CABINET

20 October 2022

UPDATED MEDIUM-TERM FINANCIAL PLAN

Report of the Chief Financial Officer

Recommendation

It is recommended that Cabinet note the Council's revised Medium-Term Financial Plan as shown in Appendix A.

Summary

This report considers the effect on Eastleigh Borough Council's Medium-Term Financial Plan (MTFP) of the economic impacts currently being felt both nationally and, to some extent, internationally. The significant additional financial pressures necessitate the need to drive forward a more ambitious continuous improvement plan which will be developed over the coming months, with additional savings necessary from 2023/24 onwards.

Statutory Powers

Local Government and Housing Act 1989, Section 151 Local Government Act 1972, Local Government Act 2003 (Part 2- Financial Administration), Local Government Finance Act 1992

Strategic Implications

1. Regular review of the Council's financial position is key to ensuring delivery against strategic objectives set out in the Council's Corporate Plan 2015-2025, delivery of actions in the Corporate Action Plan 22/23, and contributes to the management of corporate risk.

Introduction

2. The Council's Medium-Term Financial Plan forecasts the Council's budgetary position over the coming years to enable effective and sustainable service planning. This Plan is regularly reviewed to determine the impact of service changes, Council decisions and also the national picture. In recent years, by prudently planning the Council's operations, the Budget has been well

managed with external impacts being absorbed whilst maintaining service provision and therefore a formal annual review of the Plan has been sufficient.

3. The recent COVID-19 pandemic placed additional pressure on the Council as national restrictions led to falling income, most significantly with losses from parking fees and income from cultural venues, alongside additional resource and financial burdens incurred whilst supporting Eastleigh's residential and business communities. Although effects are still being felt from the pandemic, the forecast impacts had been built into the Medium-Term financial plan and recovery has been in line with expectations.

4. In more recent months, the international economic picture has worsened as a result of the conflict in Ukraine, and this has driven up inflationary pressures, particularly for utility costs. This has led to a national "cost of living crisis". These inflationary pressures have also been seen with pressure on pay inflation which has been modelled through the Medium-Term Financial Plan and leads to the need to develop a more extensive continuous improvement plan which must be implemented sooner than previously envisaged.

5. With changes in policy direction from central government in the last few weeks, the Council is now also modelling the impact of interest rate increases which will be in excess of that forecast by the market when the budget was set in February 2022. This is a fast-moving picture, and the revised Plan incorporates a prudent approach, whilst recognising that regular updates to Cabinet will be important as the economic situation changes.

6. This report looks at the cumulative effect on Eastleigh Borough Council of the economic changes being felt both nationally and to some extent internationally. The conclusion is the need to drive forward a more ambitious continuous improvement plan which will be developed over the coming months with significant savings necessary from 2023/24 onwards.

National and International Economic Context

7. Since the budget for 2022/23 was approved by Council in February 2022, there has been a period of prolonged, higher than anticipated inflation, currently with the Consumer Price Index (CPI) standing at an annual rate of 9.9% as at September 2022 and forecast to exceed 10%, against a Bank of England target of 2%.

8. Inflationary pressures, with recruitment and import delay challenges, have been exacerbated by increases in wholesale gas prices across Europe, arising from the Russian/Ukrainian conflict. These have led to increases in retail energy prices this year and these are forecast to continue to rise throughout the remainder of this year and into the future. Rising inflation is causing a "Cost of Living Crisis" as inflation, especially around energy bills, is likely to lead to a fall in real incomes for both households and businesses in the Borough, as increases in costs outweigh increases in earnings/income. The implications of such high inflation on the Council are significant as costs are increasing, both in terms of materials and services procured, and most

significantly forecast pay inflation, with income not increasing at the same pace.

9. One of the most utilised policies for the Bank of England to try to reduce inflation and support sterling is to increase the Bank Rate. Rate increases seen to date have increased interest costs paid by the Council to a higher level than estimated when the Budget was set in February 2022. However, the revised forecasts, as the bank rate has increased throughout the year, were within parameters previously modelled and by utilising the interest rate reserve, as intended, the additional interest rate pressures were manageable.

10. In recent weeks increased market volatility has been experienced following the Chancellor's "mini budget", which was poorly received by markets. This volatility led to the Bank of England announcing the need to step in with temporary purchases of government bonds. The impacts of the mini budget and the subsequent changes in government policy make forecasting difficult as the economic landscape is constantly moving. The Council continues to forecast prudently, and this report relies on latest economic predictions from treasury advisors, Arlingclose, to construct the revised Medium-Term Financial Plan.

11. All the above impacts are increasing cost pressures on the Council, against a relatively static core spending power for the Council, i.e., the funds received to administer services. With current inflation levels, the capped council tax increase means a real-terms reduction in funding of 6.7%.

Service Inflationary Pressures

12. Increases to fuel and energy, where prices are variable, have the most immediate impact to the Council despite the announced public sector price cap. Electricity costs have risen by 130% and gas by 176%. As these cost increases build into supply chains, prices for many more goods and services will increase and further inflationary pressures on the Council will continue to arise as contracts come up for renewal. The revised Plan attached at Appendix A now includes an inflationary provision of £200,000 per annum to counteract this pressure.

13. Staffing costs within the Council total £22M annually which represents 30% of gross revenue expenditure. As part of the local government national pay negotiations for 2022, National Employers have made a pay offer of £1,925 per employee (pro rata) which averages an increase of 7.33%. This increase is significantly more than the provision for a 2% increase which was included within the budget approved in February. The revised Medium-Term Financial Plan incorporates the impact of this offer which is calculated at an additional £1.1M per annum above the budgeted increase from 2022/23. With inflation expected to remain high, the risk of a further pressure in future years has led to a revised increase from 2% to 4% for 2023/24. The cumulative impact of pay inflation over the life of the Medium-Term Financial Plan is £15M.

14. The 'Cost of Living Crisis' is pushing more residents into poverty, and the pressure on welfare services for the most vulnerable is greater than ever. All

homelessness prevention, housing and community development services are already seeing higher demand and a greater complexity of cases which creates additional resource pressures for the Council. This is expected to worsen as increasing interest rates cause mortgages to become unaffordable for some.

15. The Council is already experiencing pockets of other inflationary pressures, particularly for construction, food, and transport. Business cases for projects, as well as service plans for income generating services are being reviewed to ensure they remain viable and will be considered during the annual planning process for 2023/24 to allocate sufficient budget provision.

Impact on Borrowing Costs

16. When the Budget was set for the 2022/23 financial year in February 2022, interest rates were forecast to average 0.50% for the financial year in line with projections from the Council's treasury advisors, Arlingclose. Throughout the year, interest rate forecasts have been updated and have increased with the view that inflation needed to be dampened by the Bank of England's Monetary Policy Committee. With subsequent changes in the national economic picture and interest rate rises, the average forecast rate incurred by the Council on variable rate borrowing has risen to 2.69% for the 2022/23 financial year.

17. This financial year there have already been four separate increases in the Base Rate in May, June, August and September, increasing the rate from 0.75% to 2.25%. Further increases are forecast to occur in November and December, with a further likely interest rate increase early in the new calendar year.

18. As Cabinet are aware, the Council has built an interest reserve over several years to mitigate unforeseen increases in interest rates. As rates increased during 2022/23 the interest rate reserve was then called upon to balance out increase in costs as planned. The reserve remained sufficient to cope with rises as forecast as interest rates were predicted to be maintained at a level lower than the Council's long-term interest rate of 3%.

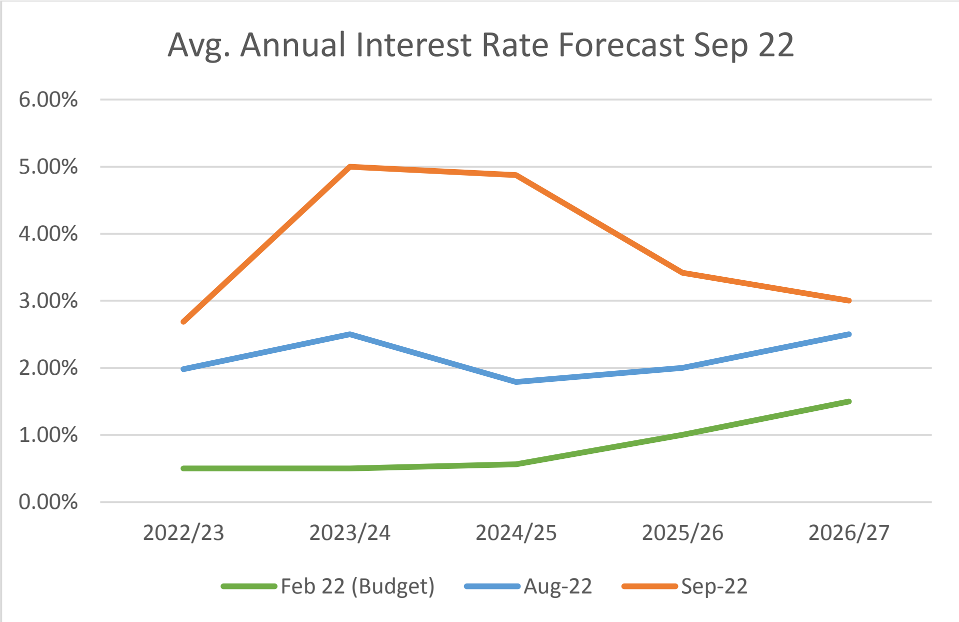
19. On 23 September, the Chancellor of the Exchequer announced the "mini budget" in Parliament. The national picture then changed with the negative market reaction to the announced plans and an immediate fall in the value of sterling. This fiscal event triggered significant uncertainty for the economic landscape with immediate reactions such as the withdrawal of mortgage products and the Bank of England's purchase of government bonds leading to revised pessimistic interest rates forecasts over the short to Medium-Term as can be seen in the table and graph below.

Forecast interest rates for Eastleigh Borough Council

	2022/23	**2023/24**	**2024/25**	**2025/26**	**2026/27**
Feb 22 (Budget)	0.50%	0.50%	0.56%	1.00%	1.50%
Aug-22	1.98%	2.50%	1.79%	2.00%	2.50%

Sep-22	2.69%	5.00%	4.88%	3.42%	3.00%

Graphical representation of Forecast interest rates for Eastleigh Borough Council



20. Since receiving the most recent interest rate forecast information from Arlingclose, the economic situation has changed again. The Government has changed its policy position on tax cuts which has lessened the negative impact on the markets. Furthermore, the Chancellor has now announced that he will bring forward the publication of his medium-term fiscal plan from 23rd November to later in October. This may help to stabilise the national economy which will then have an impact on the Bank of England interest rate deliberations, with a possibility now that rates will not rise as quickly or to such a high level. However, it remains prudent to compile the MTFP based on pessimistic forecasts until there is more certainty.

21. Whilst the Council is protected against interest rate movements on most of its borrowing portfolio due to the fixed-rate borrowing taken out over the previous five years, there is still 33% of the Council's borrowing (£176M) that is borrowed on a short-term basis, which is affected by the forecast increase to Bank Rate.

22. The Council has always been aware of the risk should the Bank of England Base Rate to rise above forecast levels, interest costs for the Council would also rise. To mitigate the risk a prudent approach was taken to set up an interest reserve. This stood at £11.9M at the end of 2021/22.

23. For 2022/23 the forecast interest rate of 5% by the end of the financial year, which exceeds budgetary forecast, will lead to an increase in interest payable of £2.877M, offset by an increase in interest receivable of £486,000. This additional pressure will need to be funded from the interest reserve. For the

2023/24 financial year it is currently forecast interest costs could rise by a further £7.2m, leading to a further draw on the Council's reserves.

Revised Medium-Term Financial Plan

24. The Medium-Term Financial Plan draws together estimates of expenditure and income streams for the Council. The consolidation of all financial information allows the Council to identify either a surplus or a deficit operating position for each year. Any surplus is appropriated into reserves and if a deficit is forecast, a savings target is identified which will ensure the Council can operate within the funds available. A summary of the MTFP is tabled below with a more detailed analysis being included at Appendix A.

25. Where there are unanticipated pressures, such as the Council is experiencing currently, alongside the formulation of an efficiency strategy there is the ability to use reserves to enable enough time for efficiency plans to come to fruition. Within the revised MTFP, uncommitted New Homes Bonus and a small number of reserves have been allocated over a number of years to ensure plans can be introduced in a measured and calculated way. This planned delivery of savings is vital to ensure the long-term financial viability of the Council. It is worth noting that the Council's decision to retain New Homes Bonus funding to enable capital projects in the past has enabled improvements throughout the Borough that would otherwise not have been achievable. The intention is to take advantage of the funding to help to balance the budget in the short term, with the aim of replenishing the fund in the future when possible.

26. As part of the efficiency plans, there will be a need to transform some services and improve the way we work to take advantage of efficiencies wherever possible. Where it can be demonstrated that costs are being incurred to enable more efficient working and transformation, then the Government allows the flexible use of capital receipts. In order to apply for this ability to use capital receipts to offset revenue costs, the plan needs to be submitted to Government once it has been approved by Council. A report will be taken to Council for approval alongside the Budget report in February 2023 to enable the direction to be received.

27. Assumptions included within the previous Medium-Term Financial Plan have been challenged to ensure they are still applicable. This has included the increase in pay inflation for future years and also the slipping of the negative impact of the rebasing of Non-Domestic Rates to 2024/25. It is assumed that the policy on setting Council Tax at 1% below inflation will remain, although with inflation running at nearly 10% this will be at the capped level of 1.99%.

28. Early estimates of financial pressures included within the MTFP for 2023/24 are detailed in the table below. Staffing pressure, inflation and other service pressures will become ingrained in future years budgets, and therefore have a cumulative impact on the MTFP, hence the need for urgent action as part of the Continuous Improvement Programme and ongoing scrutiny by service managers and Executive Heads to identify potential efficiencies within current budgets.

Pressure	Initial 2023/24 Impact
Staffing	£2.4M
Inflation	£1M
Other Service Pressures	£1M
Total	**£4.4M**

Corporate Continuous Improvement

29. The Budget approved by Cabinet in February 2022 included an ongoing corporate continuous improvement target totalling £3.5M by 2026/27. Considering the estimated impact of all known and forecast economic events, the continuous improvement target needs to increase to ensure that the Council can continue to maintain a balanced budget into the future whilst still providing services to the community. The revised cumulative savings targets are estimated within the table below:

	2022/23 £000	2023/24 £000	2024/25 £000	2025/26 £000	2026/27 £000
Original target	500	1,500	2,500	3,000	3,500
Revised target	500	3,500	5,000	8,650	8,650

30. The scale of this increase necessitates a more transformative approach in the short term. The Executive Team have already begun formulating a plan in consultation with Portfolio Leads to address the upcoming financial challenges. The plans need to be fully costed and all impacts understood before they can be fully quantified and either implemented or brought to Cabinet for approval as appropriate. Initial estimates suggest that the savings targets will be achieved for 2022/23, 2023/24 and 2024/25.

31. Initial discussions with Portfolio Leads and senior management have identified the following potential ongoing savings to help achieve the 2023/24 requirement.

Corporate Continuous Improvement Type	2023/24 Identified Saving
Spending Money Wisely	£374,000
Income Generation	£413,000
Organisational Transformation	£2,577,000
Total Saving	**£3,364,000**

32. These savings are now being fully explored and costed ahead of implementation and will be brought forward for formal approval to Council alongside the Budget in February 2023.

33. Delivery of this programme is vital to ensure the Council can continue to deliver a balanced Budget. Cabinet will need to consider the prioritisation of services to meet the challenges ahead. To ensure the continuous improvement plan is delivered effectively, the projects will be sponsored by the Chief Executive and progress will be reported regularly to Cabinet. The programme will involve all Executive Heads and they may be allocating service leads to project manage individual projects affecting their areas. The Programme Board, sponsored by the Chief Executive, will include representatives from Finance, HR and Communications teams as regular attendees.

34. An all-staff briefing was held on Thursday 6 October to apprise staff of the financial challenges that the Council now faces, against the background of this rapidly evolving national and international landscape. This has prompted initial feedback from the Trade Unions, on behalf of their members. It is worthwhile stating that the Council's relationships with the unions are exceptionally positive and have been nurtured over many years based on trust and openness.

35. In summary, the unions understand the need for robust action and would like the Council to commit to protecting staff as far as possible, with other potential savings and income opportunities being explored first. Whilst there is an understanding of the need for a reduction in headcount, protecting staff is the overriding priority. In pursuit of this, the Council's policy of consultation with staff and unions will be undertaken as a matter of course, prior to and formal reduction in staff numbers or services.

36. Reference was made to staff morale during this challenging time and to this end, there is a clear expectation that any reduction in headcount will be reflected in a commensurate reduction in the workload for remaining staff. The aim of the efficiencies programme will be to balance workload with resources, and this will achieve the joint aims of both the unions and the Council.

Risk Assessment

37. The Medium-Term Financial Plan is brought together considering all known and potential financial risks the Council may face over the next few years. The Plan is integral to the risk management process in respect of the Council's finances. The Medium-Term Financial Plan is constructed on a prudent basis in order to ensure that budgeting is realistic, and plans are affordable. There remain risks around the national economic picture, primarily around inflation and interest rates, however the assumptions contained within the Plan are based on prudent estimates in conjunction with independent advisors.

38. The savings targets included within this Plan, as detailed within paragraph 29 of this report, must be achieved in order for the Council to maintain financial stability into the future. The is a risk that the forecast savings and additional income will not be realised. This will be mitigated by the creation of the Programme Board (detailed in paragraph 33) with regular reporting and management of delivery.

39. The regular reporting to Cabinet of impacts to the Council's finances, both positive and negative, along with revisions to the Medium-Term Financial Plan where appropriate, will ensure that action can be taken as necessary to deal with any necessary implications.

Equality and Diversity Implications

40. The Equality Act is not relevant to the decision in this report because the decision does not relate to eliminating discrimination, advancing equality of opportunity, or fostering good relations between different people. Therefore, it is considered that for this decision the Equality Duty does not need to be addressed and an Equality Impact Assessment (EqIA) has not been carried out.

Climate Change and Environmental Implications

41. There is no direct impact, positive or negative, to climate change or the environment. However, it is possible that the formation and implementation of a revised continuous improvement plan may have an impact on the pace of delivery of the Climate Change Programme. This will be reported to councillors as plans are developed and implications fully analysed.

Conclusion

42. In recent months the national economic situation has worsened particularly with rising inflation, and this has inevitably had an impact on the Council's financial position. The combination of inflationary pressures and forecast interest rate increases have resulted in a significantly revised Medium-Term Financial Plan being developed over the last few weeks which includes a challenging target for efficiency savings that must be achieved. Cabinet is asked to note this report and support updates on the delivery of efficiencies being scheduled for future Cabinet meetings.

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Appendices Attached:	1

LOCAL GOVERNMENT ACT 1972 - SECTION 100D

The following is a list of documents which disclose facts or matters on which this report or an important part of it is based and have been relied upon to a material extent in the preparation of this report. This list does not include any published works or documents which would disclose exempt or confidential information.

None.