Section 25 Report from Chief Financial Officer

Section 25 of the Local Government Act 2003 requires the Chief Financial Officer (the Director of Corporate Operations) to report to the County Council when setting its council tax on:

- the robustness of the estimates included in the budget, and
- the adequacy of the financial reserves in the budget.

The County Council is required to have regard to this report in approving the budget and council tax. It is appropriate for this report to go first to Cabinet and then be made available to the County Council in making its final decision.

Section 25 concentrates primarily on the risk, uncertainty and robustness of the budget for the next financial year but most also look ahead at future years. Given the significance of the medium term forecasts to 2025/26 outlined over the past year and updated in the budget report, this Section 25 report considers not only the short term position but also the position beyond 2023/24 in the context of Government funding and the service pressures we face.

Robustness of Estimates in the Budget

The budget setting process within the County Council has been operating effectively for many years and is based on setting cash limits for directorates each year allowing for pay and price inflation and other marginal base changes in levels of service whether these be the increasing cost of social care or the requirement to make savings to balance the budget.

Individual directorates are then required to produce detailed estimates for services that come within the cash limits that have been set. More recently, the requirement to make savings has dominated the budget setting process and major transformation and savings programmes have been put in place to effectively and corporately manage the delivery of savings within the required timescales, or as is more recently the case, to provide cash flow funding to support a longer delivery timescale for the more complex elements of the programmes.

Appropriate provisions for pay and price inflation are assessed centrally with directorate input and are allocated to directorate cash limits. Specific inflationary pressures within the financial year are expected to be managed within a directorate's bottom line budget but general and specific contingencies are still held centrally in the event that inflationary pressures have a severe impact in any one area (for example, energy costs).

Separate work is also undertaken to assess the demand led areas of service provision, which mainly relate to:

- Adults' Social Care.
- Children's Social Care.
- Waste Disposal.

Any requirement to increase budgets in these areas is considered corporately and may require additional savings to be made across the board to meet the increased demand. This is seen as a more effective way of managing cost pressures and enables strategic decisions to be made about resource allocation and the impact on service provision, rather than these decisions potentially being made in isolation by each directorate.

The budget preparation process for 2023/24 has had a much greater focus on inflationary pressures due to the unprecedented economic conditions that are putting pressure on wage inflation, energy and fuel which in turn is feeding into many of the services that the County Council provides directly or procures from third parties.

Budget management within the County Council remains strong as demonstrated by the outturn position each year since funding reductions began and as reflected in the annual opinion of the External Auditors who have given an unqualified opinion on the annual accounts and in securing value for money / financial resilience.

In producing the budget position for 2023/24 and the forecast to 2025/26 all key elements of the financial picture have been reviewed, including the remaining Tt2019, Tt2021 and SP23 savings. Whilst the Tt2019 Programme is expected to be fully delivered by the end of this financial year, there are elements of the other two programmes which Directors feel are unlikely to be delivered. Whilst activity on these proposals will continue, a prudent assumption of £12.9m of undeliverable savings has been taken into account in the forecasts for 2023/24 and beyond

Budget 2023/24

The budget for 2023/24 has been produced in line with the process outlined in the section above and therefore I am content that a robust, Council wide process has been properly followed and driven through our Finance Business Partners working with the Operational Finance Team. Further oversight is then provided by the Head of Finance and myself, in presenting the final budget and council tax setting report to Cabinet and County Council. This included a significant piece of work to consider all of the additional inflationary pressures that the County Council is facing in 2023/24 which are set out in detail in the December Cabinet report that set the provisional cash limits for the new directorates, linked below:

Financial Update and Budget Setting and Provisional Cash Limits 2023/24 (hants.gov.uk)

This included a further £80m that has been removed from detailed budgets and this is reflected in the directorate summaries contained in Appendix 3. Whilst there are some delivery timescales that extend beyond the end of 2023/24, this is at a much lower level than previous programmes and is supported by cashflow funding as appropriate.

Despite additional funding being made available through the Autumn Statement and the provisional local government finance settlement, the County Council faces a range of increased financial pressures due to workforce pressures, high inflation, fuel and energy costs and further growth in services to younger adults which have added to the significant extra pressure in adult's social care approved within the budget last year.

Clearly the SP2023 savings were expected (at the time) to close the predicted budget gap in 2023/24, but the impact of pay and price inflation and growth in services means that an unplanned draw from the Budget Bridging Reserve (BBR) is required in

2023/24 to balance the budget, which impacts on our usual strategy to balance the budget in the interim year using the BBR (2024/25) before looking to address the gap in 2025/26, both of which are discussed in more detail later in this report.

The robustness of the budget is underpinned by the detailed work that is carried out to predict financial pressures in demand led services and to reflect that properly in the budget underpinned by contingencies as well as by the existence of directorate cost of change reserves, which can be used to meet unforeseen costs during the year as well as providing funding for investment to achieve savings.

Risks in the Budget 2023/24

Since the period of austerity began from 2010, the biggest financial risks related purely to reductions in government funding, and social care demand and cost pressures. Since 2019/20 the County Council has not received any Revenue Support Grant so the risks have shifted towards the extent to which increasing cost pressures outstrip available funding, particularly given the Government control over council tax rises. These items together with other traditional risks are outlined below:

a) **Government Funding and Policy** – The Autumn Statement announced last year did provide additional resources to the County Council, both for 2023/24 and into 2024/25.

   Whilst we therefore have certainty of funding for the next two years, our medium term financial planning horizon extends to 2025/26 and it is difficult therefore what to predict for this year, albeit as outlined later in the report, fundamental change will be required in the next Spending Review if the County Council is to remain financially sustainable.

b) **Social Care Demand Pressures** – This is by far the biggest financial risk that the County Council faces. In last year's budget we saw price increases in the residential and nursing sector of between 16% to 18% and this created full year costs of £35.3m in 2022/23 rising to £45m in 2023/24 on top of the £13.5m per annum we already set aside.

   This year, since September has seen increases in the number of high cost younger adults coming forward for care and this has added £14m to the budget for 2023/24.

   The County Council cannot ignore this potential increase and must budget accordingly, which it has done and must continue to closely monitor actual costs against this position during the year.

   Children's social care continues to experience high levels of 'front door' activity post pandemic and this is increasing costs in a range of areas albeit it is not showing significant numbers of new looked after children. Costs for social workers and agency staff remain high and recurring funding of £9.7m has been added to the budget next year as a continuation of the additional funding for social workers added in response to the post pandemic surge in activity. Without this continued funding, caseloads would rise to unacceptable levels given the increased levels of activity that the County Council is responding to.

   I am therefore content that the budget for 2023/24 contains a realistic assessment of the likely growth we will face in the year, backed up by further contingency amounts and reserves if growth should be higher than forecast.

c) **Council Tax** – The Government has presumed that local authorities will increase council tax by the maximum permitted by the referendum thresholds and on this basis, in line with current County Council policy, the recommended increase is 4.99%, of which 2% relates to adults' social care, in line with the thresholds included in the Autumn Statement and provisional local government finance settlement released in December last year. It should also be noted that this increase is less than half the current rate of inflation.

   This change as I understand will stay in place at least until 2025/26 so provides some certainty for the future albeit it still requires full County Council to agree the increase in each of the years. Nevertheless, from my viewpoint as Chief Financial Officer, given the County Council's predicted financial position, I will be recommending that council tax is increased by 4.99% in each of the years, since without this increase in funding it will increase the gap we face by 2025/26 and place even more pressure on services to reduce spend.

d) **Pay Inflation** – In previous years, this has not been seen as a major issue within the budget especially as wage rates within Council's have aligned to the National Living Wage over time. However, the full year impact of the April 2022 flat rate award has increased costs by some £12m in future years and there are concerns that there will be calls for much higher pay awards as part of the April 2023 negotiations.

   At this time, the County Council has allowed for an average increase of 5.6% in 2023/24, reflecting the Government's call for wage restraint in the public sector next year, but also allowing for the impact of the National Living Wage, which will have a big impact on the lower scales. This does however remain a risk in the budget for the first time in many years and would need to be covered by general contingencies if an award greater than this was agreed.

e) **Pension Costs** – The 2022 Pension Fund valuation has shown a fully funded position against liabilities for the first time since pension funds were required to cover 100% of their liabilities, albeit the 2019 valuation was over 99%. This has meant that overall our employer pension contribution rate has seen a small decrease from 18.4% to 17.8% from 2023/24 onwards, which gives surety for the next 3 years. The County Council decided not to take the full benefit of the surplus position given the downturn in the economy since the date of the valuation and this provides a small buffer against any potential losses at the next triennial valuation.

   What it does also mean is that the £15m deficit contribution that was saved as part of the last valuation and used to contribute to reserves in the meantime is now available to build into the bottom line of the budget and has been taken into account from 2023/24 onwards.

f) **Price Inflation** – This is usually an area of low risk outside the potential increases within social care. However, for 2022/23 we saw a significant spike in energy costs due to global issues with supply. This equated to nearly £7m additional costs for the County Council, which was allowed for within central contingencies but was expected to be temporary.

   During 2022/23 we have seen significant pressure in workforce costs, energy costs and fuel all of which have fed through into the costs of our own direct service delivery and for services that we procure from third parties. The December Cabinet report (linked above) has set out in detail the inflationary pressures that have been taken into account in setting cash limits for next year, which I believe to be robust.

In addition, a specific recurring contingency has been created in 2023/24 for any emerging pressures during the year, which will be allocated on a business case basis. This is in addition to our normal level of general contingency and seems prudent in light of the inflationary environment we continue to face.

g) **Treasury Risk** – The County Council has limited exposure to interest rate risk as most long term borrowing is undertaken on a fixed rate. At the present time we are not undertaking any new or replacement long term borrowing due to the significant 'cost of carry' involved and our ability to internally borrow given our high level of reserves and cash balances. However, we do need to be mindful of the fact that we do not want to store up a large value of external borrowing that needs to be taken out in less favourable circumstances as our reserves reduce. Given current predictions on base rate levels and the fact that long term borrowing rates are based on the price of gilts rather than the underlying base rate, this is still considered low risk at this stage.

The recent rapid changes in the Bank of England base rate have not only meant that we have benefited from increased investment income, this year and next, but has also provided some opportunities for the repayment of debt, which has not been a feature for many years now. This both reduces the debt charges we have to pay and reduces our investment risk exposure as cash is used to repay the debt.

No long term benefit of additional investment income has been taken into account in the 2025/26 forecast as it is expected that interest rates will regularise over time, albeit some economists predict that this will not be at the low levels experienced for at least the last decade. Again this is considered to be a prudent position.

<u>The Adequacy of Reserves</u>

The County Council's policy on general balances is to hold a minimum prudent level which based on the previous risk assessment is around 2.5% of net expenditure. The level of general fund balances was 2.6% of net expenditure at the beginning of 2022/23.

Overall the level of earmarked reserves and balances that the County Council holds stood at £883m (including schools and the Enterprise M3 LEP reserve) at the end of March 2022 and these reserves, the majority of which are held for specific purposes as set out in the Reserves Strategy in Appendix 5, underpin the overall MTFS and the Capital Programme.

Those reserves that are available to support the revenue position are used sensibly to manage change and provide the time and capacity to properly implement savings plans that seek to minimise the impact on service users. Cash flow funding to support the Transformation to 2021 and SP2023 savings programmes has already been included in our financial plans.

What is different this year is that not only do we need to draw from balances to meet the deficit in the 'interim year' 2022/23, but we also have a gap of £53m?? in 2023/24 which will need to be balanced by the use of the BBR. On top of this, if we are to align with the current plan for the medium term, the gap in 2024/25 will also need to be met from reserves to balance the budget. At this point in time, the BBR can only cover the deficit in 2023/24 leaving the County Council some £100m short of balancing the budget in 2024/25.

Whilst this is a concerning position, the very fact that the County Council has a healthy level of reserves means that there are options for using these flexibly in the short term to meet the deficit, which could include:

- Identifying any uncommitted revenue reserves with Directorate cost of change reserves that could be diverted to the BBR
- Temporarily using risk reserves that would need to be re-instated as quickly as possible.
- Borrowing to fund the capital programme or reducing the size of the capital programme to release revenue reserves to add to the BBR.

The last two of these options should be seen as a last resort and the County Council will also need to consider other ways of supplementing the BBR in the intervening period to increase its size before the 2024/25 financial year begins. At the end of this financial year a review of reserves will be undertaken and it is proposed that any early delivery of savings approved in November 2023 is contributed to the BBR rather than to Directorates cost of change reserves. This is a change in the current reserves policy that will need to be agreed by County Council.

Given the flexibility in the total level of reserves that the County Council has and as long as further action is taken to increase the size of the BBR in the run up to the 2024/25 financial year, I am content that there are adequate levels of reserves to underpin the County Council's financial strategy and that there are other options that could be deployed if necessary that give further assurance in this regard.

CIPFA Financial Resilience Index

Following the heightened national focus on the finances of local government due to a number of local authorities experiencing severe financial difficulties and requiring Government support, the Chartered Institute of Public Finance and Accountancy (CIPFA) produced a Financial Resilience Index (FRI) which uses a range of financial information and other factors to generate a series of measures against which all authorities are 'stress tested'.

The Index for 2021/22 has been published, but there are some elements around reserve levels that are missing for Hampshire due to the complication of how to deal with a negative DSG reserve, which we are following up with DLUHC and CIPFA as clearly this is a national issue. Having said this we know that our level of reserves is one of the highest in the country and is therefore one of our lowest risk areas.

There are no material changes to our higher risk areas, the only change of note is that our social care spend ratio (as a proportion of net expenditure) is now relatively higher risk when compared to other similar authorities, reflecting the fact that for 2021/22 the overall net spend figure will have reduced due to Tt2021 savings but the level of social care spend has remained high in relative terms.

I am still content that the results of the FRI reflect what we already know about the financial sustainability of the County Council and is supported by the fact that there are only a few areas flagged as high risk and these remain the same as previous years.

CIPFA Financial Management Code

In addition to the FRI outlined above, CIPFA have also published a Financial Management Code, designed to aid local authorities in assessing and developing their financial management activities across all areas of governance and management.

Full compliance with the code is now required and the County Council has already taken steps to self-assess itself against the code and make a number of improvements and changes to ensure compliance.

As with last year, there remains one standard where our practices are not in strict alignment with the exact wording of the code, which is :

The leadership team monitors the elements of its balance sheet which pose a significant risk to its financial sustainability.

The guidance quotes various specific areas covered by this Standard including:

- Capital investment and the maintenance of assets
- *Long and short term investments*
- *Debt collection*
- *Cash flow management*
- *Borrowing*
- Reserves

Whilst we do not present these items in the context of a balance sheet, all of them are covered through specific or general financial reporting to the Corporate Management Team (CMT), albeit that the items highlighted in italics are delegated to the Chief Financial Officer to deal with on a day to day basis. Having said that they do of course form part of the medium term financial planning carried out through CMT.

I therefore believe that the County Council is still compliant with this item and the code overall.

Budget 2023/24 – Conclusion

Given the details outlined above, provided that the County Council considers the above factors and accepts the budget recommendations, including the need to put of council tax by the maximum permissible (in line with the Government's presumption and the County Council's policy) and the level of earmarked reserves and balances, a positive opinion can be given under Section 25 on the robustness of the estimates and level of reserves for 2023/24.

The Position to 2025/26

The main report outlines the medium term forecast to 2025/26 which has varied significantly since reported in February last year when a cumulative budget deficit of £157m was expected.

Over the year, inflation and service growth pressure have increased the deficit, but following the Autumn Statement a total of £103m of additional resources have been identified through Government grant, business rates and increased council tax levels (assuming they are agreed by County Council) which reduce the forecast deficit to £132m by 2025/26, albeit we do not have any settlement figures beyond 2024/25.

The County Council has consistently stated that unless something is done to address the annual growth in social care costs, that we are not financially sustainable in the medium term, as it is not possible to continually remove money from other budgets to meet the increased demand in these areas.

Whilst the forecast deficit has reduced to £132m, the Corporate Management Team have been reviewing their budgets and options for further savings, on top of the £640m that has already been removed, and concluded that even at the highest level, savings in excess of £100m are extremely unlikely and will have severe impacts on service provision if implemented.

2025/26 represents the first year of a new Spending Review period and it is hoped that the financial case for upper tier local government has already been made to central government given that social care was one of the few services to receive extra funding in the Autumn Statement.

It is therefore still possible that with a combination of :

- Achievable savings
- Legislative change
- Additional government funding in 2025/26
- Use of reserves

That the budget for 2025/26 could be balanced. This is not the same thing however as saying that the County Council is financially sustainable as reserves will need to be used to balance the budget in all the years from 2022/23 to 2025/26. As mentioned in the main report, without a fundamental change to the way in which local government is funded in the next Spending Review (essentially Government needs to fund the annual growth in social care costs or remove the referendum threshold) the County Council will be in the position of not being able to balance its budget within the next Spending Review Period, but most likely in either 2025/26 or 2026/27.

The next Spending Review (likely to be in Summer 2024) is therefore critical to ensuring the County Council's future financial sustainability and this will be the focus of lobbying with central government and our MP's over the coming period.

Rob Carr

Director of Corporate Operations

27 January 2023