising there may be a need to adjust their focus to support the recovery plan and refreshed Change Portfolio);
- We will look to position the Authority to take forward an investment strategy for recovery; and
- On a technical level, we will manage the in-year financial impact of Covid-19 as follows:
    - Additional unplanned direct Covid-19 costs will be the first call on the Government grant e.g. PPE, mortuary provision, shielding hubs;
    - The second call on the Government grant will be where specific decision to relax controls has been made by Corporate Board/Members e.g. stepping down the Oxygen finance scheme, 3-month rent rebates; and
    - Outside of these two categories any forecast of increased spend or decreased income will be set against directorate/volatility reserves. The use of any residual Covid-19 grant and any other funds released will then be prioritised to top-up these reserves for 2021/22 based on the assessed financial risk.

3.5. This approach is recommended as it places the accountability on Services for effectively managing any financial impact of Covid-19 during the year whilst enabling strategic decisions on both the direction of travel and how any costs should be funded later in the financial year when the overall position has stabilised.

4. 2021/22 MTFS Refresh

4.1. Diagram 2 shows the areas of activity that will need to be undertaken to deliver a refreshed 2021/22 MTFS, alongside a further review of reserves. Taking each of these in turn the narrative outlines how it is proposed the learning from 2020/21 is built into the process.

Diagram 2: Areas of Activity to Deliver a Refreshed MTFS



4.2. Updated Resource Forecasts
The basic model of resource forecasting used for the 2020/21 MTFS remains valid. However, the level of uncertainty we are now facing 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, the pace of recovery from Covid-19 and the Government's national response becomes clearer.

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

- Best Case – minimal recession, return to previously levels of activity by April 2021
- Most Likely – short lived recession lasting up to one year with a one-year gradual recovery; and

- Worst Case – medium term recession lasting whole of MTFS period with some minimal recovery from year three onwards.

Table 1: Additional MTFS Savings Required as part of 2021/22 MTFS Refresh			
	Best Case	Most Likely	Worst Case
New savings in 2021/22	£8m	£16m	£44m
New savings over MTFS (including the figures above)	£0m	£23m	£82m

The five key variables in all the scenarios are the annual growth in the council tax taxbase, inflation and then the three variables over which we have more influence – the DSG deficit, the level of additional spending allocations whether driven by demand or priorities and the annual council tax increase. All assume Member's support continuing to increase the council tax by 2% per annum. A reduction of 1% in the council tax increase in any one year would increase the level of savings required by £3m.

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 2021-26. The 'most likely' scenario is that £23m additional savings will be needed in addition to £33m already included in the MTFS approved in February.

Most of the additional savings (£16m) are forecast to be required in 2021/22. The need to make the 'right' savings that support the delivery of the Council Plan and do not stifle recovery increases the importance of effectively managing the Council's spend in the current year and, if possible, building capacity to both defer the need for savings and support investment needed to deliver future savings. This additional capacity could avoid the need to make knee-jerk reductions in services just to deliver a balanced budget in 2021/22. As a result, the availability of reserves will be critical to allowing the managed, effective implementation of the necessary changes to services to deliver the savings needed. However, it should be noted that any use of reserves for this purpose impacts of the retention of the investment funds and the resources available to invest in recovery.

4.3. Refresh of Savings Plans

As well as the need to refresh savings plans in light of Covid-19 the 2020/21 refresh will require detailed action plans for the delivery of savings in each of the next two years and outline plans for those 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 in part or in full the Service/Directorate will bring forward alternative deliverable savings for consideration.

4.4. Identification of Unavoidable Cost Pressures and Right-Sizing

The MTFS assumes £4m a year for new cost pressures. Notionally £1.5m of this has been set aside to meet the additional costs of the National Living Wage across each year of the MTFS; leaving £2.5m a year to meet any net new cost pressures.

There are two elements to the identification of unavoidable cost pressures – 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.

Excluding any impact in 2021/22 of Covid-19 on our cost base there are three areas where additional funding has already been identified as potentially being required. These are:

- £25m one-off funding over five years to offset the forecast overspend on the High Needs DSG over the medium term;
- The continued increase in the cost of placements for Looked After Children both in terms of unit costs and complexity of cases (potentially an additional £2m in 2021/22); and
- The increase in demand and cost of provision for children with disabilities (potentially an additional £1m in 2021/22).

Funding these pressures alone would outstrip the resources currently available in the MTFS in the next two years. The 'most likely' option assumes an additional £2.5m a year will be needed to meet additional cost pressures.

The key risk here is any potential inflationary/deflationary impact. The economic outlook is uncertain and each 1% variation in pay and prices compared to the 2% assumed in the MTFS in any financial year will be an additional cost/saving of between £4m and £5m.

4.5. Investment in Ambitions and Recovery

The 2020-25 MTFS put in place the £20m Revenue Investment Funds and an expanded Capital Investment Fund as well as maintaining the Organisational Change Fund to deliver on the ambitions of the Council Plan. The intention, through the 2021/22 MTFS refresh is to at least maintain these funds at their current levels.

The Investment Funds are currently secured as sufficient resource has been set aside as part of the Reserves Strategy. If the additional costs of Covid-19 can be managed in 2020/21 using the remaining Emergency Response Grant and in-year underspends, then the need to redirect the Investment Funds to meet the costs of Covid-19 should be avoided.

There is a need to more closely align the use the Investment Funds to proposals emerging from the recovery work, and the benefits anticipated from investing in recovery to the MTFS to ensure that the resources required/created are identified at the earliest opportunity and/or any resource constraints are understood.

The alignment will be ensured by proposals for investment/recovery going through the same challenge and scrutiny lens as all other spending/savings proposals. As part of thinking about how we support investment in our ambitions and recovery, there will also be the opportunity to consider how we can make more effective use of our balance sheet to support this activity.

Given the desire to invest in recovery and the known levels of additional spending need and a lower than expected resource base there is likely to be limited financial capacity to invest in service improvements that require an on-going resource commitment and that will not lead to future cashable savings.

4.6. <u>Identification of Further Budget Reductions</u>
The delivery of material additional savings in 2021/22 will mean that the savings identified are likely to be those that can be delivered with minimal preparation. There is a real risk that such savings will not only be inconsistent with the ambitions of the Council Plan but also will undermine the service redesigns only recently put in place to support the new target operating model.

It is therefore proposed that an approach is put in place to ensure the savings identified are the 'right' spending reductions for the organisation over the medium term. The proposed approach is:

- Services are urged that, from now, spending in 2020/21 should be managed downwards to create capacity in reserves and so defer the timing from when additional savings are needed, in particular to create some flexibility in 2021/22 to smooth any budget requirements dependent on up-front investment;

- Priority is given to investment that delivers budget reductions in future, with benefits built into the MTFS as part of the decision-making process;
- Services start to develop contingency plans that identify how over the medium term the cost of services can be reduced and the investment that would be needed to support this. This should be done within the following hierarchy of options:
    - Invest to save proposals that do not reduce the level of service from automation, innovation, digital and efficiencies;
    - Further right sizing of budgets;
    - Targeted reductions in lower priorities, reflecting benchmarking analysis; and
    - Service reductions.

Alongside this work on identifying budget reductions there will be a further review of reserves to see if we can free some up capacity to allow the lead-in time for 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.

4.7. <u>Challenge and Scrutiny</u>
The challenge and scrutiny of proposals will provide the biggest step change to the MTFS process from last year. Corporate Board are recommending the introduction of:

- Enhanced 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 independent evidence, such as benchmarking information and innovative developments across the sector, to challenge and validate proposals and to provide some strategic insight to target savings; and
- Analysing the alignment of spend with the Council Plan objectives and the impact of proposals on performance.

5. Capital Programme

5.1. 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. The resulting Capital Strategy consisted 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.

Local authorities are required to approve a Capital Strategy on an annual basis. For 2021/22 the annual refresh will ensure the Strategy is consistent with the priorities and outcomes of the Recovery Plan and aligned to the emerging thinking on long term place-shaping, as approved by Cabinet in June. 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 and investment.

6. The Need for a Balanced Budget

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 i.e. the five years of the rolling MTFS. Therefore, for the purposes of the proposals being developed the medium term has been taken as the five years 2021/22 to 2025/26.

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 replaced when the short-term need has passed, subject to a risk assessment. This will ensure the MTFS for 2021-26 will be fully balanced on an ongoing basis.

This is consistent with the Reserves Strategy approved as part of the MTFS in February 2020, with the risk assessments being updated as part of the bi-annual refresh.

7. Next Steps

7.1. The starting assumption for the 2021/22 MTFS refresh is that the impact of Covid-19 in 2020/21 in excess of the Government funding 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.

7.2. The approach set out in the report is a holistic one which combines the uncertainty over our medium-term resource levels, growing demand pressures and the resourcing of the Recovery Plan, including the use of our balance sheet. This means the 2021/22 MTFS refresh will be more complex than usual and is likely to require some difficult choices about priorities.

7.3. 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 recovery and options for future budget reductions and invest-to-save proposals. This work will be aligned to the Cross-Party Member Working Groups set up to inform the Council's approach to recovery.

7.4. The next reports to Cabinet will be the Recovery Plan and the first 2020/21 Financial Monitoring report in September 2020. These will start to clarify the assumptions made in setting out the forecast resource forecasts that underpin the MTFS.

7.5. The proposed timetable through to Council agreeing the 2021/22 budget and MTFS in February is shown below.

Approach to Agreeing the 2021/22 Budget and MTFS	
Date	**Report**
10 September	Report to Cabinet on the Recovery Plan. Report to Cabinet on the 2020/21 Quarter 1 Financial Monitoring.
12 November	Report to Cabinet on the 2020/21 Quarter 2 Financial Monitoring.
10 December	Report to Cabinet on the draft 2021/22 budget proposals, MTFS, capital strategy and review of reserves.
December and January	Political Groups continue to work on their budget and MTFS proposals.
January	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 2020/21 Quarter 3 Financial Monitoring. Cabinet release the Conservative Group's 2021/22 budget resolution(s). Opposition Groups release any amendments to the Conservative Group's proposals.
4 February	Council sets 2021/22 budget and council tax, 2021-26 MTFS and the Capital Strategy.

8. Financial Implications

8.1. 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.

9. Environmental Implications

9.1. The Council Plan engagement will specifically address climate change and environmental issues to inform the final plan and MTFS.

10. Background Papers

10.1. None

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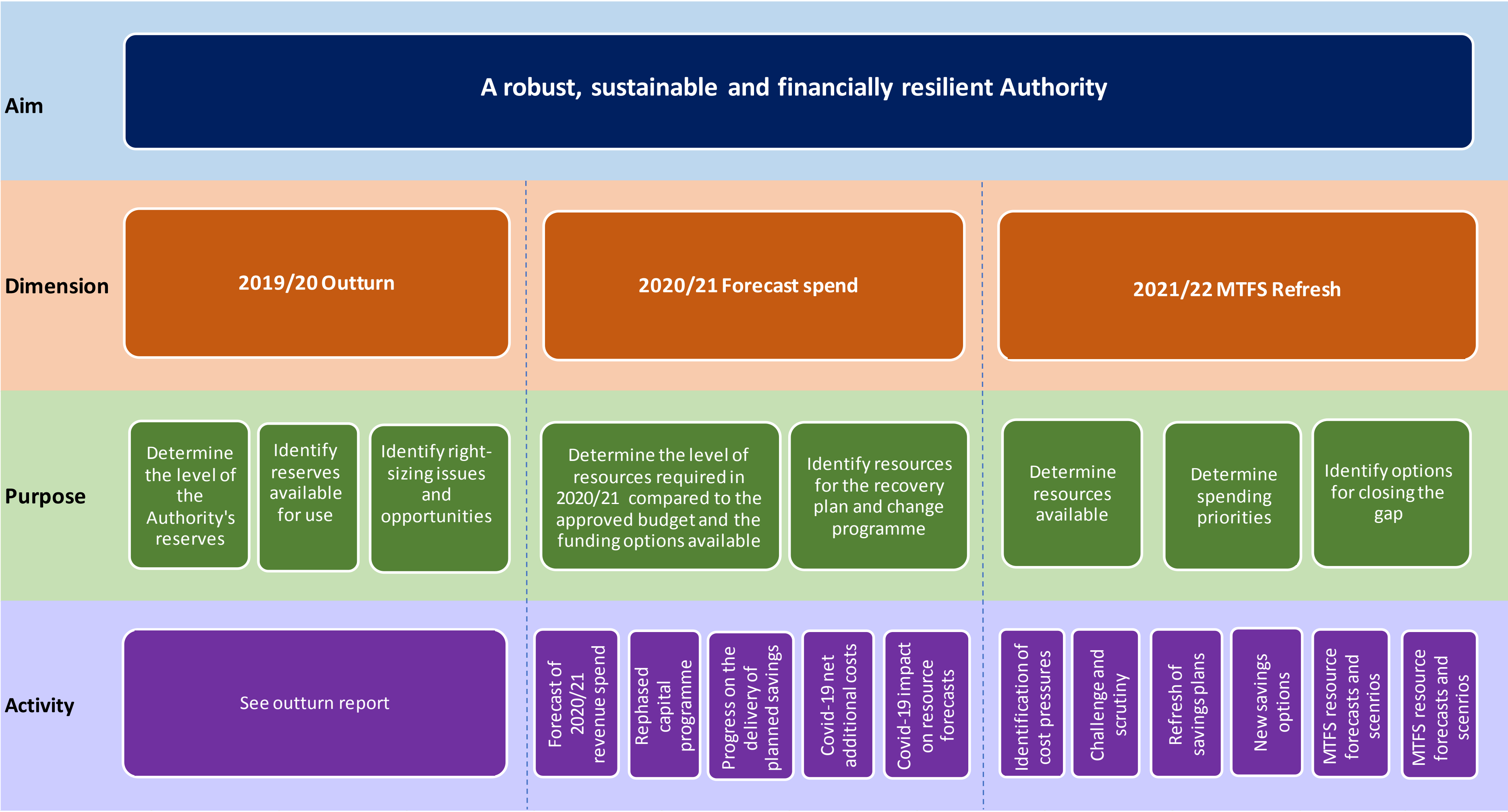
Elected Members have not been consulted in the preparation of this report.

Appendix A

Framework for a Robust, Sustainable and Financially Resilient Warwickshire



Appendix B

Resource Scenarios and Underlying Assumptions

New savings in 2021/22	£8m	£16	£44
New savings over MTFS	£0	£23	£82
Assumptions			
Core BCF/iBCF funding	All social care grants continue for MTFS period	All social care grants continue for MTFS period	Grants not already announced for this parliament stopped
Council Tax Collection Fund Deficit	£8m in 2021/22 and £3m in 2022/23	£8m in 2021/22, £3m in 2022/22	£15m in 2021/22, £7.5m on 2022/23
Business rates income	Taxbase maintained, deficits met from £8m NNDR appeals reserve used	£8m NNDR appeals reserve used, further 5% reduction in 2021/22	£8m NNDR appeals reserve used, 10% reduction in 2021/22 and 5% in 2022/23
Council tax taxbase	1% growth in 2021/22, 1.5% in 2022/23, thereafter 2%	0% growth in 2021/22, 1% in 2022/23, thereafter 2%	1% a year for the period of the MTFS
Council tax increase	2% per annum	2% per annum	2% per annum
DSG deficit	DSG brought into balance in 5 years and reserve released	Deficit reduced to the £28m provision in the current MTFS in 5 years	As per current DSG recovery plan
Additional permanent spending pressures	Spending pressures met from within the MTFS provision	Increase provision from £2.5m to £5m a year	Increase provision from £2.5m to £7.5m a year
Inflation	No recession, inflation increases to 2.5% a year	Managed within 2% provision each year	Recession, inflation drops to 1.5% a year
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