Leicestershire County Council

SCRUTINY COMMISSION - 7TH SEPTEMBER 2022

MEDIUM TERM FINANCIAL STRATEGY - LATEST POSITION

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

Purpose of the Report

1. The purpose of this report is to provide members with an update on the worsening short and medium term financial position in light of the current economic climate. The report also details the changes to be made to the previously agreed 2022-26 capital programme following the latest review, and covers the specific revenue budget monitoring position as at the end of period 4 (the end of July).

Policy Framework and Previous Decisions

2. The 2022/23 revenue budget and the 2022/23 to 2025/26 capital programme were approved by the County Council at its budget meeting on 23rd February 2022 as part of the Medium-Term Financial Strategy. The MTFS forms part of the Budget and Policy Framework as set out in art 4C of the Council's Constitution.

3. A report on the worsening MTFS position was presented to the Cabinet at its meeting on 24th June 2022.

Timetable for Decision (including Scrutiny)

4. The Cabinet will consider a report on the Medium Term Financial Position on the 16th September 2022 on potential measures to help mitigate the position, as well as the proposed changes to the previously agreed 2022-26 capital programme.

Medium Term Financial Strategy

5. The County Council is facing a challenging, worsening and frightening financial outlook. The current MTFS anticipated a funding gap of £8m in 2023/24 rising to £40m by 2025/26. An initial review of the position in light of the emerging inflation levels suggested that the gap had grown to £28m next year rising to £71m by 2025/26, as reported in the MTFS Update report to Cabinet on 24th June 2022. Since then an offer has been made by the employers in respect of the 2022/23 pay award (which is a fixed flat rate pay increase of £1,925 pa per employee to be implemented from 1st April 2022). This works

out on average to be 6.4% and will add around £6m to costs in the current year over and above what is budgeted for with implications for future years, especially if further pay awards over and above 3% are agreed.

6. When the impact of inflation was assessed in June the Bank of England was expecting inflation to peak at 11% in October. The outlook has worsened again, with a peak of 13% (or higher) now expected. Despite a higher peak there are no indications that prices will fall back towards their historic level resulting in a permanent increase in the Council's cost base.

7. The pressures of high inflation levels, coupled with an ever-increasing demand for core services, especially following the Covid-19 pandemic, is presenting a challenge across the whole local government sector. However, as a very low-funded authority Leicestershire is much worse placed than most to be able resolve the problem.

8. The Council will continue to pursue efficiencies. However, it is clear now that in the current climate, and on the back of the £230m of savings already delivered since 2010, it will not be possible to balance the Council's financial position without impacting on front line service delivery. Statutory responsibilities will have to be prioritised, and whilst there may be scope for assessing service levels, it will primarily be discretionary services where most savings will need to be identified.

9. The Capital Programme also needs to be rationalised. A review over the summer has resulted in some schemes being removed or delayed. This has resulted in a net decrease in the funding gap of the capital programme by £9m to £134m overall providing an annual revenue saving of £0.5m per annum.

10. However, the capital review has also indicated that inflation increases across the programme, but mainly on the major capital projects, could add an additional £45m to the capital programme funding gap. This has not yet been included in the revised capital programme because of the wider financial implications. Unless action can be taken this would add around £2.5m per annum to the revenue budget.

11. The County Council continues to press the Government to address the imbalance on relative funding levels between local authorities. Furthermore, the financial situation also requires the Government to deal with the structural national issues around funding for those services, such as social care and Special Educational Needs and Disabilities (SEND), which are experiencing a relentless growth in demand. Proposals currently being pursued provide little comfort that the financial pressures falling on local authorities such as Leicestershire will be reduced.

2022/23 REVENUE BUDGET MONITORING – PERIOD 4

12. The period 4 revenue budget monitoring exercise shows a net projected overspend of £13.6m.

13. The 2022/23 revenue budget and the 2022/23 to 2025/26 capital programme were approved by the County Council at its budget meeting on 23rd February 2022 as part of

the Medium Term Financial Strategy. The monitoring information contained within this report is based on the pattern of revenue and capital expenditure to the end of July 2022.

14. A summary of the position on the revenue budget is shown below and set out in more detail in Appendix A.

REVENUE BUDGET MONITORING STATEMENT
FOR THE PERIOD : APRIL 2022 TO JULY 2022

	Updated Budget	Projected Outturn	Difference from Updated Budget	
	£000	£000	£000	%
Schools Budget – Schools and Early Years	0	-310	-310	
Schools Budget – High Needs	0	10,780	10,780	
Net Total	0	10,470	10,470	
Children & Family Services (Other)	93,241	95,351	2,110	2.3
Adults & Communities	183,334	187,794	4,460	2.4
Public Health	-1,446	-1,446	0	0. 0
Environment & Transport	84,502	83,422	-1,080	-1.3
Chief Executives	13,409	13,169	-240	-1.8
Corporate Resources	35,745	37,375	1,630	4.6
Capital Financing	22,000	21,700	-300	-1.4
Contingency for Inflation	11,027	21,627	10,600	96.1
Other Areas	6,614	1,364	-5,250	-79.4
Contribution to budget equalisation earmarked fund	22,290	24,190	1,900	8.5
Contribution to General Fund	1,000	1,000	0	0.0
Total	471,716	485,546	13,830	2.9
Funding	-471,716	-471,906	-190	0.0
Net Total	0	13,640	13,640	

15. The key projected variances that have been identified are set out below. Further details of major variances are provided in Appendix B.

Children and Family Services – Schools Budget

16. Overall an overspend of £10.5m is forecast on the Dedicated Schools Grant. This is made up mainly of overspends of £10.7m on the High Needs block and £1.3m on the Early Years block, offset by an underspend on the Schools Block from schools growth (£1.7m) which will be retained for meeting the costs of commissioning school places in future years.

17. The High Needs Block is projected to overspend the grant received by a net £10.5m in 2022/23. This is £1.6m higher than the position forecast in the original MTFS 2022, of

which the majority is due to around 100 new Early Years specialist places identified as being required from September 2022.

18. Nationally, concern over the impact of Special Educational Needs and Disabilities (SEND) reform on High Needs expenditure, and the financial difficulties this exposes local authorities to, is growing. Whilst the recently released Green Paper is set to result in systemic changes to the national SEND system such changes may take a number of years to deliver and none appear to address the funding issues.

19. Leicestershire has been invited into the Department of Education's (DfE) Delivering Better Value (DBV) in SEND programme as a result of the deficit. Discussions are at the early stages to identify the support, more likely to be through the deployment of consultants rather than additional funding, and how that may assist addressing the deficit. Procurement of a Strategic Partner to support the delivery of the Transforming SEND in Leicestershire (TSIL) programme has been undertaken; this programme and the DBV programme will be closely aligned. Discussions have taken place with DfE regarding the strategic partner and funding. Whilst the cost cannot be charged to the DSG grant the investment is recognised as a key step in reducing the deficit and as such would be taken into consideration if there was a call on the County Council to contribute to the deficit reduction, as has been the case for authorities with even more serious deficits.

20. At the end of 2022/23 the accumulated High Needs deficit is forecast at £39m. Without new interventions the high needs deficit is forecast to continue to increase over the MTFS period and is not financially sustainable. This creates a significant and unresolved financial risk to the Council.

21. The Early Years budget is showing an overspend of £1.3m. The budget is based on the number of hours used by the DfE to calculate the original 2022/23 Early Years grant income in December 2021. The 2022/23 Early Years grant income was increased in July 2022 by £1.4m to allow for the Spring Term 2022 census. The forecast hours paid to Providers for 2022-23 are £2.7m more than the budget, leading to a net £1.3m overspend. However the 2022/23 Early Years Grant income will be retrospectively adjusted in 2023/24 to allow for the hours paid in Spring 2023, and it is anticipated that this adjustment will clear the £1.3m deficit accounted for in 2022/23. The Early Years deficit of £4m as at March 2022 is separate to this. This was the result of problems with previous census data and additional payments to Providers during Covid-19. The Councils request for additional support from the DfE has been turned down, and arrangements will be made to recover this deficit from 2023/24 by retaining some of the increase in grant funding due in that year.

<u>Children and Family Services – Local Authority Budget (Other)</u>

22. The Local Authority budget is projected to overspend by a net £2.1m (2%), mainly relating to a projected overspend on the Children's Social Care Placement budget (£1.1m), and social care staffing budgets (£1m).

23. Whilst overall Looked After Children (LAC) numbers for Leicestershire for 2022/23 appear to be in line with budgeted numbers, reflective of LAC increase of 5% and subsequent projection of 730 LAC at the end of financial year compared with 695 LAC at the beginning of the financial year, the placement mix is projected to be different compared with the budgeted position - driven largely by a significant increase in the last quarter of 2021/22 of complex needs placements for older children, with some requiring high levels of care and support resulting in higher than the average cost for some placement provision. For example, current projections within the 16plus placement budget include three 52-week placements in this financial year at a weekly cost of £6k plus – a 300% plus increase on the average cost of 16plus placements, and a significant contributing factor for the current projected overspend position.

24. Related to residential care budget pressures and current challenges is the sustained high demand for parent-baby assessment placements with the increased focus and legal requirement to keep babies with their parents whilst assessments take place. The Council is now mandated by the courts to meet this legal expectation. The higher rate of parent-baby placements has been sustained over the last 6 months. If this rate continues, this too will have an impact on the MTFS which will continue to be monitored.

25. As part of the actions being taken to mitigate against these financial pressures, the Defining Children and Family Services for the Future programme has several workstreams to enable MTFS benefits to be achieved, alongside the Social Care Investment Programme (SCIP) working in partnership with Barnardo's. This will have a positive impact through the creation of additional capacity for under 16's, over 16's and parent and children places, which should be in place during 2022/23. With increasing demands projected and a market shortage, further investments are planned, subject to the individual business cases and availability of suitable property and staff.

26. Social care staffing teams continue to remain under pressure with a net projected overspend of £1m above budget for the current year – largely due to market pressures resulting in increased agency spend. Nationally there is a shortage of qualified social worker staff and this has recently been acknowledged through further work indicating a 6% reduction nationally in applicants to undertake social work training. Further research is showing qualified social work staff do not remain in front line work on average for more than 8 years. There is also a growing number of staff moving to agency work, or neighbouring local authorities, for inflated rates of pay. All of these factors and issues are all very prevalent within Leicestershire., This is despite positive recruitment and retention activities, such as increasing the number of staff undertaking the apprenticeship Social Work course, and Leicestershire paying market premia payments to try to ensure average pay is more in line with similar posts across the region. This has resulted in continued pressures and challenges for social care service budgets in Leicestershire, resulting in the current projected overspend position. The position is after an additional net growth of £2m added to the budget in 2022/23 for increased caseloads.

Adults and Communities

27. A net overspend of £4.5m (2.5%) is forecast for the revenue budget for 2022/23.

28. There is a continuing financial impact due to Covid-19 on adult social care which includes additional costs for commissioned services and loss of service user income. However, these seem to be now stabilising.

29. The main areas are:

- Residential Care, £2.1m income reduction. As a result of Covid-19 over the last two years the number of chargeable residential service users has declined and charging has been delayed due to funding placements through the discharge process. A review into the processes relating to residential income is taking place to accelerate recovery of income by restating charges.

- Residential Care, £3.0m overspend. The net overspend comprises two elements; firstly additional service users costs mainly due to a high number of short-term care placements following discharge from hospital and additional needs (£1.0m), service users not moving to supported living (£1.5m) partially offset by underspend on supported living and costs from service users transferring from children's services (£0.5m) which are more than originally budgeted for.

- BCF/Other NHS Income, £1.9m loss of income. A total of £6m income was budgeted for from the NHS for additional costs relating to Covid-19 mainly due to hospital discharges. However, current indications are that there will be a £2.8m shortfall in this income (funding for the first quarter of 2022/23 has been agreed and the same is expected to be agreed for the second quarter, to the end of September). Discussions are continuing with the NHS on how they may increase their support to adult social care and review discharge practices. The 2021/22 funded discharge process ended in March 2022. Reviews of service user packages from the discharge arrangements are ongoing, see actions below. The overall position is offset by additional BCF income of £0.8m.

- Homecare, £1.9 m overspend. Additional arrears payments from 2021/22 (£0.7m) and an increase in the number of service users and hours of care compared to the budget (£1.2m).

- Supported Living, £1.2m underspend. Due to a slowdown in new service users from residential care. This underspend partly offsets the overspend in residential care as a consequence of this delay.

- Community Life Choices (CLC)/ Commissioned Services, net underspend of £0.7m. Underspend from closure of CLC bases following lockdown and the vacancies that are being held.

- Community Income £1.2m additional income for contributions to support learning disability and from service users.

30. An action plan will continue to be in place during 22/23 which will focus on:

- Reviews of all service user's packages that have commenced or changed since April 2021.
- Working with NHS partners to help improve the discharge pathway including reviewing funding arrangements.
- ensure financial and funding assessments are undertaken.
- reviewing internal processes.

31. These costs are offset by a net £1.4m underspend from staffing and other minor variations.

Public Health

32. The department is forecasting to be on budget. There are minor net underspends of £20,000 which will be transferred to Public Health earmarked fund.

Environment and Transport

33. A net underspend of £1.1m (1.3%) is reported.

34. Transport is reporting a net £0.6m overspend. Overspends are forecast due to a delay in delivery of the SEN transport lean review (£0.5m) and additional staffing and agency costs (£0.2m). Fewer operational routes for Social Care transport within Fleet Services due to driver and escort vacancies have resulted in an underspend (£0.3m), however this is offset by a forecast increase in Social Care taxi costs (£0.6m). Concessionary travel reimbursement costs are forecast to be lower than budget (£0.4m) following the decision to make payments based on actual service levels as per DfT guidance.

35. Across Highways an underspend of £0.7m is reported arising from vacancies across various teams and additional income from section 38 and 278 fees.

36. There is an underspend of £1.0m on Waste budgets, relating to continuing market price rises generating increased income for recycling, scrap metal and dry recyclable materials (£1.0m) and vacancies across the service (£0.2m). AutoCad license costs and non-delivery of digital payments saving has added a small pressure (£0.2m).

Chief Executive's

37. The department is reporting a net underspend of £0.2m (1.8%) including increased costs of the Coroners Service of £0.15m and underspends due to staffing vacancies across the department (£0.1m) and increased Registrar's income (£0.25m). The departmental position includes forecast costs of £1.5m in respect of the establishment of the proposed Freeport. These costs will temporarily be funded from County Council reserves to be repaid from retained business rates generated once the Freeport goes live.

Corporate Resources

38. Overall the Department is forecasting a net overspend of £1.6m (4.7%).

39. Pressures in Commercial Services are on-going which includes recovery from the pandemic but also additional pressures through the increase in the national living wage and general inflationary pressures felt in services.

40. In the short term, measures are being taken to mitigate these inflationary impacts (including a review of school food contracts including charging and choice) whilst a fundamental review is undertaken longer term.

41. Excluding traded services, all other support services are largely spending within budget.

Central Items

42. Bank and other interest - £5m increased investment income. This is mainly due to recent increases in the Bank of England base rate from 0.5% in February 2022 to a forecast average for the year of 2%. Together with continued high average bank balances, estimated to be around £350m for the year, an additional £5m in investment income from treasury management activities is forecast. This position could increase further if the base rate continues to increase during the year. The base rate currently stands at 1.75% with some advisors commenting that it may increase to 2.75% by the end of the financial year.

43. Contribution to the budget equalisation earmarked fund £1.9m. This has been increased by £1.9m to match the forecast increase in the DSG High Needs deficit mentioned earlier in the report. This is needed due to the cashflow impact of the additional expenditure. The overspend continues to be accounted for against the grant with the expectation that it will ultimately be repaid.

44. Inflation Contingency (£28.8m, unallocated balance £11m). The contingency is currently projected to be overspent by £10.6m. The majority of the overspend is related to the pay offer for 2022/23 of £1,925 on each scale point, equating to an average increase of 6.4%. The cost in excess of the provision in the inflation contingency (based on 3%) is around £6m. It is anticipated that Traded Services will be unable to absorb the full impact of the pay offer and that around £1.2m will need to be met from the central contingency. Running costs are forecast to be higher than anticipated, particularly on Environment and Transport services and also regarding electricity and gas contracts, where increases of around 100% and 200% respectively have been forecast to occur in the autumn.

45. MTFS Risks Contingency (£8m). At this stage no release of the contingency has been assumed in the projection.

Business Rates

46. Additional Business Rates income of £0.2m is forecast in 2022/23, based on the latest information from districts on their NNDR1 forms and forecast section 31 grants.

47. The provisional outturn position of the 2021/22 Leicester and Leicestershire Business Rates Pool shows a Levy total of £13.4m, with the final position expected to be reported in November, after the completion of the external audits. Monitoring of the 2022/23 Pool

is being undertaken The first exercise for quarter one, to the end of June, shows a forecast Levy total of £15m.

Overall Revenue Summary

48. At this relatively early stage there is a forecast net overspend of £13.6m but this is uncertain due to not being able to fully assess the ongoing impact of inflation on the County Council budget. This position will be updated as more information is known during the financial year.

49. The 2022/23 outturn position is planned to be closed by the use of the MTFS Risks Contingency (£8m) and the balance being found from a combination of:
- a review of reserves (including £3.1m set aside in the 2021/22 accounts towards inflation pressures);
- introduction of spend controls; and
- restriction on inflation allocations to areas that could reduce the level of service provision.

Corporate Asset Investment Fund – 2022/23 Monitoring

50. A summary of the Corporate Asset Investment Fund (CAIF) position as at quarter 1 for 2022/23 is set out below:

Asset Class	Opening Capital Value	Capital Incurred 2021/22	Net Income YTD	Forecast Net Income FY	Forecast Net Inc. Return FY
	£000	£000	£000	£000	%
Office	57,494	0	984	3,254	5.7%
Industrial	27,209	0	544	1,564	5.8%
Distribution	454	0	-2	17	3.8%
Rural	28,575	0	-234	452	1.6%
Other	4,885	0	42	254	5.2%
Development	36,477	44	-31	-99	-0.3%
Pooled Property	28,016	0	218	830	2.9%
Private Debt[1]	23,684	4,380	126	421	1.6%
TOTAL	**206,795**	**4,424**	**1,648**	**6,692**	**3.1%**

1. Delayed distributions last year but expecting an increase this year so income likely to be understated

51. Overall the fund is forecasting to achieve a 3.0% net income return for 2022/23. The direct property portfolio (excluding developments, pooled property and private debt) has a forecast net income return of 4.7%.

52. The directly managed property portfolio is forecasted to perform in line with expectations for 2022/23.

53. The rural sector is largely unaffected by Covid-19 and is currently expected to return around £450,000 net income. The diverse assets held in the other asset class offered

from protection from Covid-19 last year. The Citroën Garage within this class is the largest holding and contributes the majority of the forecast net income.

54. Pooled property net income is expected to be similar to last year and is forecast to return around 3% from a diverse portfolio comprising of four institutional property manager funds. The private debt investment is invested in a product that is primarily composed of senior secured debt and is highly diversified. Income is forecast to be lower this year owing to repayments of underlying loans last year. Whilst new money has been committed to this asset class the income will likely be below levels until more loans are made and underlying interest payments become payable to the Council. The diversification of underlying loans does however offer considerable downside protection to the capital invested.

55. It should be noted that the above table excludes in year capital growth which is assessed annually as part of the asset revaluation exercise and reported in the annual CAIF performance report.

CAPITAL PROGRAMME

56. The current four year capital programme totals £563m, including outturn adjustments and new funding during 2022/23. Discretionary funding totals £299m, including £143m of internal borrowing through temporary use of cash balances.

57. Due to specific and significant changes to a number of schemes, the four year capital programme has been reviewed and updated for the latest known position in respect of costs, spend profiles and changes in grant funding. However, it is likely that further pressures, relating to global and local supply chains, will emerge, especially as the MTFS is refreshed over the coming months and extended to cover the 2026/27 financial year.

58. The revised 4-year programme is summarised below and shown in detail in Appendix C.

Capital Programme Expenditure 2022-26	Original MTFS 2022-26 Programme £000	In year and Outturn adjustments (from 21/22) £000	Updated MTFS 2022-26 Programme £000	Revised MTFS 2022-26 Programme £000	Revised Programme Change £000
Children & Family Services	94,012	22,532	116,544	143,528	26,984
Adults and Communities	27,213	144	27,357	27,383	26
Environment & Transport	226,408	22,137	248,545	250,236	1,691
Chief Executive’s	650	1,003	1,653	1,453	-200
Corporate Resources	12,526	1,562	14,088	13,901	-187
Corporate Programme	153,748	1,256	155,004	155,704	700
Total	**514,557**	**48,634**	**563,191**	**592,205**	**29,014**

Capital Programme Resources 2022-26					
Grant Funding/ Specific Contributions	236,430	27,940	264,370	294,993	30,623
Discretionary Funding – capital receipts/ Revenue/ Reserves	135,280	20,694	155,974	163,631	7,657
Discretionary Funding – borrowing required	142,847	0	142,847	133,581	(9,266)
Total	**514,557**	**48,634**	**563,191**	**592,205**	**29,014**

59. Overall, the net funding required for the programme has decreased by £9.3m following the review of the capital programme. There has been an increase of £29m in forecast expenditure, offset by additional capital grants, reserve contributions and capital receipts of £38m.

60. The revised position has the impact of reducing the overall amount of borrowing required to fund the capital programme by £9m to £134m, from the £143m approved in the original 22-26 MTFS. At current borrowing rates this will have the effect of saving £0.5m per annum on the revenue budget.

61. As part of the capital review an estimate of the potential increases for inflation was also undertaken. In line with what is being seen everywhere else costs are increasing across the capital programme. The significant areas impacted are with the proposed new major road schemes in the E&T programme. In many other areas across the programme the increases are being managed within block / grant allocations.

62. The overall inflation estimates show a potential additional £45m would be needed to fund the programme. Unless action can be taken to reduce the costs, the £45m would require additional borrowing, which would cost in the range of £2.5m – £3m per annum. This would be an additional cost on the revenue budget with the need to make compensating savings elsewhere.

63. The key changes from the capital review are described below.

<u>Children and Families</u>

64. The programme has been increased overall by £27m due to updated estimates of government grant funding and developer contributions, which has enabled the net discretionary funding of the capital programme to be reduced by £3m.

65. Estimates for Department of Education capital grants have been updated for the latest known position; £16m additional for Basic Need, £9m for High Needs Provision and Children's Homes Capital programme £1.5m. The original MTFS estimates were prudent due to the short notification of the grants. Other increase includes £3m for additional section 106 contributions.

66. Due to the additional grant funding the overall amount of discretionary funding to the programme can be reduced, including a £2m reduction to the Children's social care investment plan (C-SCIP) programme.

Adults and Communities

67. No significant changes.

Environment and Transport

68. The updated programme includes an overall increased requirement of £1.7m, which is entirely funded from specific earmarked reserves.

69. The main changes are; updates for the replacement costs of the Leicester and Leicestershire Integrated Transport Model (LLITM) refresh £0.5m increase; the inclusion of a Highways Plant replacement programme £0.7m over four years; and revised costs of work for Ashby Canal Reed Bed, increase of £0.2m. These changes are all funded from earmarked reserves.

70. The capital review has highlighted that there are significant financial pressures within the E&T programme due to rising levels of inflation on major contract schemes estimated costs, including the Melton Mowbray Distributor Road (MMDR) North and East and Southern section projects and the Zouch bridge replacement project. A bid to the government for levelling up grant funding for the Zouch bridge project has been submitted with an announcement expected as part of the Chancellor's autumn statement later in the year.

71. Other changes to the E&T programme include the transfer of £0.5m from the recycling and household waste sites (RHWS) programme to preventative maintenance. This returns funding temporarily allocated to the RHWS programme during the pandemic.

Chief Executive's

72. The programme has been reduced by £0.2m over the four years. Following an increase to the Leicestershire grants revenue budget as part of the original MTFS, it is now possible to reduce the capital allocation by £50,000 per annum. A further review will be undertaken to ascertain if the capital allocation can be closed or amalgamated with the revenue programme.

Corporate Resources

73. Overall the departmental programme has been reduced by £0.2m due to latest estimates of costs for the ways of working – office infrastructure programme.

74. The updates to the programme also include a transfer of the funding previously allocated to the Score+ programme to the new LCC public sector decarbonisation programme to continue Climate Change projects, £1.2m.

Corporate

75. The changes to the corporate programme show an increase in discretionary funding required of £0.7m. The position includes changes as shown below:

- Inclusion of a new proposed investment at Panniers Way, Oakham, £5.6m as part of the Corporate Asset Investment Fund (CAIF). The investment is subject to final approval expected in early September.
- Reduction of £0.9m for the latest estimated costs of the CAIF investment in phases 3 and 4 development at Airfield Farm.
- Reduction of £4m to the Asset Acquisition allocation for new projects within the CAIF programme for the above changes, and the latest estimate of the funds required to reach a target investment fund at £260m.

Capital Receipts

76. The latest estimate of capital receipts for the four year programme has been updated by £6.2m. The estimated increase contributes to the reduction in the overall discretionary funding required for the capital programme.

Summary and Outlook

77. The recent review of the capital programme has led to an increase in expenditure of the four-year programme by £29m, but a net overall reduction in discretionary funding of £9.3m due to increased grants and additional capital receipts, totalling £38m. These changes reduce the level of borrowing required for the capital programme to £134m, saving around £0.5m on the annual revenue budget.

78. As part of the capital review the estimated impact of inflation, particularly on major capital schemes within the programme have been assessed. Unless action can be taken this could add between £40m and £45m to the capital programme, adding to the capital funding gap. At current rates additional borrowing of this level would cost around £2.5m per annum, for the next 40 years. This would be an additional cost to the revenue budget with the need to make further revenue savings elsewhere.

MTFS REFRESH 2023-2027

National Position

79. At the Monetary Policy Committee meeting in August, the bank of England raised interest rates by 0.5% to 1.75%. The biggest single increase for 27 years. The move is an attempt to help stem the ever increasing levels of inflation being felt nationally (and globally), largely driven by significant increases in commodity prices (especially wholesale gas where prices have doubled since May) with expectations of continued restrictions in supply. Further increases are expected in the coming months with interest rates peaking at 3% in spring 2023.

80. CPI inflation is now expected to rise from 10.1% in July to in excess of 13% before the end of 2022. Furthermore, it is forecast that it will remain in excess of the 2% target right through 2023 before falling back in line. As income is not expected to increase at this rate these forecasts suggest an increasing squeeze on resources throughout 2022 and 2023. As inflation is expected to fall back to the Bank of England’s target, rather than go negative, the consequence for the is that there will be a permanent reduction on the level of services the Council is able to deliver.

81. UK GDP growth is expected to continue to slow before contracting in each quarter between Autumn 2022 and Autumn 2023, moving the economy into recession.

82. Rising wages and continued low unemployment levels will to some extent boost tax revenues although the increase in interest rates will increase the costs of servicing the national debt. With the potential for tax cuts, dependent on the national political situation, to help address the impact on the cost of living, the prospect of additional funding for local government seems remote.

83. As reported in June, analysis by the Society of County Treasurers suggested that £1.5bn of additional costs would be incurred by County Council’s this year nationally - £729m more than when budgets were set. This analysis was taken before the more recent and worsening inflation forecasts and significantly before the recent pay award offer made by employers which will add 6-7% onto the pay bill – significantly in excess of what most authorities will have budgeted for. A number of authorities are already suggesting that balancing the books in the current financial year will be difficult enough, let alone being able to do so for the next financial year and beyond.

84. It is increasingly likely that the country will experience a significant recession, driven by inflation. A recession would normally reduce inflation but the UK is forecast to move into stagflation where the economy is squeezed by slow growth, high unemployment, and rising prices. The fall in GDP will have a direct impact upon tax revenue, both locally and nationally. It will not just reduce income, but service demand increases as inflation impacts the most vulnerable.

85. At this stage it is unclear what changes will be introduced by a new Government. It is likely that the new prime minister will implement an emergency budget later in September.

Leicestershire Position

86. The MTFS will be refreshed over the autumn, with a similar approach taken to that followed in previous years, namely continued investment in organisational change, planning and robust delivery of savings and a realistic allowance for growth. However, as mentioned this will be done with much greater urgency in the context of the serious financial position the County Council is facing, with a significant funding gap faced in 2023/24 (usually at this stage the following year’s financial position would be balanced). There is also a great deal of uncertainty around the likely ongoing impact of inflation, the impact of other service reforms (in particular Adult Social Care) as well as the Council’s core income levels.

87. The financial position outlined in the June report showed a gap of £28m in 2023/24 rising to £71m in 2025/26 after estimating the impacts of inflation on the revenue position.

£m	**22/23**	**23/24**	**24/25**	**25/26**
Current MTFS Gap	0	8	24	40
June estimate of inflation	3	20	27	31
June Gap	**3**	**28**	**51**	**71**

88. The Cabinet report in June highlighted that there is a significant amount of uncertainty around the financial position in the short and medium term. Also, that as well as the impact of inflation there are a number of other risks and challenges that will feed into the financial position.

Pay award

89. An offer has been on the employers' side of a pay award which is a fixed increase of £1,925 for all grades. At this stage it is unclear whether this will be accepted. Such.an increase would mean a 10.5% increase for staff on the lowest grades but overall, the impact on the pay bill is a 6.4% increase. This will add an additional cost of £8m for 2022/23 over and above what was budgeted for which will continue through the life of the MTFS. This can be seen in the table below. Any increases in subsequent years over and above the 3% provided for will add further to the gap. In simple terms, each extra 1% would add about £1.8m to the council's bottom line. So for example if each year in the MTFS saw a pay award of 5%, the gap by 26/27 would be £16m higher.

National Living Wage

90. The National Living Wage (NLW) impact interacts with the impact of the pay award for internal staff. But there are additional costs associated with commissioned services, especially in Adult Social care. Each 50p increase on the rate adds approximately £10m to the Council's bottom line. Depending on the level the NLW is set at could add a further £8m to £21m to the 26/27 gap.

Running costs

91. Based on inflation of 11% for next year, 5% the year after and falling back to 3% after that (compared to an assumption of 3% built in at the time the MTFS was set) , an additional £12m of running costs were anticipated next year rising to £18m per annum over the life of the MTFS. Numbers being projected now are significantly in excess of this amount and clearly subject to significant uncertainty both in terms of how high they go (for example the Bank of England latest projection is for inflation peaking at 13% whereas the Citi group are forecasting 18%) and how quickly and to what level they will reduce back down to. A pessimistic scenario could see double the estimated £18m impact over the MTFS period. This position assumes that increases in contracts during the current

financial year will have a delayed impact on the budget because of the timing of contract renewals.

Adult Social Care Reform

92. A separate report on the agenda for this meeting provides the details of the proposed reforms and the potential financial impact for the County Council which is currently highly uncertain given that some of the details of the proposals and the parameters that will be applied around levels of funding, potential charging and expected additional costs are still unclear. However, current estimates suggest an ongoing impact of between £15m to £20m per year net increase in costs by the end of the MTFS period. Shortfalls of this magnitude have been reported by other County Councils.

Special Education Needs and Disabilities

93. The underfunding of Special education Needs and Disabilities (SEND) has caused a significant financial problem for the County Council for a number of years. At the time the budget was set, the cumulative deficit between SEND costs and High Needs funding was expected to reach £37m by the end of the current financial year and grow to £63m by the end of the MTFS. Predictions going forwards are uncertain but continued growth in both numbers and average costs could see the gap grow to over £100m by 2025/26. There seems little prospect of support from Government to help alleviate this position. The DfE seems to be hardening its position with on-going overspends seen as local government's problem. Opportunities are being explored with Newton Europe around mitigations to offset the financial impact.

NHS Income

94. The MTFS assumes that £6m of income from the discharge process will be received each year from the NHS bodies. As shown in the budget monitoring for Adults and Communities above, it is anticipated that only £3.2m will be received in the current year and could fall away completely in later years,

95. To help mitigate this, one specific area that is being pursued is the extent to which Adults' and Children's social care costs are being met from local NHS organisations.

Services Demand

96. Increasing population in Leicestershire, especially in older age groups, increasing pressure on the Councils budget.

Social Care

97. Existing pressures within the MTFS continuing, requiring increases in growth and adverse in year budget variations for Adult and Children's social care services.

Mitigations

98. There are also a number of factors that could potentially help mitigate the financial risks

Adult Social Care Precept	Precept permitted to continue – 1% precept would generate £3.6m for each year permitted. The precept was included for the next 2-years in the last spending review, but has not been confirmed by the Secretary of State.
Main element (core) Council Tax	Permitted increase without referendum is increased from 1.99%. Higher inflation would usually create expectations of a higher cap, but the severity of the cost of living crisis could result in Government maintaining a low cap.
Council Tax Collection funds net surplus	23/24 currently includes £1m deficit deferred from 20/21 (due to deficits caused by Covid). Latest forecasts show that a net surplus of £2m from 22/23 will offset that deficit.
Business rate reset	Provision of £6m built in against the Government resetting the business rates baselines in 23/24, in line with policy. Every year this gets delayed provides an additional £6m one off funding.
Fair Funding Review	The review implementation date has been postponed several times and April 2023 seems unlikely. The shift in Government priorities have lowered the County Council's expectations even if a review does progress.
Additional interest on cash balances	Upward movement on interest rates leads to greater returns on treasury management activity
New Homes Bonus Grant	Possibility that the Government might extend NHB grants.
Services Grant	One-off grant in 22/23 of £4.3m. The national pot of £822m may be redistributed in later years on the same or a different basis, possibly as a result of the Fair Funding Review

99. The implications of the various issues described above will be assessed based on the latest emerging information over the coming months and fed into the December Cabinet report. However, in short the financial position is dire. Even if a significant number of the mitigations materialise it is likely that the Council will be faced with a gap in excess of £20m for 2023/24 (and this assumes all savings are delivered in line with expectations). Having an expected gap of this size so close to the budget being set is unprecedented.

100. To balance the budget the use of reserves or other short-term measures will undoubtedly be adopted by some authorities. Whilst this can deal with short term problems of a one-off nature it does not solve the structural imbalance between income and expenditure that inflation is causing. It is vital that all resources are targeted at solving the problem rather than just delaying tackling them.

101. It is important that the savings that are already under consideration are progressed and delivered on as soon as possible. Furthermore, there will be a need to add in significantly

more savings as part of the MTFS refresh in the autumn. Crucial in progressing this is the need to push on crystalising the Savings under Development.

102. However, this will be nowhere near enough to address the financial challenges ahead. In order to identify further areas where savings can be made Departments are being targeted to present options for how they could reduce their budgets, focussing on options around cheaper provision, increased efficiency, increases income and reduced demand.

103. Additional savings and reductions in growth will be brought forward for inclusion in the December Cabinet report. Growth will be subjected to significant scrutiny to ensure future projections are robust. Additional growth will only be included for unavoidable demand driven pressures. Growth for service improvements is clearly unaffordable and so will not be included.

104. With respect to capital schemes and projects, there is no room for additional schemes to be added unless they are invest to save, related to end of life of assets needed for essential service delivery or fully funded from external sources.

105. The capital funding gap, which was £143m at the timed the MTFS was set, is now £134m, but with the prospect of additional inflation pressures of £45m if action cannot be taken. With interest rates now increasing significantly this adds approximately £2.5m per annum to annual revenue costs and hence the funding gap needs to be reduced.

106. Core service capital schemes (such as Highways Maintenance and Schools) will be restricted to the annual capital grant allocations and banked developer funding only. And services such as ICT and Property will need to be focussed on maintaining service delivery rather than enhancing it. In some cases where it is possible, there will be a need to mothball schemes until they can be delivered after inflationary or acute current cost pressures subside.

107. Whilst there will be a strong focus on identifying and driving out further efficiencies, the reality is that after £230m worth of savings having been made over the last 12 year period there is limited scope. As such this work will also need to involve looking at service reductions across all service areas. Any non-statutory services, or those where service levels are above statutory minimum levels, will need to be considered for reduction or for being stopped following appropriate consultation being undertaken.

108. In addition to the usual MTFS planning process, the continuing difficult financial position in the current year will require the Council to put in place measures to control levels of expenditure, similar to those introduced during the Covid-19 pandemic. This will not replace the financial responsibilities that people have in their roles. For the spend controls to be successful, continued ownership by everyone who has a part in spending or generating income is vital.

109. The control measures would be adapted to reflect the severity of the financial position and would be expected to cover:

- Targeted recruitment controls to restrict non-essential hiring including a focus on agency, consultants and specialist advisors
- Procurement controls to ensure greater commissioning support unit input into contract renewal/extension, use of frameworks and exceptions
- Greater scrutiny of external expenditure
- Limited approval of new projects to essential schemes only
- Controls on grants to ensure that wherever possible they are used to cover existing spend pressures rather than for new service initiatives.
- Restriction of budget inflationary increases where service levels can be amended

110. Controls are likely to be required until:

- The MTFS gap is at an acceptable level
    - First 2 years balanced
    - Final 2 years at a manageable level
- Good certainty of savings delivery, especially for the next 2 years
- Local government outlook becomes clearer.

111. It should be noted that the implementation of spend controls is not service cuts, although it should influence how services are delivered. Future savings will not be prioritised based on where spend was reduced through the controls, managers will need to consider the potential to make permanent changes to their services.

112. If progress towards resolving the medium term financial gap is limited, and there is not enough confidence in delivering existing and newly identified savings and managing demand growth in the coming months, further spend controls, with greater levels of scrutiny on individual budgetary decisions will need to be put in place.

Planning Framework

113. The key Government announcements in the coming months will be;

- The Autumn Budget Statement anticipated in November.
- The Provisional Local Government Finance Settlement expected mid/late December.

114. The broad MTFS timetable is:

- September to November 2022 – refresh growth, savings and capital including consideration by Lead Members.
- September to November 2022 – engagement
- Autumn - National Budget and National Living Wage.
- December 2022 – the Cabinet is requested to approve the draft MTFS for consultation.
- December 2022 – receipt of the Provisional Local Government Finance Settlement
- January 2023 – consultation on the draft MTFS, including Overview and Scrutiny Committees and the Scrutiny Commission.

- February 2023 – the Cabinet is requested to approve the final draft MTFS for submission to the County Council.
- February 2023 – County Council is requested to approve the MTFS for 2023/24 to 2026/27.

Recommendation

115. The Scrutiny Commission is asked to note the contents of this report.

Circulation under the Local Issues Alert Procedure

None.

Equality and Human Rights Implications

There are no direct implications arising from this report.

Background Papers

Report to the Cabinet – 27 May 2022– 2021/22 Provisional Revenue and Capital Outturn
https://politics.leics.gov.uk/documents/s169173/Provisional%20Outturn%20Report%20-%20FINAL.pdf

Report to County Council -23 February 2022 – Medium Term Financial Strategy 2022/23 to 2025/26
https://politics.leics.gov.uk/documents/s166677/MTFS%202022-26%20Report%20to%20Cabinet%2011-02-2022.pdf

Appendices

Appendix A: Revenue Position as at Period 4, 2022/23
Appendix B: Revenue budget major variances
Appendix C: Revised Capital Programme 2022-26

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