HIWFRA Full Authority

Purpose: Approval

Date: **6 DECEMBER 2022**

Title: **BUDGET UPDATE REPORT**

Report of Chief Financial Officer

SUMMARY

1. The Authority received a budget report in October 2022 providing an update on the 2022/23 financial monitoring position and the impact of inflation on the service. This report builds upon the contents of that report providing the Authority with an update on the 2022/23 financial monitoring position and the budget setting position for 2023/24.

2. The service continues to face significant inflationary pressures; however, the combination of careful financial management and the use of contingencies means that an underspend against the budget of £0.590m is currently forecast. Further detail is provided in paragraphs 9 -17.

3. The setting of the budget for 2023/24 has worked alongside the development of the priorities for year four of the Safety Plan. As part of this work Executive Group, informed by directorates, have considered requests for additional funding and opportunities for delivering efficiencies.

This report requests approval for changes to the base budget as an outcome of this work.

4. This report provides the best estimates we have currently. The forecast position for the 2023/24 financial year has been updated to reflect information from the 17 November fiscal event. However, until the local government finance settlement in December 2022 the report continues to be based on a series of assumptions. A full MTFP will be produced and presented to the Authority alongside the Budget and Precept Report at the February meeting.

5. The report also provides an update on the Authority's capital investment priorities, with a particular focus on the impact of the capital programme on the revenue budget. A full capital programme update will be included alongside the Budget and Precept Report at the February meeting.

BACKGROUND

6. A series of single year financial settlements have made forward financial planning for the Authority challenging with indications that this approach will continue for next year. This provides challenges to the Authority in planning more than one year ahead limiting the ability to manage its financial position further than March 2024.

7. At the time of writing, there is no specific information available in respect to the funding settlement. Therefore, this report is based on several prudent but realistic assumptions to inform the recommendations being made. Inevitably the final settlement will differ in some respects from these assumptions. Any changes will be reflected in the Budget and Precept report and the MTFP.

8. As part of the developing an MTFP the financial principles for the Authority continue to be maintained and aid financial decision making. These are set out in Appendix A.

2022/23 BUDGET MONITORING

9. The forecast position for the Authority in 2022/23 is an underspend of £0.590m, as set out in Table 1.

Table 1	Budget	Forecast	Over / (under) spend
	£'000	**£'000**	**£'000**
Wholetime Firefighters	37,125	38,499	1,374
On-call Firefighters	8,318	8,057	(261)
Staff	15,041	14,627	(414)
Other Employee Costs	2,179	2,247	68
Premises	8,744	9,553	809
Transport	1,739	2,323	584
Supplies and Services	7,893	7,523	(370)
Third Party Payments	2,792	2,839	47
Income	(3,277)	(4,138)	(861)
Net Service Expenditure	***80,554***	***81,530***	***976***
Contingency	800	-	(800)
Capital Financing	1,529	730	(799)
Net Expenditure	**82,883**	**82,260**	**(623)**
Funding	**82,883**	**82,850**	**33**
Net Position	**0**	**(590)**	**(590)**

10. Inflation is the driver of significant pressures on the 2022/23 budget, amounting to an estimated £1.3m across pay and non-pay costs, net of the use of contingencies. This pressure was discussed in detail in the October 2022 report to the Authority and is summarised in Table 2.

11. Table 2 also summarises the in-year impact of careful financial management, additional income generation and lower capital financing costs in arriving at the forecast underspend of £0.59m, slightly less than the £0.63m forecast at the end of Quarter 1. This is explained in further detail in the paragraphs beneath.

Table 2	Forecast (under)/ overspend
	£'000
Excess non-pay inflation	1,158
Pay inflation	2,509
Pay contingency (3.3%)	(1,526)
Inflation and general contingencies	(800)
Sub-total inflationary pressure	**1,341**
Expenditure budget underspends	(304)
Additional income	(861)
Benefit of lower capital financing costs	(799)
Funding	33
Net position	**(590)**

12. Pay expenditure forecasts are based upon the most recent pay offers from employers to the respective unions for Firefighters and Staff. At the time of writing a pay offer of 5% for Firefighters has been made. A pay offer of £1,925 for Staff (between 4% and 10% depending on grade) has been accepted. Both amounts are above the 3.3% included when setting the budget for 2022/23 last February, which was considered to be prudent at the time. Costs associated with new recruits, overtime and the additional bank holidays are creating further pressures, although vacancies and the removal of the additional 1.25% employers' NI contributions from November 2022 bring down the overall forecast overspend across employee budgets.

13. The forecast overspend on premises relates to inflationary pressures on energy costs (£1.014m), offset by an underspend against the business rates budget of approximately £0.3m as a result of the successful first tranche of a review of the rateable value of sites across the Authority's estate.

14. The overspend against the transport budget is a combination of inflationary pressures on fuel costs (£0.139m), costs associated with staff travelling between sites (£0.092m) and increased repairs and maintenance costs due to increases in the number and complexity of repairs on the fleet (£0.296m). The forecast underspend on the supplies and services budget is most significantly due to savings related to IT systems.

15. Rising interest rates have had a positive impact on the income the Authority generates from investing the cash balances it holds, while the Authority is also benefiting from additional rental and service charge income through its estate.

16. The slower than planned progress with the Station Investment Programme means the Authority has not yet incurred capital expenditure to the level anticipated when setting the budget. This has meant the Authority has not taken on additional external borrowing and therefore has incurred lower interest and Minimum Revenue Provision (MRP) charges than budgeted, resulting in a projected saving against the capital financing costs budget this year. The ongoing impacts are considered in the capital investment priorities section of the report, as is the impact of inflation on the capital programme.

17. The forecast position for 2022/23 also assumes the successful delivery of efficiency measures of £0.8m, largely delivered through careful financial management within the Operations directorate. More detail is provided within the efficiencies section of this report.

2023/24 BUDGET SETTING

18. The process of setting the budget for 2023/24 is underway. Budget setting is inextricably linked to the development of the annual Safety Plan priorities, so these processes run in tandem.

19. The following sections of the report cover efficiency measures, delivery pressures and the capital programme. The overall forecast budget position for 2023/24 is then considered.

EFFICIENCY MEASURES

27. Efficiency measures of £800,000 are on track to be delivered during 2022/23. These have been delivered mainly from careful financial management in the Operations Directorate.

28. The MTFP identified the requirement to deliver further efficiencies of £562,000 during 2023/24. These efficiencies will again be delivered through further work within the Operations Directorate in addition to ongoing savings which have been achieved against the premises budget as a result of successfully challenging the rateable value of building within the Authority's estate. An additional saving has been delivered by the reduction in Local Government Pension Service contribution rates from 16.8% to 16.2%.

29. 2023/24 is the final year of the two-year efficiency plan. Consideration of future efficiencies will be informed by the Medium Term Financial Plan and wider future service planning.

DELIVERY PRESSURES

20. The budget setting process for the 2023/24 budget is being undertaken in extremely challenging circumstances and in a time of great political and economic uncertainty. The Executive Group have carefully reviewed and challenged any identified delivery pressures to ensure that they are essential and support our priorities.

21. Due to the current level of uncertainty, delivery pressures are presented here in four categories:

    a) Base budget increases that are essential to ensure continued high performance during the next financial year

    b) One off investment funded from reserves to support service priorities. These will be funded from existing reserves

c) Additional priorities resulting from the current economic climate that will need to be addressed in the coming years but may not be affordable during 2023/24

d) Priorities that will likely need to be met over the short, medium or longer term but where cost estimates have not yet been developed.

The detail of these delivery pressures is set out within Appendix B. It is recommended that type a) and b) pressures are approved for inclusion in the budget subject to affordability and that type c) and d) pressures are noted.

CAPITAL INVESTMENT PRIORITIES

25. The Capital and Investment Strategy was last presented to the Authority for approval in February 2022 and is updated annually. This document gives a high-level overview of how capital expenditure and capital financing (as well as treasury management and investment activity) contribute to the provision of local services, along with an overview of how associated risk is managed and the implications for future financial sustainability. Alongside this, the Authority prepares and regularly updates its capital programme forecasts, most recently as part of the outturn report to the Authority in July 2022. The Treasury Management Strategy sets out the Authority's strategy for managing its investments and borrowing.

26. The Capital and Investment Strategy explains the available sources of funding for capital expenditure. Three of these sources are capital receipts, capital grants, and contributions from other bodies, albeit the Authority has relatively limited opportunities here and receives no capital funding from central government.

30. Capital expenditure can also be funded through direct contributions from revenue and the Authority does this through annual planned contributions to reserves from the revenue budget, as well as adding one-off amounts to the Capital Payments Reserve when possible. Pressures on the revenue budget do however limit the extent to which this can be done affordably. The Reserves Strategy presented in February 2022 and outturn report in July 2022 identified that although the current reserves balances remain relatively high, existing balances are largely earmarked to agreed priorities, including a significant commitment to the vehicle replacement programme from the Capital Payments Reserve. The vehicle replacement programme is regularly reviewed to identify whether there are any opportunities to reduce the call on reserves, however it continues to be a priority for the organisation to replace the oldest vehicles in the fleet to

maintain operational effectiveness and avoid significant vehicle maintenance liabilities.

31. Prudential borrowing provides a further option to fund capital expenditure, although this results in ongoing costs to the revenue budget. The Authority has agreed that it will only use prudential borrowing where there are clear service or financial benefits (and it will not borrow to invest primarily for financial return) and as a result prudential borrowing of approximately £45m was agreed for the Station Investment Programme. Interest costs and Minimum Revenue Provision (MRP) charges associated with prudential borrowing become a growth pressure on the revenue budget.

32. The latest Medium Term Financial Plan (MTFP) and associated modelling allows for the capital financing costs budget to be increased from £1.5m in 2022/23 to £3.6m in 2025/26 to accommodate increased MRP and interest costs associated with the capital programme plans.

33. The Authority can reduce the impact of the capital programme on the revenue budget if alternative sources of funding can be identified to reduce the planned use of prudential borrowing. Opportunities could arise, for example, if there are gains on the disposal of assets, if earmarked future calls on reserves are not fully required, or if there are in-year underspends against the capital financing budget that could be added to the Capital Payments Reserve. These opportunities should be actively considered if they arise.

34. With the recent increases in interest rates, it is likely that there may be some additional one-off income from investment balances during the next financial year. This income cannot be built into base budgets as investment balances are forecast to sharply decline to deliver capital programme and other priorities. However, if it is not needed to balance the revenue budget, this income could be used to protect the capital programme, either by making an additional one-off contribution to the capital payments reserve or by creating an interest rates risk reserve.

35. Updates on the Authority's estates capital programme and carbon reduction pathway plans are being presented to the Authority in separate reports elsewhere on the agenda for this meeting. A simple summary of the capital programme is however included in exempt Appendix D to this report. A full update to the programme will be prepared as usual as part of the February budget setting report to the Authority.

36. It should be noted that large capital projects can by their nature span multiple years with the exact timing of expenditure and overall project costs always subject to a degree of uncertainty. The Chief Financial

Officer will work closely with the Director of Corporate Services and the Authority's treasury management advisors Arlingclose to closely monitor and forecast expenditure and to ensure external borrowing is taken out in the most cost-effective way possible for the Authority at the point it is needed.

37. Where elements of projects in the approved programme are revenue in nature and do not meet the criteria for capital expenditure, these costs will be charged to the revenue budget and funded from the Capital Payments Reserve. They will continue to be reported to the Authority as part of the capital programme to give a complete picture of the cost of each project against the agreed funding, however within the accounts these costs will be coded correctly as revenue expenditure.

38. The Chief Financial Officer continues to be advised by Arlingclose, the Authority's treasury management advisors, on borrowing decisions. Given the Authority's reserves balances and the fact that expenditure on the Station Investment Programme has not yet been incurred to any significant degree, the advice over the past year has been to continue to 'internally borrow' in the short term (i.e., making use of cash balances) and deferring any new external borrowing until the timing of expenditure and amounts required become certain.

39. The advantage of this strategy is that it means the Authority has been able to avoid borrowing too much and/or too soon, therefore avoiding the associated costs and additional risks, and has not committed to incurring interest costs over the next 50 years on borrowing funds it was not certain would be required.

40. The disadvantage is the exposure to interest rate risk. The macroeconomic environment has changed significantly since the Authority first approved the use of prudential borrowing for the Station Investment Programme, with interest rates for short and long term borrowing now significantly higher than any forecasters had previously projected, albeit expectations over longer term rates have eased somewhat over recent weeks. When the Authority does need to borrow, however, it will potentially be more expensive than if the Authority had done so a year ago, or even 6 months ago.

41. Schemes within the capital programme are also facing inflationary pressures. The outturn report in July 2022 set out that £60,000 from the inflation contingency in the revenue budget would be used to meet inflationary costs on the Fleet Maintenance Centre (FMC) Sprinklers project and a further inflationary pressure of £66,000 has since been identified during delays to the scheme while issues raised by planning

officers were resolved. An underspend on the EV Charging Points project of £160,000 has, however, been identified by the Director of Corporate Services.

42. Paragraph B.17 of the financial regulations within the Authority's constitution sets out that the Chief Fire Officer, in consultation with the Chief Financial Officer and Chairman of the Authority, is authorised to make changes within the overall approved capital programme limits where it is in the Authority's interests, with the changes being reported back to the full Authority.

43. The Chief Fire Officer therefore approved on 9 November 2022 the reallocation of £126,000 of the unspent balance from the EV Charging Points project to fund the inflationary increase on the FMC project. The balance of £34,000 will be returned to the Capital Payments Reserve in addition to removing the requirement to fund the previously identified £60,000 inflationary pressure on the FMC project from contingencies. This will allow the full contingency to be used to meet the identified revenue budget pressures detailed elsewhere in this report.

44. This change is in the Authority's best interests as it has allowed the Authority to secure a time limited price through the tender process and avoid the risk of further inflationary increases to the scheme costs. This will enable the Director of Corporate Services to achieve the objectives of both the EV Charging Points and FMC Sprinklers schemes whilst also returning £34,000 to the capital payments reserve and £60,000 to the revenue budget contingency in 2022/23.

FORECAST BUDGET POSITION

22. With no further information, the position for 2023/24 continues to be built using several prudent but realistic assumptions. These will be revised to take in to account the Local Government Finance Settlement in December.

23. Noteworthy assumptions informing the forecast position for 2023/24 included within this report are:

- 2022/23 pay and non-pay inflation remains in line with the forecasts set out in the October 2022 report
- Inflation forecast to be 5% for non-pay and 4% for pay during 2023/24
- No additional support for inflation is provided by government

24. The October 2022 report assumed council tax would rise in line with the referendum limit of 1.99%. The November fiscal event confirmed that the referendum limit will increase to 3%, so the assumption has been made that the Authority will propose a council tax increase at this level.

25. Billing authorities provide more up to date information on changes to the Council Tax base each autumn. Based on previous years' trends, an increase of 1% has been assumed. No information on collection fund surpluses or deficits is available so an assumption of no surplus or deficit has been made. Any changes to these assumptions will affect the position and will be factored in once known.

26. Reasonable assumptions about pay and non-pay inflation are included as part of the budget setting process. However, inflation on some non-pay items is currently significantly higher than would normally be expected. It is difficult to predict if these elevated rates will continue or if there are short term factors affecting prices. An assumption of inflation equating to 5% has been built in for 2023/24 across all non-pay budgets, however there is a risk that inflation may be different from this assumed level. Inflation forecasts will continue to be reviewed with a further updated included in the Budget Report if inflation forecasts change materially.

27. The Medium Term Financial Plan produced in February 2022 suggested a deficit of £0.189m at the start of 2023/24. The budget update report produced in October 2022 suggested this could increase to £3.985m. The table below summarises changes since the October report:

Table 5	**£'000**
October 2022 forecast budget gap	3,985
Revised inflation assumptions	51
Additional delivery pressures	156
Council tax referendum 1% increase	(545)
Removal of employers 1.25% health and social care levy	(364)
Projected 2023/24 budget gap	**3,283**

28. A slight revision to inflation assumptions as well as the total delivery pressures exceeding the £250,000 that was assumed at the time of the

October report have increased the budget gap. This increase is more than offset by the increased council tax referendum limit and a reduction in employers National Insurance contributions.

29. Assuming that all the assumptions made, including on funding, are correct then the budget gap for 2023/24 could be addressed as follows:

	£'000
Use of Grant Equalisation Reserve (full balance)	1,097
Temporary suspension of Grant Equalisation Reserve contribution	625
Reduction in annual revenue contributions to reserves	1,561
Total mitigations	**3,283**

30. This would mean that £1.561m less would be available to support future investments. However, this approach would give the Authority sufficient time to develop a plan to address the budget gap. In line with the financial principles a reduction in reserve contributions would only happen as a last resort. The projected deficit also relies upon the successful delivery of efficiencies, which are well developed and set out elsewhere in this report.

31. As the detail of the local government finance settlement is not yet available, no further changes have been made to the funding assumptions. However, initial indications suggest that some areas of funding such as business rates may be higher than forecast in this report. Were this to be the case it may allow the Authority to close the budget gap without reducing reserve contributions.

32. Additionally, due to increases in interest rates the Authority is likely to receive additional one-off investment income next year. If this additional one-off income is not needed to balance the budget, then it would be prudent to use this funding to build greater resilience in the capital programme or to build a reserve to mitigate against the risk of rising interest rates.

TREASURY MANAGMENT

45. The Treasury Management Mid-Year Monitoring Report is attached as Appendix C. The Authority has borrowed and invested sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy. The Mid-Year Monitoring Report sets out the performance of the treasury management function from the beginning of April to the end of September 2022 and is a requirement of the CIPFA TM Code.

SUPPORTING OUR SAFETY PLAN AND PRIORITIES

46. Ensuring that funding is appropriately accounted for is vital for all public sector organisations. Good budget management in the past has allowed underspends to be achieved, which have been added to reserves to fund future investment and change activities.

47. As resources are scarce and a good deal of uncertainty remains, it is essential that spend is carefully prioritised and that resources are directed to the highest priority areas in line with the Safety Plan.

CONSULTATION

48. Consultation on the budget proposals will take place with businesses and Unions as part of the budget setting process for 2023/24.

RESOURCE IMPLICATIONS

49. Decisions made in this report will be reflected in the final 2023/24 Budget and Precept Report, to be presented to the Authority in February 2023.

IMPACT ASSESSMENTS

50. The proposals within this report are considered compatible with the provisions of relevant equality and human rights, Data Protection and Health and Safety Legislation.

LEGAL IMPLICATIONS

51. The Fire Authority is required to set a balanced budget and council tax level by 1 March 2023. This report provides background information and initial proposals which will be expanded on in the Budget and Precept report.

OPTIONS

52. The process of setting a budget is a series of options about how best to use the resources available to deliver organisational priorities. This report has provided some information about the proposed options based on the current best available information. Full detail on the options proposed will be provided to the Authority as part of the Budget and Precept Report and MTFP in February 2023.

RISK ANALYSIS

53. Over recent years financial management processes within the service have improved meaning that the risk of unexpected financial pressures has reduced.

54. Uncertainty over the medium term financial position and potential funding cuts are risks identified in the organisational risk register. The outcome of the Budget and Spending Review will impact on these risks. However, the Authority is in a stable financial position and has reserves that could be drawn on to mitigate this risk in the short term while plans to address funding shortfalls are developed.

55. In appendix B various medium term priorities for investment are identified. It is important that the Authority continues to look forward to understand the medium term impact of current decisions as well as the challenges it may face in the future. This is an important part of mitigating risks to the medium term financial stability of the Authority.

EVALUATION

56. This report provides an update to the Authority on the budget setting progress to date. Full details will be provided as part of the Budget Setting and Precept report in February 2023.

57. Evaluation of the impact of the growth pressures and high-level efficiencies will be picked up as part of business as usual processes within the service.

CONCLUSION

58. It is recommended that the Authority consider the content of this report, including areas where there is still uncertainty about the position for 2023/24 and subsequent years.

RECOMMENDATION

59. That the budget monitoring position be noted by the HIWFRA Full Authority

60. That the category a) and b) Delivery Pressures set out in Appendix B be approved by the HIWFRA Full Authority for inclusion in the 2022/23 budget subject to affordability

61. That the category c) and d) Delivery Pressures set out in Appendix B be noted by the HIWFRA Full Authority

62. That the amendment to the capital programme made by the Chief Fire Officer under paragraph B.17 of the financial regulations be noted by the HIWFRA Full Authority

63. That the mid-year review of treasury management activities set out in Appendix C be approved by the HIWFRA Full Authority

64. That the changes to the capital programme set out in exempt Appendix D be approved by the HIWFRA Full Authority

APPENDICES ATTACHED

Appendix A – Financial Principles

Appendix B – Delivery Pressures

Appendix C – Treasury Management Mid-Year Report

Appendix D – Updated capital programme (exempt)

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