Cabinet Report

Decision Maker:	Cabinet
Date:	11 July 2022
Classification:	Open
Title:	Medium Term Financial Planning (2023/24 to 2026/27)
Wards Affected:	All
Key Decision:	Yes
Financial Summary:	This report sets out the financial framework for the budget setting cycle and medium-term financial planning for this year
Report of	Gerald Almeroth, Executive Director – Finance and Resources

1. Executive Summary

1.1. This report outlines the Council's updated financial position over the next four years and provides the financial framework for the Council to deliver its key policy objectives. While the Covid-19 pandemic continues to have a residual impact on the Council's finances, the dominant feature now affecting the Medium-Term Financial Plan is the impact of high inflation.

1.2. The local election in May this year saw a change in Westminster City Council's administration to Labour and therefore a change in the Council's priorities. The new corporate plan is currently under review and this MTFP will form a key part of how the Council prioritises its expenditure to support the achievement of these new objectives.

1.3. This report updates the medium-term budget assumptions approved at Full Council in March 2022 and extends it a further two years to 2026/27 to coincide with term of the new administration. The funding position for local government is still undetermined at this point and will be impacted by several central government policy initiatives due over the coming years including the Fair Funding Review, Adult Social Care reform and the impact of the 2021 Census.

1.4. The financial position has been updated and provides an indicative position for planning purposes, which shows a budget gap of £10.9m in 2023/24, rising to £61.3m by 2026/27.

2. Recommendations

2.1. To note the revised medium-term financial planning forecast to 2026/27 and to agree the budget process approach as set out in the report.

3. Reason for Decision

3.1. The preparation of the budget and four year medium-term financial plan is the first stage of the annual business planning cycle for the forthcoming financial year 2023/24. There is a statutory requirement to set a balanced budget and submit budget returns to the Department of Levelling Up, Housing and Communities (DLUHC). Approval of the revenue estimates constitutes authority for the incurring of expenditure in accordance with approved policies.

4. National Context

4.1. In 2021 there was a relatively strong rebound in the economy as it emerged from pandemic restrictions, but the war in Ukraine and the subsequent increasing energy prices has resulted in a more difficult economic picture in 2022, with inflation hitting 9.1% in May and the Bank of England forecasting it to go above 10% by the end of 2022. The Bank has also recently announced a third consecutive increase in interest rates with the base rate now at 1.25%.

4.2. UK policy makers are particularly concerned at the growing risks of both a 'wage-price spiral' and of 'stagflation' (high inflation combined with falling economic activity). A particularly 'hot' labour market (caused in part by a large rise in the number of people becoming economically inactive post-pandemic restrictions) will be increase workers bargaining power which could result in higher wages which in turn further fuel price inflation. There are early signs that this is starting to materialise, with stronger pay growth in some sectors, and average pay rising by 4% in the year to April 2022. Despite this, price inflation of more than 9% means that 'real' wages (wages adjusting for inflation) are falling, and we are starting to see falls in consumer confidence and retail spending.

4.3. As a result, both the Organisation for Economic Coordination and Development (OECD) and International Monetary Fund (IMF) have downgraded their outlook for the UK economy, and the Bank of England's central forecast is for calendar year GDP growth to be broadly flat in 2023.

4.4. This more difficult economic picture will have an impact on London and Westminster. While the borough's more affluent residents will be relatively insulated from the cost-of-living pressures, residents on lower incomes are particularly vulnerable, and research suggests that Londoners face inflation that is higher than that seen across the UK. While some of the sectors in Westminster will be relatively resilient (e.g. professional services), retail, hospitality and arts and culture had not fully recovered after the pandemic (with footfall across the borough still down around a third on pre-pandemic levels) and will be particularly vulnerable to falls in consumer spending.

4.5. Next year – 2023/24 – will be the second year of the Government's three-year Comprehensive Spending Review (CSR), and at the time of writing remains the driver of the Local Government's funding. Additionally, the Department for Levelling Up, Housing and Communities (DLUHC) is set to continue with its Fair Funding Review which seeks to reset the formula that drives core funding across authorities, based on a different set of assumptions on need and resources. The conclusion of this review has been postponed several times now, but recent comments from the Minister suggest it is very much still on the agenda.

5. Local Policy Context

5.1. The Council has a new administration following the local elections in May 2022 and work is underway to revise the Council's overall vision statement and objectives to reflect the new political priorities. The Council is aiming to launch this in September.

5.2. In a concurrent report on this agenda the Council is setting up a Commission to look at the Future of Westminster and act as an advisory board to assist the Council in shaping and delivering the actions to deliver on these new political priorities. The Commission will have four themes of enquiry, namely:

Housing: **–** Advise on increasing the supply of genuinely affordable housing to meet housing need in the city. As a priority advise on options for improving: the way the Council responds to homelessness and housing need and the quality of services provided to the Council's own tenants and leaseholders.

Fairness and Equality: – Advise on policy approaches and initiatives that will enable and deliver a fairer, more equal and inclusive city.

Economy and Employment: Advise on how the Council enables more Westminster residents to share in the economic successes of the city.

Energy and Green Transition: – Advise on ways to enhance and accelerate climate action supported and delivered by the Council to achieve the objective of achieving net zero Westminster by 2040.

5.3. The Council's Medium Term Financial Strategy over the next four years will enable the Council to effectively invest its available financial resources to deliver the new administration's priorities.

6. Medium Term Financial Plan: 2021/22 to 2023/24

6.1. The MTFP approved at Full Council on 3 March 2022 outlined a total residual budget gap up to 2024/25 of £29.969m. This is summarised in the table below:

	2022/23 £m	**2023/24 £m**	**2024/25 £m**	**TOTAL £m**
Annual Budget Gap	0.000	14.304	15.665	**29.969**

6.2. The total budget gap is inclusive of £13m savings to 2024/25 which were approved by Full Council in March 2022. The updated budget gap assumes that these savings will be delivered in full.

7. Current Financial Position

7.1. The General Fund outturn position for 2021/22 was a net outturn of £2.0m (1.1%) overspend against an approved budget of £183m. The Council used its general reserve balance to absorb the final year-end position. This was a more favourable position compared to earlier forecasts mainly due to the wider use of Covid specific grants. These grants ceased in 2022/23 so the Council may be exposed to continued risks including ongoing reductions in commercial income.

7.2. The current forecast for 2022/23 is a balanced position against the budget. However, the sharp increase in inflation will provide challenges to that position as annual contract inflation becomes apparent. In addition to inflation, income volatility will remain as another significant risk both this year and in the medium-term as economic activity is expected to remain significantly lower than pre-pandemic levels.

7.3. The Council holds £57m in unallocated General Fund reserves as risk mitigation, which may be utilised to fund any net overspend this financial year. This is considered a robust level of reserves to manage in-year pressures that may arise from either reduced income levels beyond those factored into the 2022/23 budget or from inflationary pressures. It will also help manage the positive delivery of savings over the medium term and cover one-off shortfalls in between years in the budget process.

7.4. There are earmarked reserves for other specific risks, invest to save funds and capital financing. These will be reviewed to ensure that they are being held effectively and where appropriate released for investment in achieving the Council's policy objectives or for supporting ongoing savings delivery.

8. Medium Term Financial Plan: 2023/24 to 2026/27

8.1. The assumptions in the medium-term financial plans have been reviewed up to 2026/27 and the revised position is outlined in the table below. There is considerable uncertainty in forecasting over this period, but it is good practice to set a financial framework within which the Council can effectively plan.

8.2. The budget gap is estimated to be £61.3m up to 2026/27, which represents 12% of the Council's gross controllable 2022/23 budget, the equivalent of 3% per annum.

	2023/24 over 2022/23 £'m	2024/25 over 2023/24 £'m	2025/26 over 2024/25 £'m	2026/27 over 2025/26 £'m	Total £'m
Estimated Funding:					
Core Funding and Grants	(0.133)	(2.952)	(3.533)	(3.597)	**(10.221)**
Damped loss from Census / Fair Funding Review	0.000	9.000	9.000	9.000	**27.000**
Corporate Provisions:					
Capital Financing	3.000	3.000	3.000	3.000	**12.000**
Inflation: Pay	4.043	2.748	2.803	2.859	**12.453**
Inflation: Non-Pay	10.483	5.000	3.000	3.000	**21.483**
Corporate pressures and Investment provision	3.000	3.000	3.000	3.000	**12.000**
Approved Savings:					
Net existing savings approved	(9.507)	(3.915)	0.000	0.000	**(13.422)**
Budget Gap	**10.886**	**15.881**	**17.270**	**17.262**	**61.299**
2022/23 Gross Controllable Budget					**£495m**
% of gross budget					**c12%**

8.3. The changes since the March 2022 position taken to Full Council are broadly as follows:

- extension of MTFP horizon by a further two years to 2026/27;
- assumption that base core funding will increase by 2% per annum each year to 2026/27;
- delay of Fair Funding Review's expected implementation from 2023/24 to 2024/25, and;
- increase in inflation assumptions underpinning cost estimates.

8.4. On 28 June 2022, the Secretary of State for Levelling Up, Housing and Communities announced his intention to introduce a two-year financial settlement for 2023/24 and 2024/25. Alongside this, DLUHC will also review the number of funding sources that have proliferated in recent years with the aim of streamlining those streams. These announcements are welcomed and give some certainty for Councils to be able to plan ahead more effectively.

8.5. Despite the certainty that a two-year settlement provides, the expected reduction in funding from the Fair Funding Review and the impact of the recently published census remains a significant risk to the Council's financial outlook. The outcome of the Fair Funding Review will be subject to consultation and therefore is unlikely to be implemented until 2024/25. The Council is also preparing a robust challenge to the census outcome, and it is unlikely that this will be concluded in time for the population estimates to be included in the funding settlement process for next financial year.

8.6. The MTFP maintains its income modelling assumptions in line with Government forecasts of economic recovery and considering local circumstances. Inflation on fees and charges has not been assumed in the forecasts yet so these will be reviewed in detail in due course. No assumptions for council tax increases have been made either.

9. Approach to identifying new savings and implementing current proposals

9.1. In terms of new savings, Executive Directors and their teams will be working collaboratively to identify opportunities for delivering both near term efficiencies and medium-term transformational change. Efficiencies in the near term are expected to include a focus on demand management interventions, greater automation, more use of data, analysis and intelligence to target resources more effectively, and continued property asset rationalisation. Transformational change will include digital innovation across services, use of advanced and predictive analytics to support deeper automation and operational targeting, prevention-based service redesign, and a highly collaborative approach across the organisation and its partners to find cost-reduction solutions whilst still delivering key outcomes. Invest-to-save opportunities will be encouraged as part of the approach for both revenue and capital.

9.2. Delivery of existing savings commitments remains a key priority to ensure the Medium-Term Financial Plan does not become an even greater challenge, however these will be reviewed by the new administration during the planning process.

10. Housing Revenue Account

10.1. The Housing Revenue Account (HRA) is a statutory ring-fenced account that captures all transactions relating to the Council's duties as a social landlord and the operation of the Council's housing stock. Whilst it is separate to the General Fund, it is still required to undertake medium and long-term financial planning in much the same way. This is done via the HRA 30-Year Business Plan. It is a statutory requirement that this is updated at least annually and must demonstrate long-term financial viability whilst also delivering the Council's housing priorities.

10.2. The business plan considers all HRA revenue streams (principally tenant rents and leaseholder service charges, but also other sources of income) and sets these projections against anticipated expenditure on management and maintenance (both revenue and capital), staffing and other running costs (including a fair share of Council overheads recharged from the General Fund). The HRA holds its own reserves and can therefore operate a deficit in any single year where this can be covered by available reserve balances.

10.3. The sections below detail the key considerations for the 2022 business plan update that will be delivered in conjunction with the Council's wider MTFP process. The new iteration of the business plan will consider the 30-year period from 2023/24 onwards.

<u>HRA Capital Capacity</u>

10.4. The HRA capital programme is the vehicle through which the Council can identify and prioritise funds to support two important areas of investment: (1) improving the condition of its existing stock; (2) delivering new affordable housing.

10.5. In October 2018, restrictions on HRA borrowing (known as the Debt Cap) were eased to allow local authorities to set their own borrowing limits (in much the same way as they do for the General Fund). However, the HRA is still subject to the CIPFA Prudential Code and must therefore set borrowing limits that are sustainable within the context of the 30-year business plan. This means that all borrowing is ultimately underpinned by the affordability of interest on new debt within the HRA revenue budget.

10.6. The current approved HRA business plan set two simple parameters to assess the sustainable borrowing capacity of the HRA:

- a minimum HRA reserve level of £17m for the next 5 years (reverting to 10% of turnover thereafter, £11m), this is reflecting the higher risks during intense development periods, and;

- a minimum interest cover ratio of 1.20 to ensure that the operating surplus is not entirely committed to covering interest costs (and can therefore tolerate some volatility on interest rates, inflation, etc).

10.7. The MTFP process will involve a complete refresh of all assumptions that go into the business plan (including the capacity parameters noted above). There is a strategic requirement to increase HRA borrowing capacity to deliver a higher level of social and affordable housing, so the HRA is required to identify savings at a level that is consistent with the General Fund over the period and to help mitigate the increasing risks of higher inflation costs and anticipated investment in the service to improve its impact for residents

Rent Setting

10.8. A key consideration for the HRA business plan refresh is future rent levels, given that social rents are the main source of HRA revenue. Rent increases are subject to the government's policy on rents for social housing (which are regulated). The current policy was set for a five-year period, with 2023/24 being Year 4. This stipulates maximum annual rent increases of CPI+1% (based on September CPI).

10.9. The business plan currently assumes that rent increases will at least keep pace with inflation over the life of the plan. With the UK experiencing its highest rates of inflation for 40 years clearly these are assumptions that will need to be carefully reviewed. It is important to note that this could have a direct impact on HRA borrowing capacity if the revised assumptions leave the HRA with a lower operating surplus.

Risk Measures

10.10. Whilst the economic climate is creating some substantial financial challenges for the HRA business plan, each iteration of the plan contains a series of measures designed to help the HRA to manage the sort of volatility noted above. The capital programme holds a contingency, the revenue budget has a level of interest cover, and HRA reserves exist to manage short-term issues. These are all things that can be leveraged to keep the HRA on a sustainable footing, and a review of appropriate risk cover will form another integral part of the business plan update.

11. Capital Strategy Review

11.1. The approved capital programme has a gross spend of £2.7bn and a net spend of £1.5bn over the next fifteen years. This includes a significant housing development and regeneration programme that relies on capital receipts from private sales to help subsidise the affordable housing elements. The net capital cost is financed from revenue borrowing, which is allowed for in the MTFP. The capital programme will be reviewed this year with the new administration policy objectives in mind and in particular look to increase the amount of affordable housing delivered and to reduce the revenue borrowing impacts.

11.2. The Council is committed to embedding climate action and sustainability into all areas of work and the Climate Emergency Action Plan includes work to incorporate carbon impact assessments into all capital-funded project proposals, to maximise the climate benefit of council investments and limit new sources of emissions wherever possible.

12. Dedicated Schools Grant

12.1. The DSG has a cumulative deficit of £1.167m after an in-year overspend of £3.554m in 2021/22. £2.290m of the in-year overspend relates to special educational needs and disabilities (SEND) mainly due to an increasing number of pupils with Education, Health and Care plans (EHCPs) and significant increases in allocations via the new education banding tool (EBT), which is being corrected over 2022/23. £0.746m related to school restructuring costs which will not continue as schools have agreed to fund a budget to pay for these going forward. The remaining overspend relates to one off Early Years allocations.

12.2. A deficit management plan is being finalised for submission to the Department for Education (DfE) and this will return the DSG to a balanced position within three years after taking account of actions agreed at the Schools Forum in March regarding the EBT review to cap some of the banding values and carry out a recalibration to amend the other overfunding currently in the system. These actions are estimated to reduce the top up allocations to schools (while still meeting the cost of identified provision).

12.3. There are 11 schools (out of 40) with deficit balances at 31st March 2022 compared to 13 last year. Two of the schools with deficits will amalgamate from September 2022 and the others have or are finalising deficit recovery plans. Falling pupil rolls have played a significant part in schools having difficulty in managing their budgets and with the impact of higher inflation on costs there is a risk that this will become more difficult.

12.4. The Department for Education (DfE) has confirmed the Government's ambition that all mainstream schools funding will be via the National Funding Formula (NFF) rather than the current local formula allocations. The full move to the NFF is expected within five years (2027/28 funding year) with a gradual pace of change, starting with a requirement to move 10% closer to the NFF factor values in 2023/24. The move to the NFF may lead to some schools benefiting from an increase in funding and others having funding which is protected at a historical level with minimum future increases. The DfE will also review the central school services block which may result in lower funding for central services such as admissions, leadership costs, finance, and the virtual school. The DfE will consult with authorities on these changes in due course.

13. Timelines

13.1. The broad timeline of this year's budget setting cycle is outlined in the table below:

Group	Month	Comments
Cabinet	11 July 2022	Financial planning report – review assumptions, set out four-year budget gap and agree savings approach
Executive Leadership Team (ELT)	July to September 2022	ELT, directors, and officers review service expenditure across directorates, identify savings options
Budget and Performance Scrutiny Task Group	Late January 2023	Scrutiny of the MTFP and savings options and proposed capital programme
Cabinet	13 February 2023	Agree the 2023/24 budget and four-year MTFP
Full Council	8 March 2023	Approve the 2023/24 budget and four-year MTFP

14. Legal Implications

14.1. This report is submitted to the Cabinet in accordance with the Finance procedure rules. Cabinet is asked to note the revised medium term financial forecast to 2026/27 and to agree the budget process approach as set out in the report.

14.2. The function of calculating the City Council's budget requirement and the City Council's element of the Council Tax, and the function of setting the Council Tax, are the responsibility of the full Council. The function of preparing estimates and calculations for submission to the full Council is the responsibility of the Cabinet.

14.3. Section 25 of the Local Government Act 2003 requires that when a local authority is making its budget calculations, the Chief Finance Officer of the authority must report to the Council on the robustness of the estimates made for the purposes of the calculations and the adequacy of the proposed financial reserves.

14.4. The Council has a statutory duty to have regard to the report of the Chief Finance Officer on these issues when making decisions about its budget calculations.

14.5. Some savings proposals may only be delivered after specific statutory or other legal procedures have been followed and/or consultation taken place. Where consultation is required, the Council cannot rule out the possibility that they may change their minds on the proposal because of the responses to a consultation, and further reports to Cabinet or cabinet member (as appropriate) may be required.

14.6. Apart from statutory duties relating to specific proposals the Council must consider its obligations under the Equality Act.

14.7. If General Fund Reserves are used to support the budget, they will need to be reimbursed at the earliest opportunity to provide the necessary, margin of safety in future years

15. Consultations

15.1. No specific consultations arise from the recommendations in this report, however, individual savings proposals that come forward as part of the budget process may require specific consultation.

15.2. The new administration has expressed an interest in introducing some form of participatory budgeting where residents are involved in the budget process and get to have a direct say in how their money is spent by the Council. Options on how best to do this in a meaningful way will be reviewed in due course.

If you have any queries about this report or wish to inspect any of the background papers, please contact:

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BACKGROUND PAPERS

- Medium-Term Financial Plan 2022/23 to 2024/25 (Cabinet, 17 February 2022)