CAB3430
CABINET

REPORT TITLE: GENERAL FUND BUDGET OPTIONS & MEDIUM-TERM FINANCIAL STRATEGY

21 NOVEMBER 2023

REPORT OF CABINET MEMBER: Cllr Neil Cutler, Cabinet Member for Finance and Performance

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WARD(S): ALL

PURPOSE

The public sector faces the most significant financial challenges and demand pressures in living history. Stubbornly high inflation and soaring service, construction and energy costs are leading many other councils to be reporting overspends that are spiralling out of control.

It was clear from the previous Medium Term Financial Strategy (MTFS) produced in November 2022 (CAB3374) that Winchester also faces unprecedented financial pressures over the medium-term, with a recurring £3m annual deficit forecast by 2027/28.

Projections have now been updated and the new Medium-Term Financial Plan (MTFP) is set out in appendix 1. This shows that, although the council's immediate financial position through to 2026 is sound and stable, budget pressures (primarily from new responsibilities put onto District councils) have now worsened the budget gap to £3.4m by 2026/27. This gives us a window of opportunity to take radical action to tackle the looming crisis and give the council a financially sustainable future.

We are putting in place robust measures to address the challenge. Cabinet has initiated an organisation-wide transformation programme to seek out and to deliver transformational changes to the way we deliver services in order to save £3m a year within 3 years: '*Transformation Challenge 2025'*. This tier-one strategic project, whilst still in the early execution phase, is now rooted across the council, with all staff and councillors having had opportunities to be involved and put forward transformational ideas. Transformation 2025 (TC25) is essential to meeting the dynamic budget challenges in the medium term and details of this are set out in section 12 of this report.

This Medium Term Financial Strategy (MTFS) sets out the organisational approach for managing financial resources to protect our core council services and enable delivery of the Council Plan priorities going forward. It provides an overview of the existing financial position for the council and a forecast outlook over the medium term, four-to-five-year, planning period.

This report looks to explain the cost drivers, cost pressures, planning assumptions, risks and opportunities that may impact the council's financial position in future. It describes how we plan to respond to the major financial challenges ahead and the principles we will adopt in managing and using our financial resources to get the most out of the limited funds we have available.

The MTFS gives us clarity over what financial resources we have at our disposal to deliver the priorities from the Council Plan. In particular, balancing the delivery of core council services with the Council Plan's areas of enhanced focus around supporting local people with the cost of living; making the Winchester District go greener faster; investing in public spaces to deliver pride in place that is rightly deserved; and listening better to our community.

Projections used for the MTFP are subject to a high degree of uncertainty; particularly with the Government only confirming one year's settlement agreement figures at a time (with the 2024/25 one not due until late December 2023) and no certainly over the promised Fair Funding Review. As a result, this MTFS uses assumptions based on the best knowledge available at this time to set out proposals to address both the existing and emerging budget pressures set out in this report.

RECOMMENDATIONS:

That Cabinet:

1. Note the assumptions set out in section 13 of this report and the projections set out in Appendix A.
2. Approve the Medium-Term Financial Strategy as set out in sections 13 to 17 of the report.
3. Approve that a detailed budget be prepared for consideration by Council in February 2024 based on the assumptions set out in this MTFS; final spending review announcements; and including the following options:
    a. That, in relation to Greener Faster and carbon reduction priorities:
        i. £200,000 per annum be included for the carbon reduction measures on waste and recycling vehicles to enable the change to HVO fuel (as set out in paragraph 15.2).
        ii. £1,400,000 per annum (less assumed 80% government funding) be included to expand recycling services to include food waste collections (as set out in paragraph 15.2).

iii. £400,000 per annum be included to implement other changes to the collection of recyclables (as set out in paragraph 15.2).

iv. £500,000 be reduced in the annual waste income budget to reflect proposed changes to the Hampshire Inter Authority Agreement on waste (as set out in paragraph 15.2).

b. That, in relation to the council's TC25 digital transformation programme:

i. £100,000 per annum be included for the support and coordination of digital channel shift work across the council's services.

c. That, in relation to services:

i. An additional £100,000 per annum be included to fund the increased external audit fees.

ii. NNDR budgets be reduced by £177,000 per annum to reflect the reduced liability on corporate properties.

iii. An additional £20,000 per annum be included to fund the increased costs of temporary accommodation.

d. That, in relation to service income annual budgets, amendments be made as follows, in response to revised estimates (see also paragraph 15.3):

i. Building control fees reduced by £100,000

ii. Land charges income reduced by £100,000

iii. Legal services reduced by £50,000

iv. Pest control reduced by £50,000

v. Garden waste service income increased by £90,000

vi. Car parking income increased by £100,000

e. That Council Tax will increase in line with the Government referendum limits (currently a maximum of 2.99% for a Band D property).

f. That the annual contribution to the IT reserve be increased by £100k to support critical infrastructure and the digitalisation theme of the transformation programme.

g. That a Future of Waste and Recycling reserve of £1m is established (using funds from the Major Investment Reserve) to support the implementation of the new recycling offer for residents.

4. Due to the inflationary increase in the Waste Collection contract cost, approve a corresponding September 2023 CPI rate increase to Garden Waste subscriptions with effect from March 2024, resulting in charges increasing to £45 for small bins and £69 for large bins (but maintaining the concessionary price at £29).

IMPLICATIONS:

1 COUNCIL PLAN OUTCOME

1.1 The budget approved in February 2023 (CAB3388 refers) directly supported the delivery of all outcomes set out in the Council Plan.

1.2 The Council Plan sets out five priority areas that the council wants to achieve over the five period to 31 March 2025. Underpinning the Your Services, Your Voice priority (focussed on providing high quality, good value, resilient services) the MTFS sets out the framework of guiding principles to enable the council to take financial decisions, to plan and manage budgets and use its financial resources to support delivery of all services and priorities in the Plan. During the next 12 months the council will commence preparation of a new Council Plan to be adopted from 1 April 2025.

1.3 This report sets out a clear focus on the Council Plan priorities centred on tackling climate change. The council declared a climate emergency in June of 2019 and all work in the council has to consider its carbon impacts.

1.4 Council in February adopted four areas of enhanced focus including Greener Faster, Cost of Living, Pride in Place and Listening Better. The MTFS directly supports delivery against these areas by allocating budgets to (amongst other things) reducing the carbon impact of vehicles; digitalisation of services to enable customers to go ‘paperless’; funding to support and coordinate digital channel-shift work; and joint-working with partners to manage key facilities and infrastructure more effectively.

1.5 The MTFS also sets out how we will engage, communicate and consult on plans to bring financial sustainability to the council in the light of the enormous, sector-wide pressures on local government services and finances.

2 FINANCIAL IMPLICATIONS

2.1 These are set out throughout the report.

2.2 A Medium Term Financial Plan (MTFP) is kept under review throughout the year as potential pressures emerge and gives an updated future outlook for a rolling four year period. All base assumptions are revisited annually as part of the budget setting process and this informs detailed budgets and spending plans that come forward for approval by Council in February each year.

3 LEGAL AND PROCUREMENT IMPLICATIONS

3.1 Under section 151 of the Local Government Act 1972 a local authority must make proper arrangements for the administration of its financial affairs. Under s28 of the Local Government Act 2003 a local authority must review its budget calculations from time to time during the financial year and take appropriate action if there is any deterioration of its budget.

3.2 The council is required under Chapter 3 of the Local Government and Finance Act 1992 to set a council tax for the forthcoming year along with its budget estimates. The decision must be made by 11 March of the preceding year. The council's prospective income from all sources must be equal to its proposed expenditure.

3.3 The council is also required to set a balanced budget, taking into account a range of factors, including consultation feedback and decisions must be taken in accordance with the council's duties in the Equality Act 2010.

3.4 The approval of the budget and setting of the Council Tax is a decision reserved to Full Council under the Local Government Act 2000 and the Local Authorities (Functions and Responsibilities) Regulations 2000 (as amended). Under these regulations, the Cabinet makes recommendations as to the setting of the council tax and budget to Full Council.

4 WORKFORCE IMPLICATIONS

4.1 This MTFS details the organisational approach for managing financial resources to protect our core council services and enable delivery of the Council Plan priorities going forward. Employees are critical to the delivery of these services and priorities and at 31 March 2023 the council had a workforce of 405 FTEs.

4.2 The report sets out the current challenges in local government finances and proposals for the council to deal with these locally with a major transformation programme. Whilst there are no proposals in this report to amend any employee budgets, it is recognised that successful transformation of services will involve significant staff resource.

5 PROPERTY AND ASSET IMPLICATIONS

5.1 The council's General Fund has a property portfolio valued at £170m as at 31 March 2023 of which £68.4m is classified as investment properties (held solely for rental income and/or capital appreciation). A key strand of the Council's financial strategies is to maximise income from its assets, where possible, and seek to manage risk by achieving a balanced portfolio of assets. Options considered during the budget planning process may therefore involve the refurbishment or disposal of assets.

6 CONSULTATION AND COMMUNICATION

6.1 Stakeholder engagement is an important part of the council's budget planning process. Feedback from the regular Residents' Survey provides opinion on local priorities; views on emerging policy; and the relative perceived importance of council services. This insight helps the council to take financial decisions; to plan and manage budgets; and to use its financial resources to support delivery of priorities.

6.2 Consultation principles including those of consulting in good time; being inclusive but with clear and appropriate limits; consulting using clear, simple information; and using responses to inform decision making are specified in and underpin the TC25 programme.

6.3 An initial 2024/25 budget consultation exercise is planned for November/December 2023. Once the detail of service transformation options are formulated, these will form the basis of an in-depth stakeholder consultation during 2024.

6.4 Additionally, consultation specifically for this MTFS and the 2024/25 budget will include:

a) A presentation to and discussion with parish council representatives at the November Parish Briefing meeting.

b) Discussion with local business representatives through the Chamber of Commerce and the Business Improvement District (BID) Winchester District Strategy Group business briefing in early 2024.

c) Scrutiny Committee consideration of proposals in this MTFS report and the Budget Report ahead of Cabinet decision making in November and February respectively. Scrutiny feedback will be summarised and presented to Cabinet for consideration with both reports.

7 <u>ENVIRONMENTAL CONSIDERATIONS</u>

7.1 The 2023 edition of the Council Plan recognises the top main challenge facing the district as "the climate emergency and the pressing need to reduce the Winchester district's carbon footprint." In response, an enhanced focus has been given to going greener faster. The main areas of activity are reducing carbon emissions; ensuring environmental resilience; reducing energy demand; and increasing renewable energy.

7.2 It is recognised that significant investment will be required to achieve carbon neutrality targets and that this must be balanced against the challenging budget conditions being faced by all local authorities.

7.3 As a commitment to the carbon neutrality ambitions £800k was included within the revenue budget to support feasibility and programme delivery work. A further £250k 'Greener Faster Reserve' was set aside in February 2023 to support the council to expand renewable energy; explore the use of council assets for carbon and nutrient offsetting, reduce energy demand in council-owned buildings, lower the carbon footprint of council and contractor vehicles; as well as enhance active travel provision.

7.4 The MTFS includes a £200k per annum baseline revenue budget to fund carbon programme delivery work.

7.5 As well as these revenue resources, specific projects are funded through the capital programme, supported in many cases through external grants. Examples include the provision of solar panels to council properties and to local businesses, the installation of EV charging points throughout the district and replacement of windows in the city offices. Further proposals for investment in a significant energy generation project on Council land is currently subject to feasibility review.

8 PUBLIC SECTOR EQUALITY DUTY

8.1 The council, in the exercise of all its functions, must have due regard to the Public Sector Equality Duty in section 149 of the Equality Act 2010. The content of this report is part of the budget consultation process, and the requirements of the Public Sector Equality Duty are considered alongside any relevant budget options put forward.

8.2 The Medium-Term Financial Strategy is an overarching framework relating to financial resources and priorities at a very high level. A full Equality Impact Assessment will be undertaken for each proposed service change or proposal that aligns to the principles included in this MTFS to highlight the potential equality impacts.

8.3 An Equality Impact Assessment (EqIA) has been undertaken on the decisions recommended within this Medium-Term Financial Strategy report and has not identified any potential impacts to individuals or communities with protected characteristics.

9 DATA PROTECTION IMPACT ASSESSMENT

9.1 All data is securely stored in council systems and the council is certified with Public Sector Network (PSN) connection compliance. New project work set out in this report and the Capital Programme will be subject to individual data protection impact assessments.

10 RISK MANAGEMENT

Risk	**Mitigation**	**Opportunities**
Property Commercial tenants unable to pay rents or subject to business failure	Close monitoring of rent position by property team with support to tenants through effective working relationships.	Potential to increase commercial property income when rent reviews are carried out.
Slowdown in commercial property investment, meaning that the	The council's advisors are reviewing the property investment	

Risk	Mitigation	Opportunities
council's development schemes achieve less interest or less income than expected.	market and will provide advice as to timing of any marketing.	
Legal The council is unable to balance the revenue budget resulting in the issuing of a S114 notice.	Proposals set out in this report, including the strategy for management of reserves mitigate against this.	Present a balanced budget in difficult circumstances
Timescales Slower than projected economic recovery affecting income received by the council TC25 does not deliver £3m of annual savings within three years.	The council has set aside an Exceptional Inflation reserve of £2.9m to mitigate slower than expected recovery. Other uncommitted revenue reserves are available to support further increases to the projected deficit. The programme is governed by a Programme Board and progress (financially and in timescales) is being monitored through PAC Board as a tier-one corporate project.	
Financial The council is unable to balance the revenue budget Risk of lower than projected demand for income generating services specifically parking	Proposals set out in this report, including the strategy for management of reserves mitigate against this. The council has uncommitted revenue reserves available which can be utilised as a last resort as above	Streamlining of services and digitalisation provides opportunities to improve the customer experience as well as making savings.

11 SUPPORTING INFORMATION

National and Local economic and financial overview

11.1 The medium-term outlook for the council's finances is dominated by two key factors; firstly the macro-economic volatility the UK is experiencing (with high inflation and rising interest rates); secondly, the unknown impact of the long awaited fair funding review and proposed further business rates retention proposals for 2024-25 and beyond.

Economic outlook – inflation and interest rates

11.2 The CPI inflation rate, which peaked at 11% in mid-2022, has gradually reduced through 2023, with the rate in September being 6.7%. The Bank of England are forecasting (in their Monetary Policy Report, November 2023) that inflation will continue to fall towards 4.5% by the end of 2023. However, the reduction has been much slower than economists had predicted, meaning prices for many of the council's service inputs (e.g. construction materials and electricity and gas supplies) remain high.

11.3 The Bank of England has said they "*will keep interest rates high enough for long enough to get inflation back to the 2% target*". The higher interest rates have significantly increased returns on the council's investments during the current year. This provides a short-term benefit given current cash balances, however it does mean that when, as projected, the council moves to a net borrowing position, costs of borrowing are likely to be much higher than they would have been over the last decade. In addition, the increased cost of borrowing available to the council has a detrimental impact on the financial viability and affordability of capital schemes reliant on borrowing to fund them.

Local government financial landscape.

11.4 The landscape for local authority finances in England is bleaker than ever. The combination of stubbornly high inflation (baking-in high prices in contracts); rising demand for services; and lack of freedom and certainty in funding (with council tax caps and no sign of the Fair Funding Review) are leading many councils to report overspends spiralling out of control.

11.5 Council chief financial officers (CFOs) must set a balanced budget for the financial year ahead. If the council's forecast income is insufficient to meet its forecast expenditure for the next year the CFO must issue a 'section 114 notice' to publicly indicate that it cannot meet its spending commitments. For many CFOs, despite managing to balance the budget 12 months ago, many councils are now 'running out of road' to prevent this financial insolvency.

11.6 Seen as a rarity until 2020, 2023 has seen multiple s114 notices issued by councils across the country; with the treat of many more to come over the next two years. Although the majority of these are from upper tier or unitary authorities, a survey published in October by the District Councils' Network

(DCN) revealed that 52% of respondents did not expect to balance their budget in 2024/25 without needing to draw on reserves.

11.7 Winchester is no exception to feeling the same financial pressures as other councils. The MTFP (appendix 1) is showing a projected annual budget shortfall of £3.42m per annum in 2026/27, rising to a shortfall of £5.66m by 2028/29. This is an increased deficit since the £3m gap reported in the November 2022 MTFS and further detail on the reasons is set out in section 15 of this report.

General Fund Revenue (£m)	Forecast 2024/25	Forecast 2025/26	Forecast 2026/27	Forecast 2027/28	Forecast 2028/29
Budget Surplus / (Shortfall)	**0.000**	**-0.000**	**-3.421**	**-4.447**	**-5.660**

Table 1 – extract of the 2024/25 – 2027/28 MTFP showing the forecast budget shortfalls over the medium-term planning period.

11.8 The MTFP is showing a sound and stable position for Winchester for the next two financial years through to April 2026. This gives us a limited window of opportunity to tackle the looming crisis forecast from 2026 onwards.

The council's approach to tackling the financial challenge.

Transformation Challenge 2025

11.9 The first signs of the extraordinary financial pressure faced by the General Fund and the unsustainable position were set out in the MTFS in November 2022 (CAB3374). With the council's gross expenditure in the region of £35m per year, the £3m annual savings represent a very considerable 8.5% of all our spend.

11.10 It was clear this financial challenge for the council was like no other and of a completely different magnitude to previous rounds of savings since the mid-2000s. Drastic action is needed to ensure a sustainable financial future, or the council faces the same s114 fate as others in the sector.

11.11 In response, Cabinet took action and initiated a bold, organisation-wide transformation programme to seek out and to deliver transformational changes to the way we deliver services in order to save £3m a year within 3 years: '*Transformation Challenge 2025'* (TC25). A comprehensive and detailed review of the operating model for the delivery of all our services is required if the transformation if to deliver the necessary savings and protect our core services for those residents and customers in the greatest need.

11.12 An initial strategic budget review identified 12 themes for consideration. Work has continued over the year and selection of these twelve themes has provided essential learning for the next phase of this work but not significant savings. The progress of each of those reviews is summarised in appendix 4.

11.13 Recognising the limited success and/or progress of the 12 pilot projects, TC25 has been elevated to a tier one strategic project, sponsored by a new Transformation Board. The Board has clear terms of reference, setting out the transformation, financial, workforce and consultation principles of the programme. A Programme Lead and Programme Manager have also recently been appointed to drive the programme and ensure success can be achieved and measured.

TC25 Star Chambers

11.14 In the next phase of TC25, Corporate Heads of service have been working with all staff in their teams to generate ideas for service transformation. From small efficiencies to completely changing the operating model of a service, no stone has been left unturned when seeking out the transformational changes needed to save £3m a year within 3 years.

11.15 These ideas are being collated into the following five streams:

a) Digital redesign
b) Structural cost reduction through service change
c) Contract management change
d) External funding and partnerships
e) Income generation

11.16 The long list of transformation ideas are to be presented to 'Star Chambers' by each Corporate Head and the responsible Cabinet member. Challenge in the star chamber will come from the Executive Leadership Board, the CFO, the other Cabinet members, and the Programme Lead for TC25. This challenge process in November 2023 will short list and prioritise options which will then go forward to feasibility and then consultation stages in 2024.

12 2023/24 Budget Update

12.1 The latest forecast for the 2023/24 general fund budget is a surplus of £0.410m and is due to be reported in the Quarter 2 Performance Report (CAB3424 refers). Out of the forecast surplus, £0.210m is expected to be a net baseline saving and is therefore included within this paper and the projections shown in appendix 1. The forecast surplus is the net of a number of forecast favourable and adverse income and expenditure variances, relating to both services and investments.

12.2 Adverse service income variances relate to; Planning Fees, Building Control Fees, Land Charge Fees, Pest Control Fees, and Market Income. Favourable service income variances relate to; General Fund Rents, Car Parking Income, Recycling Income and Garden Waste Fees.

12.3 The forecast surplus for 2023/24 is assumed in the MTFP (appendix 1) as being transferred to the transitional reserve to support the transformation programme.

13 **Preparing the budget - assumptions used in the MTFS**

Government Funding

13.1 A local government finance policy regarding funding was set out in December 2022 and covers the two year period including 2023/24 and 2024/25. Whilst this gives some assurance for 2024/25 it does not specifically confirm all funding streams such as the New Homes Bonus.

13.2 In line with advice from our advisors, a number of key assumptions have been made in the MTFS (shown in Appendix 1):

a) New Homes Bonus will continue in 2024/25 and will be at the same level as in 2023/24.

b) A reset of business rates and changes to the current funding distribution system will not take place until 2026/27 (a further year on than in the previous MTFP).

c) Damping funding will be available to compensate for lost grant from 2026/27 and this will be phased out over a 3-year period.

13.3 The ongoing uncertainty around future government funding makes it very difficult to forecast and plan for the medium term. However, given that Winchester has benefited significantly from the current, mainly rewards-based system (New Homes Bonus and Retained Business Rates) then it is necessary to plan for future funding which is more based around ‘need’. Both the New Homes Bonus and Retained Business Rates rewards systems are both long overdue fundamental review and were only laid out in their current form for a fixed time period.

Council Tax

13.4 Council tax referendum limits for districts are expected to remain at up to 3% (the £5 limit will likely remain but is now lower than 3%).

13.5 The MTFS assumes a general annual tax base increase of 1.2%, which has been temporarily uplifted to 2.2% for 2024/25. An increase of 1.2% is generating approximately an additional £0.1m p.a. of district Council Tax Income. However, there are additional costs associated with additional properties (Environmental Services Contract cost is specifically increased based on number of additional properties).

13.6 The MTFS currently assumes a council tax increase of 2.5% in 2024/25.

13.7 Any increase in council tax will need to bear in mind the interrelationship between the town and district precepts, which are subject to the same combined referendum limit.

13.8 It is likely that any increase in council tax will remain below inflation, even if raised by the maximum allowable.

Inflation rates

13.9 The revised forecast indicated in the table below takes account of increased inflation (assumes 6.7% increase on contracts and 4% on pay). The forecast assumes inflation will fall in future years but not reach the Bank of England 2% target until 2026/27.

Fees and charges

13.10 Following previous approval of the fees and charges policy framework (whereby fees and charges will be increased by the September CPI to address contractual increases, to achieve cost recovery or to bring a fee in line with the market norm) the MTFP in appendix 1 assumes this continues to be the case. Additionally, that it continues to be the case that the Section 151 officer is authorised, in consultation with the Cabinet Member for Finance and the Cabinet Member responsible for the service, to approve a different fee where appropriate. Prices will remain frozen in Winchester Park & Walk and Park & Ride car parks.

14 Budget pressures and unavoidable growth

14.1 Whilst it is necessary to identify budget reductions to contribute towards funding forecast deficits, there are a number of issues that require attention and budget provision if the Council is to maintain delivery of its core services and key priorities.

Environmental Services

14.2 Along with the other 10 districts / boroughs and the Portsmouth and Southampton unitaries, Winchester is part of a Hampshire partnership arrangement to provide an integrated approach to collection and disposal of household waste in the county. The council's environmental services contract pays for the collection of household waste and recycling (mixed recyclables, garden waste and kerbside glass) from over 57,000 households across the district. This waste is then taken to County Council operated facilities for recycling and disposal. Hampshire County Council put forward proposals to partners over changes to the current arrangements and these could have significant operational and financial implications for all Hampshire councils. Recent Government announcements on simpler recycling opens up the opportunity for collections of recycled material on a co-mingled basis subject to the waste disposal authority ability to receive material on that basis. There is also confirmation of new burdens funding for the required weekly food waste collection. Following the Government's recent announcement, modelling of the potential costs for the Council are taking place and the confirmation of new burdens funding is awaited.

Budget implications of changes for Greener Faster and carbon reduction measures; for legislative reasons; and for the inter-authority waste partnership are:

a) The council can save 25% of its carbon output by changing the fuel used in the fleet of waste and recycling vehicles. The cost of switching the vehicles from diesel to Hydrotreated Vegetable Oil fuel (HVO) is estimated to cost up to £0.2m per annum. The arrangement would be a rolling 12 month contract with the final cost fixed at the end of February. As this is after the final budget setting in February, any additional costs would need to be found from existing budgets, should the switch proceed as planned.

b) As part of Greener Faster ambitions, the council wants to increase the recycling offer for residents. The introduction of a separate food waste recycling service could cost up to £1.4m per annum. Government have confirmed that the initial capital costs and ongoing running costs will be funded initially through new burdens grants for those councils that have not already committed to this service. However, they have also confirmed that this funding will be calculated using standard methodology and that it may well not cover the full costs incurred. Given the likelihood there will be some costs to the council from the introduction of this service it has been assumed that food waste will be 80% government funded from its introduction at an estimated date of October 2025 (noting that food waste must be introduced by March 2026).

c) Hampshire Inter-Authority Agreement (IAA) – consultation is ongoing with Hampshire County Council but the current proposed changes to the IAA could result in a net cost/loss of income of around £0.5m per annum based on penalty and incentive payments. The response from HCC as to their ability to meet the opportunities offered by the Government announcement are awaited.

d) It is estimated that changes to the collection of recyclables could cost up to £0.4m per annum in addition to the introduction of food waste collection. It should be noted that this is a high-level estimate and possible options have been changing rapidly, particularly with the Government’s announcement that additional collection receptacles are not required. It is likely there would be one-off costs in addition to this ongoing estimate.

e) The one-off costs (excluding vehicles and containers) associated with the change of services/rounds and introduction of food waste are estimated to cost up to £1.5m. The costs of this are not currently reflected in appendix 1 on the assumption that earmarked reserves would be allocated to cover these costs.

14.3 Service Income

a) Building Control Fees (existing budget £520k per annum) – following a reduction in income in 2022/23 and this trend continuing in 2023/24, a reduction in the income budget of £100k is proposed.

b) Land Charges Income (existing budget £440k per annum) – following a reduction in income in 2022/23 and this trend continuing in 2023/24, a reduction in the income budget of £100k is proposed.

c) Legal Income (existing budget £130k per annum) – following a review of the existing budget it has determined that the current budgeted level of income is not achievable and therefore a reduction of £50k is proposed.

d) Pest Control Income (existing budget £93k per annum) – following a review of the existing budget it has determined that the current budgeted level of income is not achievable and therefore a reduction of £50k is proposed. This means the service is not achieving full cost recovery.

e) Car Parking income – a baseline reduction of £1m was approved in February 2023 which reflected the reduction in usage levels post covid. Usage levels are gradually increasing and based on 2023/24 forecasts a budget increase of £100k is proposed.

f) Garden Waste Income (existing budget £1.1m per annum) – based on increased subscriptions in 2023 a budget increase of £90k is proposed. Whilst not achieving full cost recovery this does further close the current deficit.

g) Waste income - Hampshire IAA – budget pressure of £0.5m reflecting the changes explained in 15.2 c) above.

14.4 Service Expenditure

a) Digital Transformation - a core part of the TC25 transformation programme is the use of digital solutions to reduce carbon emissions (for example, by reducing printing and postage) and to encourage digital interactions for customers whilst improving that experience (for example, enabling 24/7 access to information via online self service). An ongoing budget of £100k per annum is included in the MTFP to support and coordinate this essential channel shift work.

b) External Audit Fees – Public Sector Audit Appointments (PSAA) has notified the council that following its procurement exercise, core audit fees will increase 151% for all audit clients. For Winchester this is an increase of £100k.

c) NNDR savings on de-listed corporate property – following a successful business rate appeal to the Government's Valuation Office Agency (VOA) existing budget of £177k can now be removed as a permanent saving.

d) Carbon reduction measures on waste and recycling vehicles changing to HVO fuel – budget growth of £0.2m reflecting the changes explained in 15.2 a) above.

e) Food Waste Collections – budget growth of up to £1.4m as detailed in 15.2 b) above (less assumed 80% government funding).

f) Other Recycling changes – budget growth of up to £0.4m as detailed in 15.2 d) above.

14.5 As well as service budget pressure risks around changes to the waste and recycling regime, there is a further budget pressure risk associated with the provision of temporary accommodation in the general fund's homelessness prevention service. It is too early to predict how costs for this service will be affected by potential demand increases (affected by both national policy announcements from the Government and changes in services provided by Hampshire County Council). However, service provision and policy changes are kept under close scrutiny to ensure risks are identified as early as possible.

15 Reserves

15.1 A summary of reserves is included as appendix 3.

15.2 Due to the significant risks related to both inflation and borrowing rates the Exceptional Inflation Reserve has an uncommitted balance of £2.9m. This would be enough to cover any additional costs in the short term whilst the medium term plan is developed to deal with any additional ongoing costs.

15.3 In addition, the "Transitional Reserve" established 4 years ago, has an uncommitted balance of £6.5m. This reserve has the dual purpose of supporting the critical transformation and digitalisation investment required in order to deliver the required future baseline budget savings; and also acting as a temporary buffer should savings take longer to deliver than had originally been planned.

15.4 It should be noted that major projects and regen work is usually funded from the Major Investment Reserve. With existing commitments, there is only just over £3m remaining in that reserve and all future business cases for regen work will need to take this into account (a clearer and stronger focus on financial viability). Whilst many costs can be capitalised and funded from borrowing if works proceed, upfront investment has been high for previous projects, arguably with insufficient focus on cost recovery.

15.5 Additional reserves totalling £2m were approved in February 2023 in order to support a number of high priority projects: Greener Faster; Future of Waste; Pride in Place; Digital Transformation; Regeneration; Cost of Living and Transitional Reserves. Expenditure and commitments are being regularly monitored and any changes in requirements or timing will be presented to February Cabinet.

15.6 IT Reserve – based on the latest 10 year IMT plan the annual contribution to reserves is proposed to increase from £280k per annum to £380k per annum from 2024/25. The reasons for this increase are a number of factors such as taking into account latest inflation estimates, replacement of current updated equipment (such as laptops) and increases in some forecast project expenditure such as the telephone system replacement.

15.7 Future of Waste – the waste and recycling collections are a major frontline service provided by the council to over 57,000 households across the district. Any changes to routes, bins and timetables etc. needs detailed planning; active communication to all residents; and methodical change management to ensure effective implementation. The cost of this depends on the scale of change required and this is not yet known. It has been assumed that approx. £1m of the Major Investment Reserve be ringfenced to fund these mobilisation costs which are likely to be incurred during 2025.

16 General Fund Capital

16.1 The council has a general fund capital programme totalling £38.7m over the next 10 years. Of this, £4m relates to the Strategic Asset Purchase Scheme (SAPS) which will only be spent if suitable assets are identified for purchase in line with the provisions of the scheme. Of the total programme just over £22m has been approved for expenditure, with the remaining projects, including SAPS, subject to appraisal.

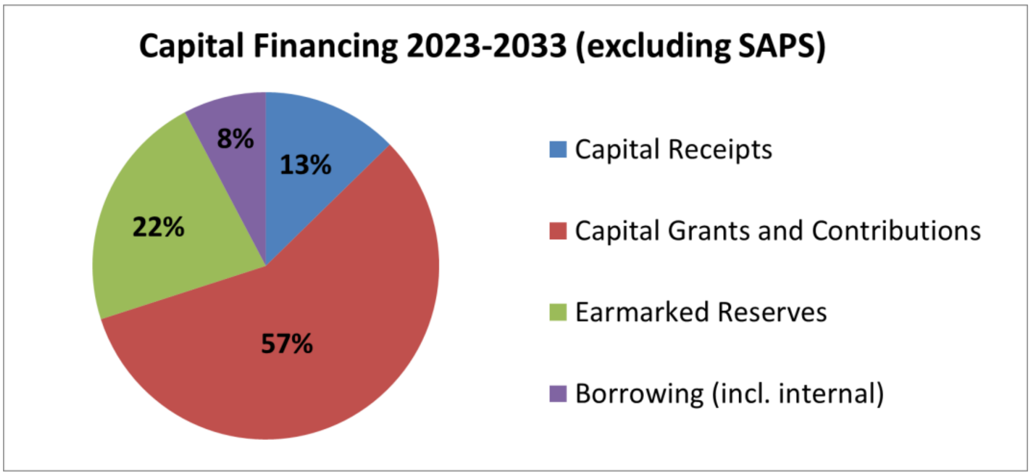
16.2 The current macroeconomic conditions present significant challenges to the capital programme. Both inflation and borrowing costs have increased significantly over the last 18 months. This led to a number of refurbishment/regeneration projects being paused in last year's capital strategy as they became unviable. However, the council still has an ambitious programme of works such as investing in a new pavilion at the King George V playing fields, a significant Disabled Facilities Grant programme, CIL funded community grants, refurbishments to play areas, investments in the council's car parks, and the creation of a Housing Company.

16.3 In the coming years, it is anticipated that, in addition to the existing programme, capital budgets may be required in order to: create ongoing savings in respect of the TC25 programme; implement digitalisation to enhance the customer experience and deliver savings; and meet the council's carbon reduction objective such as investment in solar PV.

16.4 Ongoing careful asset management is essential and there are potential opportunities from asset sales where the capital receipt could be used to either finance projects that would otherwise be unaffordable or to reduce the council's outstanding borrowing need which translates to annual revenue cost savings.

Capital Financing

16.5 Excluding SAPS (funded by borrowing if suitable purchases are identified), the proposed financing of the programme is as follows:



16.6 The main sources of finance for capital projects are as follows:

- Capital grants and contributions (e.g. Disabled Facilities Grant, Local Enterprise Partnership, and Community Infrastructure Levy);
- Capital receipts (from asset sales);
- Earmarked Reserves (e.g. the Major Investment Reserve, the Property Reserve, the Car Parks Property Reserve, and the IMT Reserve);
- Revenue contributions; and
- Borrowing including internal (also known as the “Capital Financing Requirement”).

16.7 Where possible, the most restricted funding sources should be used before using earmarked reserves or revenue contributions. Capital grants and contributions typically are for either specific projects or types of expenditure, and capital receipts from the sale of assets can only be used to finance new capital expenditure or reduce unfinanced capital expenditure (borrowing) from prior years. Revenue reserves are not restricted to capital only and can therefore fund expenditure that is not capital in nature and can be used to fund day to day expenditure should there be either an unplanned shortfall in income or unexpected additional expenditure.

16.8 Local authorities may also incur borrowing for capital projects in line with the Prudential Code as long as the capital programme overall is “affordable, sustainable, and prudent”. General Fund capital projects funded by prudential borrowing will incur an annual revenue cost over the life of the asset – a minimum revenue provision (MRP), which is equivalent to the principal repayment, and external interest/opportunity cost. There is not a requirement to apply MRP in respect of the HRA. Where a project does not provide additional income or savings in excess of the annual borrowing cost, it may be necessary for the council to make further savings elsewhere. Typically, the council funds projects from borrowing where the income and/or savings exceed the cost of borrowing.

16.9 Where the council has existing resources (e.g. reserves) it is able to “internally” borrow and so delay the need to externalise its borrowing requirement; this reduces interest costs in the short term. The council’s Capital Financing Requirement (CFR) up to 31 March 2022, which represents unfinanced capital expenditure in prior years, is shown in the table below. The CFR is increased when a new capital project isn’t financed from other resources and is reduced by the annual MRP. The council can also elect to reduce the CFR by making a “voluntary” provision above the MRP. This will reduce the amount of MRP in future years and, if funded by a new capital receipt, will also reduce the need to externally borrow and therefore interest savings can be made.

Capital Financing Requirement	**General Fund £000**	**Housing Revenue Account £000**	**Total £000**
Capital Financing Requirement at 1 April 2022	**72,812**	**186,005**	**258,817**
Unfinanced capital expenditure - in year	558	13,772	14,330
Minimum revenue provision (MRP)	(1,517)	0	(1,517)
Voluntary provision for the financing of capital	(200)	0	(200)
Capital Financing Requirement at 31 March 2023	**71,653**	**199,777**	**271,430**
Made up of:			
External borrowing	0	161,722	161,722
Internal borrowing	71,653	38,055	109,708

<u>Challenges and opportunities</u>

16.10 The Prudential Code requires that the council’s capital programme must be “affordable, sustainable, and prudent”; in addition, it must be proportionate both relative to the size of the council and in respect of the risks being proportionate to the overall capacity of the council to absorb them, i.e. “plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services and the level of resources available to the organisation”. Both inflation and the cost of borrowing have increased significantly over the last 18 months. This impacted negatively on the commercial viability of some refurbishment and regeneration schemes where a surplus after the cost of borrowing had previously been anticipated, and these were removed, for the time being, from the programme in February 2023.

Inflation

16.11 The September Consumer Prices Index (CPI) was 6.7% (compared to 10.1% a year earlier) and while remaining “sticky” is expected to continue to fall. However, inflation differs between products and sectors. For example, construction materials costs fell between July 2022 and July 2023: repairs and maintenance (-4.3%), new housing (-1.5%), and other new work (-5.0%). However, prices are still significantly higher than July 2021 with the overall increase to July 2023 being 18.5%, 21.3%, and 20.9% respectively (source: Monthly Statistics of Building Materials and Components - data.gov.uk).

Borrowing

16.12 Local authorities can borrow from the Public Words Loans Board (PWLB) which is typically the cheapest and easiest source of borrowing. Lending rates are based on UK gilts (government borrowing) plus a margin of 0.8%. Following the “mini-budget” in September 2022 gilt yields increased significantly. They subsequently fell back (though not to previous levels) but have in recent months increased again. The council’s treasury advisors expect longer term gilt yields to fall slightly in the medium term but do not expect a return to the historically low rates that were available for several years. The 40-year annuity rate as at 25 October this year was 5.76% compared to 2.3% in February 2022.

16.13 Significant changes in the cost of borrowing can impact on the commercial viability of refurbishment or regeneration projects and on the affordability of the capital programme overall. For example, for a £5m project with a 30-year life the annual cost of borrowing (MRP (principal repayment) and interest) is £240,000 per annum (4.8%) at an interest cost of 2.5% and is £325,000 (6.5%) at an interest cost of 5%. The gross yield for commercial viability needs to be more than the total MRP and interest cost.

Asset sales

16.14 As well as refurbishing existing assets, the council considers the possible sale of assets as part of its asset challenge programme. While there may be reasons not to dispose of particular assets the benefit of a sale is that it produces a capital receipt that can be used to fund capital expenditure for which alternative funding is not available or where high borrowing costs would make a project unviable. It could be used to fund expenditure that would have been funded by revenue reserves thus releasing those reserves for other purposes.

16.15 A new capital receipt can also be used to reduce prior year unfinanced capital expenditure and deliver annual revenue savings by reducing MRP (principal repayment) and interest costs. The actual saving would depend on the life of the asset concerned and on the interest costs at the time. The following table illustrates the estimated annual saving made on an asset with a life of 40 years:

Revenue saving by applying £1m capital receipt to unfinanced project with 40 year life				
	5.5%	4.5%	3.5%	2.5%
Annual saving (£'000)	62	54	47	40
Cumulative saving (40 yrs) (£'000)	2,493	2,174	1,873	1,593

Emerging projects

16.16 New "invest to save" capital budgets may be required to support the council's **TC25 programme** in order to generate ongoing revenue savings. Further investments are likely to be required as part of the council's strategy for **digitalisation**. Digitalisation presents an opportunity to improve customer experiences as well contribute to ongoing savings.

16.17 Following legislative changes, the council will be required to provide a **food waste** service by March 2026. Although government funding is expected in order to implement this change, it is possible the council may need to partly fund investment in, for example, new collection vehicles.

16.18 The council's ambitious **Greener Faster** carbon reduction goals will require further capital investment in the future. Whilst inflation and a higher cost of borrowing presents challenges, the council has successfully applied for grants to ensure projects are affordable and will continue to identify potential grant funding for future projects. Some interventions also present opportunities: for example, investment in solar has the potential to generate additional income over and above the cost of borrowing which would allow the council to make further interventions.

17 <u>Adequacy of Reserves and Robustness of Estimates</u>

17.1 There are specific requirements under Section 25 of the Local Government Act, 2003, for the Chief Finance Officer to provide a positive assurance statement about the adequacy of proposed financial reserves and the robustness of estimates made for the purposes of the budget calculation.

17.2 Reserves are detailed in this report and specific comment is made on the most significant balances. The general fund working balance is discussed above and is considered to be adequate.

17.3 When considering the robustness of estimates for the budget calculation for the current year, savings and increased income proposals included in the budget must be considered to be achievable. Considerable savings have been achieved to date, and the recent experience has been that compensating savings have been found to cover unforeseen growth pressures. The purpose of reserves, in particular the general fund working balance, is to provide a cushion for these variations.

17.4 The S151 officer is able to provide positive assurance on the robustness of the estimates, within the context of the overall budget and reserve levels, for the purpose of the budget calculations for the next year.

18 OTHER OPTIONS CONSIDERED AND REJECTED

18.1 Scope for additional savings in 24/25 to reduce the use of reserves does exist but would have a significant and direct impact on service levels and service quality. With the uncertainty that exists regarding future funding, the recommended balance between savings and use of reserves to achieve a balanced budget is considered reasonable.

18.2 However, it is essential that work to identify longer term savings through the Transformation Challenge 2025 programme as set out in this report is critical to ensure the Council can meet its obligation to set a balanced budget in 2026/27.

BACKGROUND DOCUMENTS:-

Previous Committee Reports:-

CAB3374 - General Fund Budget Options and Medium-Term Financial Strategy dated 15 November 2022

CAB3388 - General Fund Budget 2023/24 dated 9 February 2023

CAB3389 - Capital Investment Strategy 2023-2033 dated 9 February 2023

CAB3416 - General Fund Outturn 2022/23 dated 13 September 2023

Other Background Documents:-

APPENDICES:

1. Medium Term Financial Projections
2. Summary of all Revenue Proposals
3. Summary of Reserves
4. Strategic Budget Review update as at November 2023