City of Westminster

Cabinet Report

Decision Maker:	Cabinet
Date:	10 July 2023
Classification:	Open
Title:	Medium Term Financial Planning (2024/25 to 2026/27)
Wards Affected:	All
Cabinet Member/Lead Member:	Councillor Boothroyd, Cabinet Member for Finance and Council Reform
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 of Finance and Resources

1. Executive Summary

1.1. This report outlines the Council's updated financial position over the next three years and provides the financial framework for the Council to deliver its key policy objectives as outlined in its Fairer Westminster strategy.

1.2. This report updates the budget assumptions approved at Full Council in March 2023 and plans for a further two years to 2026/27 updating the medium term framework. 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.

1.3. The financial position over the planning period has been updated and provides an indicative budget gap of £6.141m in 2024/25, rising to £48.461m by 2026/27. This is an improved position on the £56.8m gap previously reported in March.

2. Recommendations

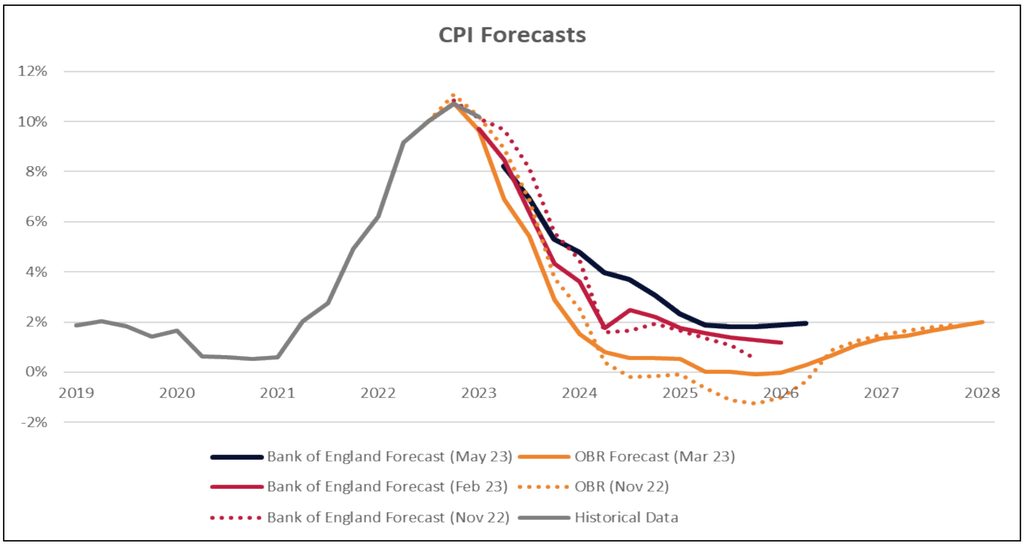
2.1. That Cabinet note the revised medium term financial planning forecast to 2026/27 and to agree the budget process approach as set out in the report.

3. Reasons for Decision

3.1. The preparation of the budget and three-year medium term financial plan is the first stage of the annual business planning cycle for the forthcoming financial year 2024/25. There is a statutory requirement to set an annual 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. It is considered good practice to produce medium financial plans.

4. National Context

4.1. Inflation has remained higher than originally expected at the beginning of this year. While twelve month Consumer Price Index (CPI) inflation fell from 10.1% in March to 8.7% in April, it remained unchanged for May and remains higher than the previous forecasts. This indicates that it will take longer to get back to the Bank of England (BoE) target rate of 2%. Price inflation continues to exceed earnings growth, with high energy prices replaced with high food prices in a continuation of the cost-of-living crisis. The graph below shows the current Bank of England and Office for Budget Responsibility (OBR) forecasts for inflation. These have recently been revised upwards with CPI now expected to remain above 5% for the remainder of 2023, dropping to 2% by the start of 2025.



4.2. The BoE continues with its policy to raise interest rates in a bid to tackle inflation. This is increasing the cost of borrowing with the potential for rates to rise further. During its June meeting the BoE raised its policy interest rate by 0.5% to 5%, marking a 13th consecutive rise. Market expectation is for rates to increase further and then begin falling back during mid-2024, although this will very much depend on the path of inflation.

4.3. The UK economy remains on course to avoid a technical recession. Economic growth is expected to remain at 0.3% throughout 2023, rising slightly to 1% in 2024.

4.4. It is expected that there will be a General Election in 2024. The current government spending review covers 2024/25, so there will need to be a further comprehensive spending review to take place soon after the general election. Public spending totals in years after 2024/25 currently show a reduction in available resources for non-protected spending departments.

5. Local Policy Context

5.1. The Council launched its new Fairer Westminster strategy on 4 October to set out the outcomes it wants to deliver for the city across five themes. The delivery plan can be found here: Delivering on our plan to build a Fairer Westminster. The key Fairer Westminster pillars are as follows:

- **Fairer Communities** – Inequality is reduced, everyone feels safe, adults can stay healthy, community and voluntary sector organisations prosper, and Westminster remains a great place for children to grow up.

- **Fairer Environment** – Westminster is a net zero council by 2030 and a net zero city by 2040, air quality meets World Health Organisation guidelines, our streets are clean, recycling is increased, people are enabled to travel more sustainably, and people have access to high-quality services within 15 minutes from their homes.

- **Fairer Housing** – The housing needs of people are met through greener and more genuinely affordable housing, homelessness is reduced, private rented sector properties are well managed, and our tenants and lessees are consistently satisfied with our housing services and the quality and energy efficiency of our housing stock.

- **Fairer Economy** – Westminster remains economically successful, Oxford Street and the West End are revived and retain their position in the national economy, small businesses are supported to grow and remain, and residents have the right skills to take advantage of the city's employment opportunities.

- **Fairer Council** – People can more easily find the information and services they need, the Council makes decisions more transparently, the Council is financially sustainable, and our procurement is responsible.

5.2. The Council's approach in developing its medium-term financial plans will continue to ensure resources are applied in a way that most effectively and efficiently contributes to the Council's Fairer Westminster ambitions. The recent Future of Westminster Commission's reports and recommendations will also be considered as part of the planning process.

6. Local Government Finance

6.1. Government announced the one-year finance settlement on 6 February 2023 for 2023/24. The underpinning Spending Review 2021 (SR21) set government departmental budgets to 2024/25. Further announcements are yet to be made on the distribution of the 2024/25 settlement to local government.

6.2. The additional £2.8bn Adult Social Care (ASC) and NHS funding given in 2023/24, increases to £4.7bn in 2024/25. Some funding comes through Better Care Fund ringfenced to support hospital discharge. The £2.8bn includes an expectation that authorities also raise funding through the ASC Precept. ASC reform on charging for services and other matters has been pushed back to at least 2025.

6.3. The core schools' budget in England will receive £2.3bn of additional funding in each of 2023/24 and 2024/25. It is estimated that schools per pupil funding will increase by about 5% in 2024/25, this however may not cover the full cost of pay awards and price increases. It also does not remove the pressure on schools with falling or low pupil numbers, which is now at 15 schools in deficit at March 2023 in Westminster. Pressure also continues on high needs funding due to the increasing demand for Education, Health and Care Plans (EHCPs) and other inflationary costs.

6.4. There is no indication from government regarding the thresholds for 2024/25 for housing social rents and council tax (capped at 7% and 5%, respectively for

2023/24). Each 1% increase in the council tax raises additional income of £0.6m.

6.5. The Department for Levelling Up, Housing and Communities (DLUHC) is expected to implement its core funding changes from the Fair Funding Review in 2025/26 alongside any changes arising from the 2021 Census population data and updating of mid-year estimates. This is one year later than previously anticipated.

7. Medium Term Financial Plan 2023/24 to 2026/27

7.1. The MTFP approved at Full Council on 8th March 2023 outlined a total residual budget gap up to 2026/27 of £56.8m. This is summarised in the table below:

	2023/24 £m	2024/25 £m	2025/26 £m	2026/27 £m	Total £m
Annual Budget Gap	0.000	11.435	27.255	18.140	56.830

7.2. The total budget gap is inclusive of £56.8m savings to 2026/27 which were approved by Full Council in March 2023. The updated budget gap assumes that these savings will be delivered in full.

8. Current Financial Position

8.1. The General Fund outturn position for 2022/23 was a net outturn underspend of £3.0m (1.6%) against an approved net budget of £185m. The Council transferred its unspent budget of £3m to general fund reserves. This was a more favourable position compared to earlier forecasts mainly due to increased income from treasury investments.

8.2. The current forecast for 2023/24 is a balanced position against the budget, but the UK's macro-economic outlook remains uncertain over the medium term with several risks and uncertainties over future government funding levels, the fiscal outlook, and the time framework of the cost of living crisis. The Council retains a level of unallocated General Fund reserves to mitigate those risks whilst also having the ability to invest in its priorities.

9. Reserves

9.1. Reserves form an important part of financial planning. Unallocated reserves and earmarked reserves are maintained for two primary reasons:

- To mitigate any uncertainties and risks facing the Council
- To enable investment into the Council's priorities over multiple years in a sustainable manner

9.2. During the Covid pandemic the Council utilised the general reserve to absorb the financial pressures experienced. In total the general reserve reduced by £5.8m between 2020/21 and 2021/22 leaving a balance of £57m to manage any unforeseen circumstances. The Council is looking to rebuild those reserve balances as a risk mitigation measure.

9.3. The current unallocated reserves balance is £60m (or 11% of the gross budget) which is considered a robust level of reserves to manage in year pressures that may arise, particularly in a Council with a high level of income related to economic activity. 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.

9.4. 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 used affectively and where appropriate released for investment in achieving the Council's policy objectives or supporting ongoing savings delivery. The use of earmarked reserves is one off in nature and so cannot be used to supplement the medium term financial plan in an ongoing manner.

9.5. Some earmarked reserves which were originally allocated for other purposes, have been reallocated, and other allocations reduced, to provide short term one-off funding for immediate Fairer Westminster priorities. These were included in the 2023/24 budget proposals and the full year cost of £8.2m per annum, was funded initially through one off reserves and then built into the base budget in future years. This ongoing pressure is mainly picked up in 2024/25. This includes financial support for the Cost of Living Strategy, free school meals and school uniform support.

10. Medium Term Financial Plan: 2024/25 to 2026/27

10.1. 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 uncertainty in forecasting over this period, but it is good practice to set a financial framework within which the Council can effectively plan.

10.2. The budget gap is estimated to be £48.461m up to 2026/27 which is an £8.369m decrease since March 2023 and represents 9% of the Council's adjusted gross 2023/24 budget, the equivalent of 3% per annum.

Core Funding and Grants	2024/25 over 2023/24	2025/26 over 2024/25	2026/27 over 2025/26	Total
	£m	£m	£m	£m
Funding:				
Core Funding and Grants	(12.474)	(0.325)	(4.241)	**(17.040)**
Estimated Loss from Fair Funding Review and Census Impact	0.000	9.000	9.000	**18.000**
Corporate Provisions:				
Capital Financing	3.000	3.000	3.000	**9.000**
Inflation: Pay	4.204	3.038	3.099	**10.341**
Inflation: Non Pay	5.116	5.208	5.208	**15.533**
Provision for Corporate Pressures and Policy Investments	3.000	3.000	3.000	**9.000**
Interest Earnings	3.000	4.000	4.000	**11.000**
Concessionary Fares	1.471	2.324	0.000	**3.796**
Temporary Accommodation additional pressures	5.000	0.000	0.000	**5.000**
Inflation on sales, fees and charges	(3.000)	(2.000)	(2.000)	**(7.000)**
Approved Savings:				
Net Savings approved	(8.725)	(3.635)	(3.615)	**(15.975)**
Fairer Westminster investments:				
Investments in base	5.549	1.393	(0.135)	**6.807**
Budget Gap	**6.141**	**25.003**	**17.317**	**48.461**
2023/24 adjusted Gross Budget				**£527m**
% of adjusted gross budget				**9%**

10.3. The changes since the March 2023 position taken to Full Council are shown in the table below and briefly explained below:

- £5m additional provision for anticipated cost and demand pressures in temporary accommodation for 24/25 onwards;
- further £3m provision in 2024/25 onwards for policy investments and future pressures across service budgets;
- delay of Fair Funding Review / Census population data expected implementation from 2024/25 to 2025/26;
- additional interest earnings in 2024/25 of £3m and £2m in 2025/26 reflecting the position that inflation and interest rates are staying higher than previously expected, and;
- revised forecast for the reduced cost of concessionary fares for 24/25 and 25/26.

	2024/25 over 2023/24	2025/26 over 2024/25	2026/27 over 2025/26	Total
	£m	£m	£m	£m
Forecast Budget Gap as at March 2023 Council	**11.435**	**27.255**	**18.140**	**56.830**
Changes & Variations				
Temporary Accommodation additional pressures	5.000	-	-	**5.000**
Corporate Pressures and New Policy Investments	3.000	-	-	**3.000**
Estimated additional interest earnings	(3.000)	(1.000)	-	**(4.000)**
Revised forecast concessionary fares	(0.865)	(0.774)	-	**(1.638)**
Funding Changes				
Delayed Implementation of Fair Funding Review / Census	(9.000)	-	-	**(9.000)**
Other Grant Funding adjustments	-	(0.465)	(0.809)	**(1.274)**
Council Tax Base increase	(0.429)	(0.013)	(0.013)	**(0.455)**
Revised Budget Gap	**6.141**	**25.003**	**17.317**	**48.461**
Movement in Gap since March 2023	(6.294)	(2.252)	(0.822)	**(9.368)**

10.4. The current medium term financial plan includes an inflationary provision of 3% for pay and 2% for prices for 24/25 and then assumes 2% for 25/26 and 26/27 in line with government's target for CPI. The updated plan has held those inflationary assumptions for both pay and prices although this will be reviewed further during the MTFP review process with reference to inflationary pressures being experienced during 2023/24 and the changing economic backdrop affecting forecasts for future years inflation.

10.5. There is some level of uncertainty on future pay inflation given that the pay award for 2023/24 is yet to be agreed. The Local Government NJC pay award offer at an average of 5% has recently been rejected by the unions. Contract inflation for 23/24 is also being reviewed to ensure that provision for 23/24 onwards is sufficient to cover these pressures.

11. Budget risks and uncertainties

11.1. Local Government Finance

The current Spending Review (SR21) lasts until March 2025. A new Spending Review will be required after the next General Election in 2024. Additional resources have been made available for social care recently, it is not expected that will be withdrawn. The long awaited implementation of the Fair Funding review, together with updating of population data from the Census, is likely to lead to reduced resources for Westminster. The ONS have accepted that the Census was done at a time (2021) that didn't reflect a 'normal' position as it was during the pandemic. The Council is leading Pan-London work to respond to the ONS to capture a more realistic position for the next mid-year population estimate.

11.2. Economic conditions
The risks and uncertainties created from the current economic climate of high inflation and interest rates are set out throughout this report. The provision for inflation has been increased but the conditions will continue to be monitored through the year and updated as required. There is a risk that the additional provision may not be sufficient or that there will be a longer-term impact beyond 2024/25. Financial plans assume inflation returns to the Government target of 2% by 2025/26.

11.3. Service Pressures
Cost pressures in temporary accommodation (TA) are a particular issue currently, although largely driven by external factors outside of the Council's control. Over this last year there has been an unusually sharp increase in the cost of private rented accommodation (over 21%). There remains a risk that this trend continues with lease renewals due in the future. Compounding market supply issues are exacerbating the pressure in addition to the impact of the cost of living crisis, and the end of the Government supported scheme for Ukrainian refugees. There is no current indication that Government is considering any changes to the rent and benefits regime so income levels will remain relatively static, meaning the net cost of TA will continue to increase. Government consultation on changes to the formula for calculating Homelessness Prevention Grant have been postponed, although there is certainty of funding for 23/24 and 24/25 with Westminster seeing small increases of c£0.1m per annum. The Council has allowed £85m to purchase an additional 270 properties for TA to partly relieve the pressure on the revenue budget and to improve the Councils support for homeless residents.

12. Approach to identifying new savings

12.1. New savings of £28.498m were agreed as part of the March 2023 budget over the planning period to 2026/27. Most of these new savings fall in 2023/24 and so it will be important to track the progress of their implementation as part of the current year monitoring arrangements. Further savings will need to be identified as the medium-term planning period progresses to close the updated three-year budget gap currently estimated at £48m.

12.2. The Council has commenced an internal "zero-based" budget review of all service budgets. The aim of the review is, subject to considering the Council's legal obligations, to examine and review council spending based on the outcomes it delivers for residents and communities and ensure they are aligned to the Fairer Westminster objectives and wider policy aims. It is anticipated that the reviews will identify areas for savings and lead to greater value for money in the future. The outcomes from the reviews will feed into the medium term financial planning process in due course.

13. Housing Revenue Account

13.1. 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.

13.2. 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.

13.3. The sections below detail the key considerations for the 2023 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 2024/25 onwards.

13.4. It is likely that there will be a need to provide some short-term investment funding to support the Corporate Housing Improvement Programme in order to achieve the outcomes being sought. There is sufficient flexibility in the HRA balances to do this with the year end balance at March 2023 being around £2.5m above the recommended minimum.

<u>HRA Capital</u>

13.5. 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.

13.6. 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.

13.7. 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), 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).

13.8. The MTFP process will involve a complete refresh of all assumptions that go into the business plan. There is a strategic requirement to maximise HRA borrowing capacity to support the delivery of social and affordable housing, alongside the need to mitigate the impact of high inflation. This means that the HRA will be required to identify savings in the same way as the General Fund to maintain a balanced 30-Year Business Plan.

Rent Setting

13.9. 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 2024/25 being the final year. This stipulates maximum annual rent increases of CPI+1% (based on September CPI). There has been no update on what central government intentions are for social rent policy from 2025/26 onwards. It is also worth noting that a cap of 7% on annual rent increases was enforced for 2023/24 (which superseded the rent policy of CPI+1%).

13.10. 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

13.11. 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 set level of interest cover, and HRA reserves exist to manage short-term shocks. 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 refresh.

14. Capital Strategy Review

14.1. The approved capital programme has a gross spend of £2.4bn and a net spend of £1.2bn over the next fifteen years. This includes a significant housing development and regeneration programme that relies on GLA grant and 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 again this year as part of the medium-term financial planning process.

14.2. 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 assessment into all capital funded project proposals, to maximise the climate benefit of council investments and limit new sources of emissions wherever possible.

15. Dedicated Schools Grant

15.1. The DSG has a cumulative surplus of £1.100m after an in-year underspend of £2.267m in 2022/23. £2.209m of the in-year spend relates to special educational needs and disabilities (SEND) which reflects the Education Banding Tool (EBT) review to cap some of the banding values and the recalibration carried out to amend the other overfunding previously in the system for pupils with Education, Health and Care plans (EHCPs). This also reflects significant work to verify destinations for 160 students previously in post 16 settings to ensure that EHCPs could be ceased and funding for support was no longer an in-year financial commitment. Further work re the post 16 settings in relation to expected costs for 2021/22 resulted in an underspend of £750,000 in 2022/23. It should be noted that there is a trend of increasing numbers of pupils with SEND.

15.2. There are 15 schools (out of 39) with deficit balances at 31 March 2023 compared to 11 last year. Two of the schools with deficits will amalgamate from September 2023 and most of 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.

15.3. The Department for Education (DfE) previously confirmed the Government's ambition that all mainstream schools funding will be via the National Funding Formula (NFF) rather than through local formulae set independently by each local authority. This will fund all schools across the country on a comparable basis. The full move to the NFF is expected within four years (2027/28 funding year) with a gradual pace of change, starting with the requirement to move 10% closer to the NFF factor values in 2023/24. The move to the NFF is likely to lead to some schools benefiting from an increase in funding and others receiving minimal funding increases. The DfE will also review the central school services block which is expected to 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.

16. Timelines

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

Group	Month	Comments
Cabinet	10 July 2023	Financial planning report – review assumptions, set out three-year budget gap and agree savings approach
Executive Leadership Team (ELT)	July to September 2023	ELT, directors, and officers review service expenditure across directorates, identify savings options
Budget and Performance Scrutiny Task Group	September 2023	Scrutiny of Council's Financial Planning approach and priorities
Budget and Performance Scrutiny Task Group	November 2023	Scrutiny of Council's savings and investment proposals
Budget and Performance Scrutiny Task Group	January 2024	Final overview of Council's budget and capital strategy following Government settlement announcement in December
Cabinet	19 February 2024	Agree the 2024/25 budget and three-year MTFP
Council	6 March 2024	Approve the 2024/25 budget and three-year MTFP

17. Legal Implications

17.1. 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.

17.2. 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.

17.3. 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.

17.4. 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.

17.5. 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.

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

17.7. 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.

18. Consultations

18.1. 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.

18.2. The Council is developing an approach to participatory budgeting and this may play a part in the engagement with communities at some stages in the coming year.

If you have any queries about this Report or wish to inspect any of the Background Papers, please contact:

Jake Bacchus, Director of Finance

BACKGROUND PAPERS

Fairer Westminster Delivery Plan (https://www.westminster.gov.uk/delivering-our-plan-build-fairer-westminster)