



**CABINET – 24 JUNE 2022**

**URGENT REPORT OF THE DIRECTOR OF CORPORATE RESOURCES**

**MEDIUM TERM FINANCIAL STRATEGY UPDATE**

**PART A**

**Purpose of the Report**

1. The purpose of this report is to update the Cabinet on the serious financial position faced by the County Council.

**Recommendations**

2. It is recommended that:
  - a) The very challenging financial position faced by the County Council be noted;
  - b) Chief Officers be authorised to undertake preparatory work on savings that are not currently in the MTFS following consultation with the appropriate Lead Member, the Director of Corporate Resources and Lead Member for Resources, with the outcome being considered as part of the roll forward of the MTFS;
  - c) The Director of Corporate Resources, following consultation with the appropriate Lead Member and Chief Officer and Lead Member for Resources, be authorised to commence preparatory work reviewing capital schemes, with a view to reducing cost;
  - d) The report be shared with Leicestershire's Members of Parliament to support them in their lobbying with Government.

**Reasons for Recommendations**

3. To inform the Cabinet of the work that needs to be undertaken to ensure a balanced budget can be set in 2023/24.

### **Timetable for Decisions (including Scrutiny)**

4. A report setting out in more detail the financial position of the Council will be considered by the Scrutiny Commission and the Cabinet in September 2022.

### **Policy Framework and Previous Decisions**

5. The County Council approved the 2022/23 to 2025/26 Medium Term Financial Strategy (MTFS) in February 2022. The key aim of the Strategy is to ensure that the Authority has appropriate resources in place to fund key service demands over the next few years. The Strategy includes the establishment of earmarked funds and the allocation of ongoing revenue budget and capital resources for key priorities.
6. In May 2022, the Cabinet noted with concern the increasing pressures on the Capital Programme relating to infrastructure required to support housing and economic growth. The report set out some of the elements required to manage the financial risk to the County Council. The report also highlighted the significant issue that increasing inflation was likely to have on the County Council's finances.

### **Resource Implications**

7. The impact of inflation and other pressures on the County Council's budget will be profound. The budget gap in 2023/24 is expected to grow from a manageable £8m at the time the MTFS was approved in February to c£20m based on current inflation projections. Over the life of the MTFS the gap could increase from £40m to over £70m unless mitigating actions are taken. These estimates will grow even further if the trend of worsening economic news continues.
8. The County Council's budget position is clearly impacted by its position as the lowest funded and spending county council in the country. It is also worth noting that any prospects that the Government's Fair Funding review will materially improve the Council's position are receding, with the likelihood of funding reform being very limited. The Council does hope that its suggestion of putting a floor under core spending power has gained some traction with Government as this would improve the Council's finances. However, the County Council cannot plan on the basis that funding reform happens or that the Government provides further funding for all local authorities to compensate for inflationary pressures.
9. The inflationary pressures are impacting on all local authorities, with a recent survey from the Society of County Treasurers showing that the potential shortfall in budgets for 2022/23 is estimated to be in excess of £700m.
10. The Council will prepare for a difficult budget. There is no doubt that significant additional savings and a restriction on new projects will be required in the next and subsequent years.

11. Over the summer work will be undertaken to identify new savings proposals. These are almost certain to mean service reductions to discretionary services such as support to businesses, waste sites and bus services. The more significant adults and children's social care budgets will also need to generate considerable savings. The inflationary impact on the £500m capital programme is significant and expected to increase. There is no doubt that some existing schemes will need to be cancelled, mothballed or reduced in scope. Options will be considered over the summer and autumn.

### **Circulation under the Local Issues Alert Procedure**

12. This report has been circulated to all Members of the County Council.

### **Officers to Contact**

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## **PART B**

### **National Financial Position**

13. At the Monetary Policy Committee meeting in February the Bank of England's inflation expectations were for inflation to peak at 7.25% in April 2022. However, after raising interest rates in June for the fifth time in succession to a 13 year high, the Bank of England revised its peak inflation estimate to "slightly above 11% in October".
14. Inflation is expected to return to the 2% target in the medium term due to "the stabilisation of the prices of commodities, albeit at elevated levels, and other tradable goods". The clear message is that high prices are with us for the foreseeable future.
15. The Society of County Treasurers recently undertook a survey to identify the implications that higher inflation would have on Councils' budgets. The headlines were that inflation is estimated to add £1.5bn to the revenue and capital budgets of County Councils this year. This is £729m higher than when budgets were set. In detail this showed;
  - Adult social care services are expected to be hit with £428m of additional in-year costs, including higher fees to care providers to offset their rising costs of running care homes. Children's social care faces £72m of additional costs.
  - The cost of delivering capital projects is set to be £397m higher, including an additional £211m in building new roads and pothole filling, while the cost of building new schools and other construction and building maintenance has grown by £149m.
  - Record energy prices are expected to add a minimum of £107m to council costs, including £60m for streetlights and £46m on fuel and energy bills.
  - Inflation on external contract and labour costs, including highways maintenance and waste management, are expected to add £136m to council budgets.
  - Rising fuel prices mean that bus, taxi and minibus providers are charging councils more for school transport services, adding £77m to councils' costs.
  - Increases in staff pay are expected to add £259m to the revenue budgets of councils.
16. The analysis was undertaken before the Bank of England's worsening outlook and focused on the current financial year. The Low Pay Commission is currently consulting on significant increases in the National Living Wage (NLW), the central projection is for a rate increase of over 15% in the next 2-years. The NLW has a significant influence on social care costs and the proposed rate is far in excess of the 2% per annum that the current Council Tax referendum limits allow.
17. Government has understandably prioritised the cost of living impact on individuals when allocating new funding. The national finances will receive a boost from rising wages and continued low unemployment. However, the cost of servicing the national debt will continue to increase and calls for tax cuts are not likely to subside as inflation rises. It would be unrealistic to expect local government to receive significant support in the short term, particularly with a recession looming.

## Leicestershire County Council's Financial Position

18. Since the 2022-26 MTFs was agreed in February 2022, world events have meant that the provision included for inflation looks to be understated for every year of the Strategy. Even small changes can have a large impact on the County Council's finances:
- 1% higher pay award = £1.5m per annum
  - 50p on the NLW = £10m per annum
  - 1% higher contract inflation = £2 per annum
- Unfortunately, the changes in inflation currently being experienced cannot be described as small.
19. The inflationary impact is not limited to the revenue budget, with labour shortages and commodity price increases driving up the cost of new infrastructure. The vast majority of the £500m capital programme relates to property and highways infrastructure that is particularly susceptible to the current wave of inflation. A significant proportion of the capital programme is externally funded at fixed amounts, meaning that any overspends disproportionately fall to the County Council compared to the initial contribution.
20. The inflationary impact on the current financial year is expected to be manageable. The main social care cost increases have been agreed and the cost of supply contracts will be increased at prearranged points through the year often using historic levels of inflation. The position will still need to be carefully managed to avoid using reserves that could usefully be invested and not making decisions that will detrimentally impact future years.
21. As the year progresses there will be a gradually unfolding picture of the impact on 2023/24. Suppliers' reaction to inflation will become clear throughout the year, NLW increases are usually announced in the autumn and the pay award should become clearer at a similar time. The flexibility to increase Council Tax may not be known until December with Government choosing between supporting local government or supporting taxpayers. Waiting for all the information to be known before reacting would be unwise, particularly as expectations are worsening with the passage of time.
22. All of local government will be impacted to a similar extent. The differentiator will be how quickly councils react to the financial challenge and their financial resilience (balance sheet strength and reality of assumptions made in MTFs). The situation is not dissimilar to the early stages of the Covid pandemic, but the expectations of Government support are much lower.
23. The local financial position has become more difficult following the pandemic and low funding is a perennial problem. However, despite its relatively low funding, this County Council is still better positioned than most. The MTFs is sufficiently robust to avoid knee jerk measures and the County Council has a good track record of savings delivery. It may not be until budgets are set for the next financial year that the difference between

authorities that are coping and those that are not becomes clear due to the use of short-term measures hiding inaction.

24. The challenges over the next few years are not limited to the direct impact of inflation. A summary of the other significant challenges that are not fully reflected in the MTFS are set out in the table below:

ASC Reforms	High risk of multiple 10s of millions of pounds above Government estimates. Distribution of grant unknown.
Health discharge income	£13m income in 2021/22, costs may not reduce in line with reductions.
Recession	Size of recession and Government response unknown. Unless mild, will drive service demand and reduce income.
Funding Reforms	No benefit assumed, but could compound problems if the expected refresh does not tactical fundamental problems
SEN reforms	Hardening of DfE position, on-going overspends seen as local government's problem
Unforeseen issues	For example, the impact of problems on partners or suppliers from the size and speed of inflation

### **Mitigations and their limitations**

25. The table below shows the financial challenge in the current MTFS with the estimated impact of higher inflation.

£m	22/23	23/24	24/25	25/26
<b>Current MTFS Unmitigated Gap</b>	22	43	69	94
<b>Savings Targets</b>	(22)	(35)	(45)	(54)
<b>Current MTFS Gap</b>	0	8	24	40
<b>Additional Inflation estimate</b>	3	20	27	31
<b>Revised Gap</b>	3	28	51	71

26. Due to the financial gap predicted when the MTFS was produced several efficiency saving initiatives are already being developed. However, the size and speed of inflation means that it is unlikely that new efficiency saving will make a significant impact on the revised £28m gap next year. Even the £71m gap in 2025/26 is unlikely to be materially reduced by savings. Increasing the £54m savings that are currently being targeted to the average level delivered since the start of austerity would only reduce the 2025/26 gap to £50 million.

27. A stronger approach to savings will be required, including looking at service reductions.
28. The referendum limit for Council Tax is 1.99%, which is the planning assumption for the MTFS. However, in recent years Government have allowed a higher increase in recognition of service pressure. If a 3% increase was assumed for the next three years this would reduce the deficit by £12m by 2025/26. Even if this were possible and implemented locally a significant proportion is left to be found by other means.
29. Restrictions on new capital schemes are likely to be required. The Cabinet has already noted that new infrastructure can only be built if external funding is secured. Unless there is a compelling rationale, for example spend to save or assets at the end of life, then it is likely a similar restriction will be required for new capital schemes.
30. For several years, service growth has been dominated by unavoidable expenditure, for example additional social care service users from a growing population. Going forward it is likely that discretionary growth will need to be restricted even further. Introducing expenditure controls that were utilised during the Covid pandemic will need to be considered.
31. The usual approach to balancing the budget, that has served the County Council well, will need to continue but be augmented by additional measures. All local authorities are under severe pressure from inflation and it is likely that those that react first will manage the best. Waiting for certainty about how bad things are going to be will only serve to reduce options and cause reactive decision making. Government's initial reaction is likely to be short term interventions and only a more substantial fix after some authorities are in genuine difficulty. Taking early action to ensure that this, low funded, County Council does not get into financial difficulty is vital.

### **Equality and Human Rights Implications**

32. There are no direct equality or human rights implications arising from the recommendations in this report.

### **Background Papers**

Report to the County Council – 17<sup>th</sup> February 2021 – Medium Term Financial Strategy 2021-25 (and updated report to Cabinet – 5<sup>th</sup> February 2021)

<https://politics.leics.gov.uk/documents/s159761/Medium%20Term%20Financial%20Strategy%20202122%20to%20202425.pdf>

<https://politics.leics.gov.uk/documents/s159779/Revised%20Cabinet%20Report%20MTFS%202021-25.pdf>

Report to the Cabinet – 27 May 2022 – Provisional Revenue and Capital Outturn 2021/22

<https://politics.leics.gov.uk/ieListDocuments.aspx?CId=135&MId=6744&Ver=4>

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