

Budget Strategy – Risk Assessment Update

| | |
|---|--|
| Final Decision-Maker | Audit, Governance and Standards Committee |
| Lead Head of Service/Lead Director | Mark Green, Director of Finance and Business Improvement |
| Lead Officer and Report Author | Mark Green, Director of Finance and Business Improvement |
| Classification | Public |
| Wards affected | All |

Executive Summary

The Council delivered a modest revenue budget surplus in 2021/22. At this early stage in 2022/23, we expect to remain within budget for the year. However, future prospects are more uncertain. There are two key variables – the risk of continued stagflation, and how the government responds to the UK’s economic position, in particular how much flexibility it allows local authorities in setting Council Tax. Initial work in developing a budget for 2023/24 has therefore addressed a range of potential scenarios and quantified the impact on the revenue budget under each, in terms of the level of savings that would be required.

This report makes the following recommendations to this Committee:

That the Audit Governance and Standards Committee notes the updated risk assessment of the Budget Strategy provided at Appendix A.

Timetable

| Meeting | Date |
|---|--------------|
| Audit, Governance and Standards Committee | 26 July 2022 |

Budget Strategy – Risk Assessment Update

1. CROSS-CUTTING ISSUES AND IMPLICATIONS

| Issue | Implications | Sign-off |
|---------------------------------------|---|--|
| Impact on Corporate Priorities | The Medium Term Financial Strategy and the budget are a re-statement in financial terms of the priorities set out in the strategic plan. They reflect the Council's decisions on the allocation of resources to all objectives of the strategic plan. | Director of Finance and Business Improvement |
| Cross Cutting Objectives | The cross cutting objectives are reflected in the MTFS and the budget. | Director of Finance and Business Improvement |
| Risk Management | Matching resources to priorities in the context of the significant pressure on the Council's resources is a major strategic risk. Specific risks are set out in Appendix A. | Director of Finance and Business Improvement |
| Financial | The budget strategy and the MTFS impact upon all activities of the Council. The future availability of resources to address specific issues is planned through this process. | Director of Finance and Business Improvement |
| Staffing | The process of developing the budget strategy will identify the level of resources available for staffing over the medium term. | Director of Finance and Business Improvement |
| Legal | The Council has a statutory obligation to set a balanced budget and development of | Director of Finance and Business Improvement |

| | | |
|--|---|--|
| | the MTFS and the strategic revenue projection in the ways set out in this report supports achievement of a balanced budget. | |
| Privacy and Data Protection | No implications. | Director of Finance and Business Improvement |
| Equalities | The Council's budgeted expenditure will have a positive impact as it will enhance the lives of all members of the community through the provision of resources to core services. In addition it will affect particular groups within the community. It will achieve this through the focus of resources into areas of need as identified in the Council's strategic priorities. | Director of Finance and Business Improvement |
| Public Health | None identified. | Director of Finance and Business Improvement |
| Crime and Disorder | None identified. | Director of Finance and Business Improvement |
| Procurement | None identified. | Director of Finance and Business Improvement |
| Biodiversity and Climate Change | None identified. | Director of Finance and Business Improvement |

2. INTRODUCTION AND BACKGROUND

- 2.1 The remit of the Audit Governance and Standards Committee includes consideration of risk. Members have requested that the Budget Risk Matrix and Risk Register be updated and reported to each meeting of the

Committee, so that it continues to be fully briefed on factors likely to affect the Council's budget position.

Current financial position

- 2.2 In 2021/22, income recovered more strongly than expected from the pandemic and the Council generated a modest surplus compared with budget. For 2022/23, there is no more direct government funding to cover the costs of Covid, but the Council has been able to set a balanced budget. Additional provision of £1.3 million was made within the 2022/23 budget for the expected impact of higher inflation on the Council's input costs. At this early stage in the financial year, it is expected that, with this provision, the Council will remain within budget for the year. If at any stage it appears that an overspend is likely, measures will need to be taken in-year to bring the budget back into balance.
- 2.3 The Council's balance sheet position remains strong. As at the end of the financial year 2021/22, unallocated General Fund reserves amount to £9 million. Short-term investments – cash or equivalent – amounted to £41 million. Long term borrowing remained modest, at £9 million.
- 2.4 The Council has an ambitious capital programme, amounting to £230 million over five years. This will largely be funded from external sources, so borrowing will increase rapidly from the current low levels. In anticipation of higher interest rates, the Council has committed to forward borrowing of £80 million, which will be drawn down between 2024 and 2026. This provides a measure of assurance that the Capital Programme remains deliverable, notwithstanding increases in finance costs and potential future constraints on local authority borrowing from the Public Works Loan Board.
- 2.5 In summary, the Council currently enjoys a sound financial position, with a balanced budget and a strong balance sheet.

Future financial position

- 2.6 The prospects for the broader UK economy over the five years of the MTFS period are extremely challenging. The Bank of England projects negligible growth over the next two years and any subsequent recovery will be modest.
- 2.7 Stagnant economic growth will be accompanied, in the short term at least, by high inflation. The Bank of England forecasts that inflation will peak at over 10% later in 2022 before falling subsequently. However, many commentators have challenged whether current policies will be successful in bringing down inflation. The implications of this analysis are that the government and the Bank of England would need to tighten policy more sharply than is currently the case in order to be sure of bringing down inflation. If inflation does not come down in line with projections, policy will have to be tightened eventually in any case.
- 2.8 The two variables which must therefore be considered in constructing budget strategies are therefore (a) the performance of the economy, which is closely linked to the global economy and subject to all the pressures of

war and constraints on energy supplies, and (b) how aggressively the government and the Bank of England respond to rising inflation. The combination of these two variables gives four possible scenarios, as shown below.



Projections for the Council’s finances under each of the four scenarios have been prepared for the purpose of updating the Medium Term Financial Strategy.

2.9 Government policy, as expressed by the funding framework, is a crucial determinant of the Council’s future financial position. This is primarily because central government restricts the amount by which Council Tax can be increased through the referendum limit and it determines the share of business rates that can be retained locally.

2.10 The MTFs projections indicate that the budget can be balanced in 2023/24 without making more savings, provided that the government increases the referendum limit to 5% and the Council takes advantage of this to put up Council Tax by this amount. On the other hand, if the referendum limit is only 2%, as would be the case if the government adopted a stricter approach to local government funding, then the Council would have to find an additional £800,000 of savings, even if it increased Council Tax by 2%, because of the impact of inflation. If it did not increase Council Tax at all, it would have to find £1.1 million of savings to balance the budget.

2.11 It can therefore be seen that the future budget position of the Council is heavily dependent on government policy in relation to the referendum limit on the one hand, and its ability to deliver budget savings on the other.

Delivering the capital budget

- 2.12 There are two main risks associated with the capital programme.
- 2.13 Firstly, the availability of funding is essential to delivery of the programme. Currently, funding for the capital programme is readily available: in the short term, through the market in borrowing and lending between local authorities; and over the longer term, through the Public Works Loan Board (PWLB). There is no indication that the government will withdraw this facility for local authorities, so long as the lending is not for purely commercial investment purposes.
- 2.14 However, it is appropriate to mitigate the risk of dependency on the PWLB, and as set out in paragraph 2.4 above the Council has sourced £80 million of forward borrowing from a private sector lender. This also allows the Council to lock in interest rates as at March 2022 for a portion of its debt.
- 2.15 A second risk to the capital budget is the impact of inflation and supply blockages. Over time, the impact of higher input costs should be reflected in higher returns from capital investment and increases in the value of capital assets. However, the Council is likely to see severe budget pressures in the short term at the level of individual capital projects, requiring additional funding to be transferred within the overall capital budget envelope and reducing the overall amount of funding available. These risks are likely to be exacerbated by Russia's invasion of Ukraine and the consequent impact on energy prices.

External factors

- 2.16 The Covid-19 pandemic shows how vulnerable the Council is to external factors, although in the event the financial impact has been mitigated through government support. The corporate risk register includes risks relating to (a) major emergencies such as a new pandemic and (b) a resurgence of the Covid-19 pandemic. This has been mirrored in the Budget Risk Register.
- 2.17 As already indicated above, the overall performance of the economy impacts both the revenue budget and the capital programme. Higher levels of inflation affect the Council in a variety of ways. The most direct is through contracts which are linked to inflation. The main item of Council expenditure, comprising around 50% of the total, is pay. A recent benchmarking exercise indicates that salaries at Maidstone have fallen behind the policy target of the local government median level for any given grade. It is estimated that an additional £675,000 growth would be required to bring salaries into line.
- 2.18 In light of the risks described above, the following changes are proposed to the budget risk register.

| Ref | Risk | Factor considered | Implications for risk profile |
|-----|--|--|---|
| I | Constraints on Council Tax increases | If the Council Tax referendum limit remains at 2% this would create a large budget gap | Impact – major (increased) Likelihood – probable (increased) |
| L | Collection targets for Council Tax and Business rates missed | Collection levels have been maintained more successfully than anticipated at the outset of the Covid-19 pandemic | Impact – major (no change) Likelihood – possible (reduced) |
| P | Financial impact from a resurgence of Covid-19 | The financial impact from the original Covid-19 pandemic was mitigated through central government support | Impact – major (no change) Likelihood – possible (reduced) |

2.19 Appendix A sets out the budget risks in the form of a Risk Matrix and Risk Register. Additionally, at the Committee’s request, the possible monetary impact of the risks has been indicated. Note that it is very difficult to quantify the financial impact of risks in precise terms. The information is provided simply to give an indication of the order of the risks’ financial magnitude. The information is also set out in the form of a bar chart.

2.20 Members are invited to consider further risks or to propose varying the impact or likelihood of any risks.

3. AVAILABLE OPTIONS

3.1 Option 1 - The Committee may wish to consider further risks not detailed in Appendix A or vary the impact or likelihood of any risks. This may impact the Council’s service planning and/or be reflected in the developing Medium Term Financial Strategy.

3.2 Option 2 - The Committee notes the risk assessment set out in this report and makes no further recommendations.

4. PREFERRED OPTION AND REASONS FOR RECOMMENDATIONS

4.1 Option 2 – It is recommended that the Committee notes the risk assessment.

5. RISK

- 5.1 Risk is addressed throughout this report so no further commentary is required here.
-

6. CONSULTATION RESULTS AND PREVIOUS COMMITTEE FEEDBACK

- 6.1 Each year the council as part of the development of the MTFS and the budget carries out consultation on the priorities and spending of the council. A Residents' Survey was completed for the 2022/23 budget and the results were reported to Service Committees as part of the budget setting process.
-

7. NEXT STEPS: COMMUNICATION AND IMPLEMENTATION OF THE DECISION

- 7.1 The Audit, Governance and Standards Committee plans to continue keeping the budget risk profile under review at subsequent meetings.
-

8. REPORT APPENDICES

The following document is to be published with this report and forms part of the report:

- Appendix A: Budget Strategy Risks
-

9. BACKGROUND PAPERS

None.