REPORT OF DIRECTOR OF CORPORATE SERVICES

Cabinet

3rd October 2022

BUDGET OUTLOOK 2023/24 to 2025/26

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1. PURPOSE OF REPORT

The purpose of this report is to:

1.1. Update Cabinet on the current financial outlook

1.2. Review and agree our financial model assumptions

1.3. Agree savings targets for taking forward the budget preparation

2. BACKGROUND

2.1. The current three year Medium Term Financial Plan (MTFP) was agreed by Council on 2nd March 2022 and was based on estimates of known commitments at that time, and formulated in the context of the Welsh Government (WG) financial settlement for 2022/23, including indicative settlements and years 2 and 3 of the plan and estimates for other key inputs.

At the time of budget setting, the risk of inflation was noted, however the greatest uncertainty at that time was judged to be the unknown impact on ongoing costs and reduced income due to COVID19.

2.2. Since then, there have been a number of significant changes to the external environment which will have a significant bearing on our budget going forward, most notably:

2.2.1. Significantly higher general inflation, which is also expected to last longer, leading to sustained cost of living pressures

2.2.2. Particularly acute increases in energy prices, impacting both transportation costs as well as heating and electricity bills for both households and businesses

2.2.3. A strong response from national unions, including the largest rail disruption for three decades, and confirmed strike action from postal staff, dock workers, refineries as well as widely predicted action from NHS staff

2.2.4. A full relaxation of COVID19 public health restrictions

3. CURRENT POSITION

INFLATION

3.1 UK inflation is being driven by a range of factors:

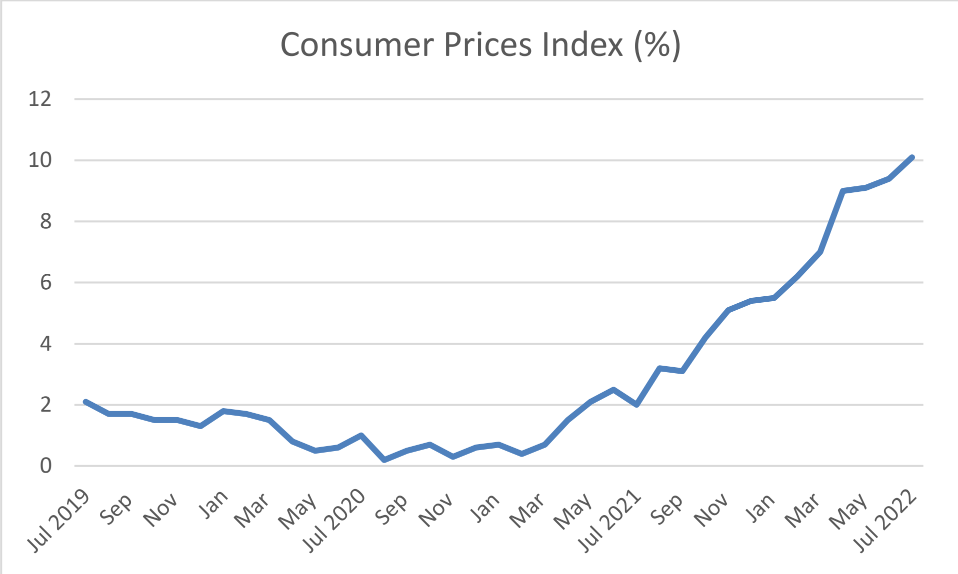
3.1.1. Increased global demand for goods and services as vaccinations have enabled the world to live with COVID19;

3.1.2. Supply shortages, in part caused by China's application of strict lockdowns in pursuit of it's "Zero Covid" policy;

3.1.3. Acute increases in both food staples and energy prices driven by the war in Ukraine. Higher wholesale energy costs not only increase direct transport and domestic prices, but also drive up the price of both manufacturing and transporting goods.

3.1.4. A tightening of the UK labour market, in part due to the effects of Brexit reducing migrant labour.

3.2. Inflation forecasts have changed rapidly in recent months. What was previously expected to be modest and "transitory" is now already at 10% and expected to persist higher and longer. The Bank of England's most recent forecast (September 2022) is that CPI inflation is expected to peak at around 11% following the UKG energy interventions, with economic growth forecasts reduced and forecasting a recession, albeit shallower than would have been the case without the intervention.



Source: ONS

3.3. The COVID19 pandemic led to two years of addition health spending, reduced tax revenues as well as the unprecedented financial scale and duration of the furlough scheme. Public Sector Borrowing for January to June 2022 was c.£66bn compared with just £13bn in Jan-June 2019. The planned increases in national insurance have been subsequently reduced in response to the cost of living crisis, further worsening public sector finances over the medium term.

3.4. Following Boris Johnson's resignation, a new Conservative Government has been formed under Liz Truss as Prime Minister. Support has been announced, capping bills for households and businesses. Whilst some details are not yet clear, the cost has been estimated at a staggering £100bn, around 50% more than the total cost of the Furlough scheme. It is widely understood this cost will be met by increased borrowing.

3.5. In this context, it is reasonable to assume that HM Treasury will need to be cautious when considering the funding envelope available for future years departmental spending – the previous UK Government has already promised a cut to income tax in the run up to the next general election. Having spent extraordinarily during the pandemic, and facing signficantly increased borrowing costs, there are likely to be further attempts to rebalance public sector finances over time.

3.6. Our previous assumption on inflation for 2023/24 was 3%. The largest impacts on the council's revenue budget from the current inflationary situation are as follows:

- Pay – because higher inflation will increase pressure for higher pay awards (and staffing is our single largest expenditure item)

- Commissioned care – because it will affect the real living wage (to be announced 22 September), on which contractual increases are based.

- Energy – despite the additional pressure in 2022-23 budget, our forward purchasing actually mitigated the worst increases at that time. The budget increase required for 2023-24 will certainly be significantly higher – so far between 1/3 and 1/2 of next year's requirements have been purchased – indications are of a possible doubling or even tripling of gas and electricity budgets required £5-10million (vs £700k last year).

- Food – last year we had to provide for a double digit increase in food prices from a local supplier. Based on current trends a further increase is likely to be required next year

BASE CASE ASSUMPTION – INCREASE INFLATION ASSUMPTION FOR 2023/24 TO 5%, WITH PAY, COMMISSIONED CARE AND ENERGY TREATED SEPARATELY

BEST CASE – INCREASE 2023/24 TO 4%

UKRAINE CRISIS

3.7. Following the launch of the "Homes for Ukrainians" scheme in March 2022 and WG's decision to be a super sponsor, there is an emerging funding pressure. We currently understand that education funding will be provided on a monthly prorated basis, but with a cliff-edge at the end of the current financial year. Our estimate is that current arrivals represent around one third of the possible final number, meaning that for the majority of school age children, we could expect to receive less than half of the indicated Year 1 tariff. Additionally members should note that both the main funding support as well as education funding is for Year 1 only, presenting a clear mismatch vs a three year visa.

BASE CASE ASSUMPTION – £1M FUNDING SHORTFALL (COULD BE HIGHER)

BEST CASE – ASSUME FUNDING IS ADDRESSED BY UKG/WG IN 2023/24

STAFFING COSTS

3.7. The April 2021 pay settlement for NJC staff was only agreed in February 2022. As such, the April 2022 settlement is considerably delayed and highly uncertain. Our 2022-23 pay assumption was 4%, which was in line with most Welsh Authorities. In the context of current inflation, this would represent a significant cut in real terms.

The NJC Employers offer is for a flat £1,925 to be added to all pay points. Even if this offer were to be accepted by unions, indicative high level modelling indicates this is more than 3% or approximately £7m above budgetted levels for 2022/23, which will have to be built into next year's base budget. Additionally, the Employers offer includes an additional day's leave, which will lead to additional budgetary costs both for front line service delivery such as waste and social care, but could also require an additional uplift for term time staff in lieu of the addtional leave.

BASE CASE ASSUMPTION – INCREASE 2023/24 NJC PAY AWARD ASSUMPTION TO 5%, WHICH ALLOWS SOME BUDGETARY CATCH UP FROM CURRENT YEAR.

BEST CASE – INCREASE 2023/24 TO 3% (THIS WOULD EFFECTIVELY ASSUME A PAY FREEZE NEXT YEAR)

3.8. The Independent Welsh Pay Review Body recommendation on teachers pay for September 2022 was announced on 21 July (normally early June) is for an increase of 5% this year and an indicative 3.5% next year. The NASUWT has campaigned for a 12% increase in September 2022 followed by 10% in September 2023, as well as additions to respond to current inflation levels. Even if accepted at the current level, we would need to increase our assumption in 2023/24 to "catch up" in budgetary terms.

BASE CASE ASSUMPTION – INCREASE 2023/24 PAY AWARD ASSUMPTION TO 5%, WHICH ALLOWS BUDGETARY CATCH UP FROM CURRENT YEAR.

BEST CASE – INCREASE 2023/24 TO 3%

3.9. Commissioned care budgets have historically been linked to the National Living Wage. Last year saw a step increase, mandated by WG, to the sector paying the Foundation Living Wage which was implicitly funded through an increase in Revenue Support Grant. Next year's calculation (published 22 September) is based on everyday living costs, and is therefore likely to lead to another double digit increase based on increased in household energy, food and fuel costs.

BASE CASE ASSUMPTION – INCREASE 2023/24 FLW INCREASE TO £10.90 (£1 / 10% INCREASE).

BEST CASE - INCREASE TO £10.70 (80p / 8% INCREASE)

COVID COSTS

3.10. With a resurgence in case numbers following the Platinum Jubilee, it is clear that COVID19 has not gone away. We have set aside overall contingency funding of £3.5m. The financial position will be closely tracked as part of budget monitoring, however for budget purposes going forward, the working assumption is that it will be fully utilised but no additional funding will be required .

BASE CASE ASSUMPTION – NO CHANGE

BEST CASE ASSUMPTION – £1M REDUCTION TO REQUIREMENT

WELSH GOVERNMENT FUNDING

3.11. Unless (and until) updated by the Westminster Government spending plans announced in the Autumn budget, the WG funding envelope was largely been set by last year's Comprehensive Spending Review. Their indicative budget allocations provided an increase of 3.6% for 2023/24 and 2.4% for 2024/25. Given the change in inflation, this is likely to prove particularly challenging. It is understood that increased tax revenues (partially driven by inflation itself) could provide the incoming UK Chancellor some additional headroom, but how that might be directed is uncertain.

In addition to the pressure on health budgets, which represent around half of WG spending, the last two years have seen a marked desire from devolved governments to go further to support household finances in "quasi-welfare" payments. Examples are the extension of the Welsh COVID19 isolation payments far outlasting the scheme in England and continuation of Free School Meal payments in school holidays.

Of interest, the Institure for Fiscal Studies (IFS) analysis of Scottish Government's future plans is an 8% drop in real terms of 4 years to departmental spending (excl health), largely to fund a 48% increase in social security spending as more generous Scottish benefits replace UK-wide benefits.

BASE CASE ASSUMPTION – NO CHANGE TO 3.6% INCREASE.

BEST CASE – 2023/24 IMPROVEMENT TO 5% INCREASE

FUNDING PRIORITIES

3.12. With a new adminstration formed in Carmarthenshire following the local government elections in May 2022, a review and refresh of the Council's plans is underway with the development of the Cabinet Vision Statement. Development of the Medium Term Financial Plan will need to reflect any changes in spending priorities including any areas of new funding and the deliverability of planned savings proposals.

BASE CASE ASSUMPTION – BUDGET ALLOWANCE FOR NEW INITIATIVES, THOUGH FIGURE UNKNOWN AT THIS STAGE

BEST CASE – ASSUMPTION THAT ANY NEW INITIATIVES CAN BE MET THROUGH DIVERTING STAFFING/RESOURCES FROM CURRENT BUDGETS

3.13. Due to public restrictions, the last two year's public consultation activities were curtailed to online and paper budget questionnaires and virtual member meetings. It is hoped that wider public engagement can take place for this budget cycle, assuming that there will be no reintroduction of public health restrictions required. It is hoped that member seminars are able to take place face to face to best facilitate what are likely to be incredibly difficult decisions. Should this not be possible, virtual seminars will be arranged as has been the case for the last two budget cycles.

4. CURRENT FINANCIAL OUTLOOK & FINANCIAL MODEL

Budget development always involves assumptions which are refined as the situation evolves and information becomes clearer. As described above, the key assumptions we need to revisit are:

- Pay award levels - both for NJC and Teachers
- Pressures allowed for in the budget – particularly energy and commissioned care
- WG settlement levels
- COVID19 pressures
- Local priorities and spending decisions

5. FINANCIAL MODEL

As was the case when developing the 2021-22 budget, it is impossible to exaggerate both the scale of the financial pressures we are facing, combined with their uncertainty. A small change in either energy prices or the path of inflation could change our forecasts by several million pounds, as would the level of funding provided by Westminster and Welsh Governments. Given this, it is deemed necessary and appropriate to focus all our efforts on the next financial year at this stage. The table below summarises key assumptions:

BUDGETARY ASSUMPTIONS 2023-24

Driver	Previous Assumption	Base Case	Best Case	Notes
Pay (NJC & Teachers)	2.5%	5.0%	3.0%	Assumes "restraint" as outlined by UKG. Next year's budget will effectively have to include "catchup"
General Inflation	3.0%	5.0%	4.0%	Excludes Energy, Pay but includes food (e.g. for school meals)
Commissioned Care	£10.57	£10.90	£10.70	Inflation for lower income households reportedly higher than headline CPI rate (IFS analysis).
Energy	c. £200k p.a.	£6m (+100%)	£3m (+50%)	Based on indicative reports from Crown Commercial Services, recognising still more that half of energy not yet purchased
Fuel	c. £1.4m p.a. (excl sch transport)	£0.7m (+50%)	£0.35m (+25%)	Base case based on increase to c. £2/l diesel
New Political Priorites	Nil	£Unknown	Nil	Possible need to incorporate new service expenditure based on additional priorities within the Vision Statement
Ukraine Crisis funding	Nil	£1m	Nil	Best case assumes resourcing can be managed within funding envelope
WG Funding	3.6%	3.6%	5.0%	Best case, additional funding secured in recognition of pressures

5.1. Service specific grants currently account for around £100 million and it is assumed that EITHER any further reductions are contained within the AEF reduction above OR that activity/expenditure is reduced in line with grant funding. Many grants have historically been "cash flat" in previous years, meaning that inflation, although low nevertheless gradually eroded the real terms value year on year. **This is raised as an acute risk given the current rate of inflation and pay offers**.

There are no signficant planned reductions that officers are aware of, however members should note that existing EU funding streams are stepping down to zero over the plan period, having already been replaced by the Community Renewal Fund (CRF) and Levelling Up Fund (LUF) projects such as Carmarthen Hwb and Towy Valley Path. CRF will be on allocation basis, whereas LUF is a bidding process.

5.2. As for all Local Authorites, the treatment of delegated school budgets has a significant impact on the scale of savings proposals across every other service area. Historically, our planning assumption has been that schools' delegated budgets do not have a specific savings target applied – this is the budget approach we have taken over the last four years, which has protected schools from substantial savings, however these have inevitably fallen across other council services. With the scale of possible reductions so vast, and school balances now showing a substantial surplus position which has increased again during 2021-22, it seems unavoidable that we will need to change our policy and seek savings from schools as well.

CAPITAL PROGRAMME

5.3. The 5 year capital plan was approved by Council in March 2022. Alongside revenue budget development work, a review of existing and new capital projects will be undertaken to inform future development of the five year Capital Programme. It is likely that any projects approved for the Levelling Up Fund will require match funding which will need to be identified.

5.4. Significant and rapid increases in both materials and labour costs in the construction sector is likely to put further pressure on the future capital programme.

5.5. Additionally, members should note there are significant capital costs associated with the Waste Strategy which are not currently included within the Capital programme. Whilst an offer of funding has been secured from WG, it is not yet clear if the full requirements can be delivered within the funding envelope.

5.6. Depending upon how acute the revenue budget pressures are, consideration could be given to a temporary pause on validation of the revenue implications of capital. Whilst possible, this could have a clear knock on impact upon the capital programme so must be very carefully considered.

SUMMARY

5.7. The MTFP model assumes growth pressures of £5.5m per annum for every year. Based on the scale of bids received in previous years, it is imperative this level is not reduced at this stage in the budget development process.

BASE CASE ASSUMPTION – BUDGET GROWTH TO INCREASE BY ADDITIONAL REQUIRED FOR FLW INCREASE

BEST CASE – FLW INCREASE CAN BE MANAGED WITHIN CURRENT ALLOWANCE OF £5.5M

With household budgets already squeezed more than at any time in the last 30 years, the Authority will not want to further add to this pressure any more than is absolutely necessary. As such clearly the ambition will be to keep any increase to a minimum – the council tax assumptions for planning purposes are therefore suggested as:

BASE CASE ASSUMPTION – MAINTAIN 3.4% INCREASE.

BEST CASE (I.E. TO FUND UNAVOIDABLE PRESSURES) – 5.0% INCREASE

5.8. Based upon the above assumptions a financial model has been constructed (see table below) which highlights the impact of the proposed changes, and identifies the likely budget shortfall. Comparative figures from the current MTFP are included for information.

Summary of Financial Model

	Current MTFP			
	2022/23 FINAL	**2023/24 DRAFT**	**2023/24 BASE CASE**	**2023/24 BEST CASE**
Previous Year's Budget	**386.2**	**416.1**	**416.1**	**416.1**
General Inflation	6.4	5.2	8.1	6.4
Pay Inflation	9.4	6.3	12.6	9.8
Other (inc COVID)	5.0	1.5	1.5	0.5
Growth – Energy & Fuel	0.6	Nil	6.9	3.2
Growth - Commissioned Care FLW	3.9	2.7	4.3	2.7
Growth – Everything else	8.4	2.8	2.8	2.8
Ukraine Crisis	Nil	Nil	1.0	0
New Initiatives			???	0
Saving Proposals – Original	-3.7	-3.9	-3.9	-3.9
Net Expenditure	416.2	430.7	449.5	437.6
Revenue Settlement	311.6	322.5	322.5	327.2
Council Tax Receipts	104.2	108.2	108.2	108.2
Shortfall	**0.2**	**0**	**18.8**	**2.2**
Council Tax increase - Original	**2.5%**	**3.4%**	**3.4%**	**3.4%**
Approx CT increase req'd to maintain current savings level (**for illustration purposes only**)			**21%**	**6%**

5.9. Key points:

5.9.1. Uncertainty over inflationary forecasts, and how public sector pay awards respond to the cost of living crisis, make future forecasts particularly difficult. This is exacerbated by the change of leadership and likely ensuing general election following Boris Johnson's resignation. As stated above, our overriding focus must now be on identifying options to deliver a balanced budget for 2023/24

5.9.2. However, even in what is considered the best case scenario, our savings proposals fall well short of what would be required next year, and thus significant work is required.

5.9.3. Following more than a decade of year-on-year budget reductions, it is not credible to think that anything like the base case requirements could be delivered through efficiencies alone. We will doubtless need to look at reductions in service levels, or in some cases possibly entire removal.

Officers will need to assess existing council services against statutory requirements, including not only statutory versus discretionary, but also the level at which statutory services are delivered, recognising that in many cases the council's current offering may be more generous that the legislative requirement.

6. BUDGET PREPARATION FOR 2023/24

6.1. The financial model tabled above will be updated as and when more information becomes available, key amongst which will be the provisional settlement, currently expected from WG in December 2022. This will be influenced by the UK autumn budget (date unclear typically Oct/Nov).

6.2. As part of the current Medium Term Financial Plan, Departments are requested to update their efficiency/service rationalisation proposals for 2023/24. This includes identification of concrete and deliverable proposals to meet the best case requirement of £6.1m, along with an appraisal of possible service reductions for consideration, depending on the scale of the requirement.

6.3. Officers will continue to refine the budget projections taking account of inflation factors, other pressures that may be identified and funding options/clarification.

6.4. In Person Member seminars on budget proposals to be convened in January 2023.

6.5. Public consultation on the budget proposals to take place in January 2023. Specific consultation methods will need to reflect any possible COVID19 alert level prevailing at the time, but additional efforts will be made to engage as widely as possible given the scale and importance of the challenge ahead.

6.6. Scrutiny Committee consultation in January/February 2023.

7. RECOMMENDATION(S)

It is recommended that:

7.1. Cabinet critically review the assumptions contained within the paper to agree a consensus for budget development, recognising the scale and uncertainty of the challenge ahead.

7.2. At an absolute minimum, it is agreed that **concrete and deliverable** proposals are developed to meet the best case savings requirements of **£6.1 million.**

7.3. Furthermore, areas for service reductions are identified in broad terms above the minimum £6.1m target, recognising many of these may be highly undesirable.

7.4. Cabinet and Corporate Management Team to attend a budget development awayday in October to review budget reductions proposals and reconsider any change in assumptions based on updated information.