Chelmsford City Council Cabinet

18th October 2022

Financial Update Report

Report by:

Cabinet Member for Fairer Chelmsford

Officer Contact:

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Purpose

The purpose of this report is to provide an update on the Council's financial position which has been adversely affected by a very significant rise in inflation that has reached 40-year highs as well broader economic disruption. The report also includes a number of recommended actions.

Options

After consideration of the updated financial information, to:

1. Approve the actions identified and note the update,
2. Note the update and amend the actions, or
3. Approve the actions identified and note the update

Preferred option and reasons

Approve the actions identified and note the update

Recommendations; that Cabinet

1. note the updated financial projection.
2. ask Directors to undertake an urgent review of fees and charges
3. approve the additional capital expenditure identified in Appendix 1 paragraph 1.24

1. Introduction

The Council-approved (July 2022) Medium-Term Financial Strategy (MTFS) for the period 2022/23 – 2027/28 provides a financial framework to support delivery of the Council's priorities as set out in "Our Chelmsford; Our Plan".

This report provides an update to the MTFS, as the financial position has worsened as a result of national and international events. The chief cause is the prolonged levels of very high inflation.

The Council also faces considerable uncertainty on key elements of its current and future budgets.

The figures contained in this report are projections and will be subject to revision, as the Council is in the process of compiling a detailed 2023/24 budget. However, all indications are that the Council faces very significant budget gaps for the current and future years.

The problems the City Council is facing are not unique. Analysis undertaken nationally by Grant Thornton, who forecast budget gaps for 2023/24 for different tiers of councils, shows that similar councils across England are also grappling with very large budget gaps. Moreover, the Government has made plain that, unlike with Covid-19, we should not expect a national solution to these problems in the form of increased Government grants.

2. Executive Summary

2.1 The exceptionally difficult financial position the Council faces has arisen broadly as a result of:

a) I**nflation of 10%** - The UK economy has not experienced such high levels of inflation in 40 years. The impact on the Council's budget has been significant in a number of areas that are discussed in the report but include higher vehicle fuel costs, especially in waste collection and recycling services, increased energy costs in all our buildings but particularly in leisure centres, higher than budgeted pay award (the national pay award for Council staff will result in an increase of staff costs of nearly 7% as a third of Council staff would otherwise have been paid less than the national living wage) and investment project costs (capital expenditure). Based on current projections, the cost of Waste and Recycling Service could increase by £22k per week and Leisure Centres £36k a week in 2023/24. The context for these variations is that a Council Tax increase of £5, the maximum allowed before referendum, generates an extra £350k in a whole year (less than £7k per week).

b) While the Government has announced Support for Energy Costs, this seems to be designed to prevent costs escalating even higher; it remains unclear if it covers the rises that have already occurred. Moreover, both the level of support and whether it will continue into 2023/24 remain uncertain.

c) Government Funding uncertainty – The Government announced earlier this year that it would provide a two-year funding settlement, raising hopes that it had taken into account the need for local authorities to plan ahead. But it has now asked all departments to seek savings, putting this in doubt. This may place significant further pressure on the Council's budget.

d) Interest Rates – higher rates impact on investment returns and borrowing costs.

2.2 The impact of these issues is discussed in the report, in Appendix 1. The Council faces an increasingly challenging position. On a like-for-like basis, since the MTFS was published, the forecast deficit for 2023-24 has risen from £4.2m to £7.9m. However, this report identifies a range of measures and assumptions that could be taken to reduce the deficit to £2.1m.

2.3 The Cabinet will receive updates next month on current year (2022/23) capital and revenue expenditure. Present indications are that a revenue overspend of up to £2.5m is possible (before allowing for business rate retention gains). This figure assumes that the pay award is agreed in line with the national offer to Council staff; a significant part of the foreseeable overspend is £1.5m of pay, reflecting the high-inflation environment.

2.4 There are large forecasting risks in the projections for 2023-24 and future years, given the volatility in the economy. This report is an update based on current data, but it does not provide comprehensive modelling of those risks. It should be noted that Services are currently completing detailed budgets which will determine the actual budget gap. At the same time, officers are working with Cabinet members to identify ways in which the Council can achieve a balanced budget for 2023/24.

2.5 At the time of drafting, it is expected that the use of unearmarked reserves in 2023/24 will be higher than normal. This use is in line with long-held Council policy that reserves are used to deal with financial uncertainty, as it is not possible to budget at the worst-case level. Also, another purpose of reserves is to enable large financial adjustments to be dealt with over several years rather than one, so providing a more effective response and outcome.

2.6 There are higher levels of risk than in previous years from inflation generally (pay increases are needed to retain staff, energy prices) and the ongoing lack of clarity of Government funding. Energy costs and Government funding are likely to remain unresolved beyond the point the Council is able to amend its budget planning for 2023/24, therefore the use of reserves is likely to be necessary.

2.7 Given the uncertainty and the need to set a balanced budget proposal in January, the MTFS published in summer 2023 will provide an opportunity to review the use of reserves in 2023/24 at a time when there should be more information specifically on energy costs and government funding.

2.8 The level of potential overspend in 2022-23 would involve significant use of reserves which would diminish them at a time when they are likely to be needed to underpin the budget proposal for 2023-24. Action therefore needs to be taken urgently to limit the scale of the overspend in 2022-23.

2.9 The report identifies a number of actions, which can be summarised as:

- Increasing capital budgets to resolve the inflationary pressures experienced with building materials and labour costs and to manage supply chain problems
- Seeking an in-year review of Fees and Charges increases in light of higher cost pressures/inflation

3. Conclusions

3.1 The financial position of the authority has become increasingly challenging reflecting the economic and political situation nationally and internationally.

3.2 The Council will set a balanced budget but is likely to need to find significant savings and use reserves to fund pressures in the short term and manage risks.

3.3 Energy and Government funding assumptions could alter drastically late in 2022. Large changes will be almost impossible to manage within the timing of the 2023/24 budget process. The MTFS report to Council in summer 2023 will give an opportunity to determine whether changes to the 2023/24 budget will be necessary on the basis of more solid information becoming available.

3.4 Meantime, action is needed to reduce the scale of the inflationary overspend in the current year and protect the level of reserves.

Appendices:

Appendix 1 : Financial Update

Appendix 2 : Core spending Power

Background papers: None

Corporate Implications

Legal/Constitutional: The Council is required to set a balanced budget. The Medium-Term Financial Strategy sets out the framework for this to be achieved.

Financial: A robust financial strategy is essential in the delivery of the Council's objectives over the medium term, ensuring decisions are taken with due regard to their financial consequences. This report supports Medium-term financial planning, which is a key element in determining the organisation's future resilience.

Potential impact on climate change and the environment: This will be considered as part of the detailed budget setting process.

Contribution toward achieving a net zero carbon position by 2030: As above.

Personnel: The financial strategy, and the development of detailed budget proposals, is supported by the Council's values and behaviour framework, which promotes a culture of responsibility and accountability.

Risk Management: Due regard to the Council's Principal Risk Register should be had when considering its budget plans, financial forecasts and level of reserves. The production of, and adherence to, the Strategy mitigates the risk of financial failure. Challenges to the Council's financial position are reflected in the Principal Risk Register, while the financial impact of other risks are considered within the Principal Risk Register as appropriate.

Equality and Diversity: Equality Impact Assessments will be considered as part of the detailed budget setting process rather than at the strategic level, to enable comprehensive assessments to be undertaken where necessary.

Health and Safety: None

Digital: None

Other: None

Consultees:

Cabinet Members, Chief Executive and Directors, Monitoring Officer

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Relevant Policies and Strategies:

Our Chelmsford: Our Plan

Medium Term Financial Strategy 2022/23- 2027/28

Capital and Investment Strategy 2022/23

Financial Update

APPENDIX 1

It is important to establish some context to the costs in this report:

- ❖ The maximum Council Tax increase allowed before a referendum is currently £5, which would generate £350k extra in 2023/24 and this has already been factored into financial planning
- ❖ Every 1% increase in pay results in additional costs of £360k
- ❖ A 1% increase in all non-statutory fees and charges would generate £200k

The following sections provide an update on how the financial situation has changed since the July MTFS report.

Inflation – Rising Costs

1.1 **Energy costs.** The Council is a significant user of gas and electricity. The budget for 2020/21 was £1.1m, and the costs have risen to £2.4m in 2022/23 (current year) with further increases projected for 2023/24.

1.2 The largest consumer of energy at the Council is leisure services, which accounts for approximately 50% of the Council's total energy consumption. The estimated cost of energy use in 2022/23 for our sports centres is £1.06m, reflecting an increase of 95% for gas and 90% for electricity in that year (allowing for some estimated change in usage). This equates to an extra £10k a week to keep our leisure centres open in 2022/23.

1.3 The Council purchases its energy through one of the largest joint frameworks in the UK (the Government's procurement agency Crown Commercial Services). The Council achieves significant economies of scale through this agreement. Existing evidence suggests that 2023-24 energy prices are up circa 190% gas and electric 115% over the cost of the 2022/23 contract. The estimated extra cost across the Council without Government support is nearly £3m.

1.4 Forecasts of energy costs show significant volatility, and the Council energy costs may not be known in full until March. Budgeting an appropriate amount for energy is therefore difficult.

1.5 The Government support package is discussed in another section further below.

1.6 **Actions – Energy Costs:** Officers will continue to heat and light leisure centres in the most energy-efficient way balanced against service need. Additional meters are being installed to provide more detailed monitoring. Officers will be using this additional information to try to identify further savings on energy use.

1.7 **Pay.** The Council's 2022/23 budget included £35.5m of funding for all staffing costs, some 60% of all expenditure (total spend £59.5m excluding benefits).

1.8 The 2022/23 budget included funding for a 2.5% increase in pay (£0.83m extra in 2022/23). To ensure the Council met it obligations under the Living Wage legislation, the 2.5% was awarded as an interim measure on the 1st April 2022, subject to further negotiation.

1.9 The Council does not belong to the national bargaining arrangement, but it is a factor in determining City Council pay, as is the local jobs market (which is heavily affected by London pay rates, much more so since hybrid working). The national Local Government pay award for 2022/23 is likely to be a £1,925 flat payment to all staff.

1.10 The Chief Executive, following consultation with the Leader of the Council, believes that it would be unsustainable if pay were not to increase to the higher of £1,925 or 2.5%, whichever is the greater. The risks of not doing so would be inability to consistently provide fundamental services such as Waste and Recycling collections in future due to retention and recruitment difficulties. This equates to just short of a 7% increase (£2.3m) in the £35.5m pay-bill. This represents an increase of £1.5m over the funding included in the 2022-23 budget.

1.11 The 2023/24 pay award would normally be forecast to be 2%, however, high levels of inflation and tightness in the labour markets mean that it is likely that this level of pay increase will be too low. It is currently assumed that a pay award of circa 5% might be needed to ensure staff retention and continued provision of services. The cost of a 5% pay award next year would be an additional £1.8m on top of this year's £1,925 flat award cost (at cost of £1.5m extra). Over the summer, officers started to plan on this basis, however, affordability has become an increasing issue.

1.12 A 5% pay award currently looks unaffordable for 2023/24 and for planning purposes it is necessary to assume a 3% increase instead. This has the impact of reducing the forecast cost by £720k. The Council's planned pay increases do meet forecasts of National Living Wage (NLW) for 2023/24 but there is a risk that NLW rates could be higher than expected, resulting in extra costs.

1.13 The total expected cost of pay inflation between the 2022/23 budget and this projection for 2023/24 is £2.6m per year.

1.14 **Actions – Pay:** The Chief Executive is likely to seek an urgency action for a decision on Council pay, to increase the staff pay award from 2.5% to the higher of £1,925 or 2.5% in 2022/23. Plan for 3% level of pay cost increase in 2023/24, recognising this may not be sufficient for staffing recruitment and retention but reflects affordability constraints.

1.15 **Vehicle Fuel.** The MTFS allowed for increased fuel costs totalling some £300k. The current projection is currently somewhat lower than that.

1.16 **Action - Vehicle Fuel:** As recommended in the MTFS, use reserves to fund additional fuel costs. Some £600k has been set aside in financial planning for this purpose.

1.17 Investment Project Costs (Capital Programme)

1.18 The Council's capital investment programme is funded from internal borrowing, receipts, contributions and grants. Once internal resources have been used it will be necessary to undertake external borrowing. When we borrow, there is a cost to the revenue budget of funding the capital programme. This revenue cost it is made up of MRP (Minimum Revenue Provision, the annual repayment of a loan) and interest. The Council's Capital programme has, like the revenue budget, been affected by inflation and supply-chain issues. Below are the material areas where budgets need to be increased for completion of schemes. Cabinet is being asked to approve some of these budgetary increases.

Borrowing calculations have been based on PWLB rates. Loss of interest on the use of resources has been calculated using 4%.

1.19 Theatres Improvements: In the current economic climate, the scheme for the refurbishment of the Front of House and Bars in both theatres has faced significant pressures on both the programme and budget.

- The scheme is delayed due to supply-chain challenges, exacerbated by world events, resulting in longer lead-in times for materials. This has also resulted in increases in the project cost and has led to inflation against the budgeted cost of items with some suppliers.
- There has been a larger volume of unexpected refurbishment issues, in part due to the age of the building, many of which could not have been anticipated.
- There has also been the need to increase spend on external consultants to deliver the project, due to the complexity of the issues uncovered as the project progressed. The appointed consultants have actively sought compromises and alternative shorter lead-in time solutions where possible with the appointed contractor.
- The current forecast cost from our QS to complete the scheme is estimated as £3.246m and the approved budget is £2.746m. An additional £500k, 18%, is therefore requested to be added to the approved budget.
- As a consequence of the delays, the works have now over-run, so cancellation/deferral of some performances has been necessary. There is a cost associated with this. The key financial variance against the 2022/23 revenue budget will be from the cancellation of Pantomime which is circa £440k of lost income.
- The additional ongoing revenue costs of the project will be to increase annual MRP by £15k in the first year. If funded from borrowing the cost for interest and repayments is estimated as £40k per annum ongoing.

1.20 Refurbishment of commercially leased property (Aquila House): The capital budget was increased to £1.1m in November 2021 following a review of the scheme by external consultants. Officers have now received the tender results for the scheme. Based on the returned tenders, the costs of the project including fees have been identified as £2.2m, an increase of £1.1m, which the consultants have identified as a consequence of the current construction market conditions. Aquila House, when let, is expected to generate rent of £400k a year. Without the works, any reletting will be exceptionally difficult due to post-pandemic changes in demand in the letting market. On completion of the refurbishment and when the property is let, its value will be around £5.5m compared to the value in its current condition which is around £1.6m. The revenue cost of financing the project is £176k. Resulting in a revenue surplus of £224k a year when fully let. The approval of the additional spend likely to require Urgency Action, in order to meet the timescales for the tender.

1.21 Tindal Square: The approved budget for Tindal Square is £3.838m, including a 10% contingency on construction and utilities costs.

- Since construction started in January 2022, there have been a variety of pressures on the scheme, which at this stage of the build are estimated to add a further £485k over and above the scheme contingency budget of £300k, bringing the final outturn full cost to £4.323m.

- The reasons for these cost increases are multiple, complex and interrelated, but many are a result of a combination of inflation, BREXIT and COVID, which in combination have added in delay and additional project costs.
- Most of this additional cost can be mitigated through an additional grant of £450k from the Government's Getting Building Fund, via SELEP, the bid for which was submitted in late August, and the use of an additional S106 contribution held by the Council. The decision on the grant application will be known later in October.
- If grant is not awarded to the Council, then the cost would be £19k in lost interest on assumed CIL funding. External borrowing would be £34k per annum in interest and repayments.

1.22 Waterside Infrastructure: This update is not intended to seek budget approval.

- The Chelmer Waterside project is progressing well. The access road and bridge are at stage 1 of a target cost contract which is establishing the detailed technical design and cost. This stage will be completed in June 2023 when the full cost should be known.
- The potential for cost increases is high. Currently there is a risk of errors in forecasting costs in in the £ms, reflecting the difficult economic conditions. However, our external consultants now expect costs to be significantly higher than the Capital Programme has allocated. There is insufficient certainty to forecast the final budget requirement or update the Capital Programme but members should be aware that the additional costs are currently thought to be £5m-£9m, mostly for the bridge. The price of materials is the largest factor.
- Members would need to approve any cost increases after stage 1 has reached completion, when the business case will be updated. By then, it should be easier to forecast the gains the Council can expect to generate from what is expected to be a self-funding scheme.

1.23 Chelmsford Sports and Athletics Centre Improvements (Approval of new scheme not a consequence of inflation)

- This proposal is to replace the surface of the outdoor athletic track at Chelmsford Sports and Athletics Centre (CSAC) which is in need of replacement and scheduled for 2023/24. At the same time as the track is closed it would be sensible to take the opportunity to upgrade other external areas (such as some surfaces and toilets).
- The track was installed in 1998 and has had remedial works to extend its life in 2011 and 2018. Replacing the surface will ensure Trackmark Certification and provide a long-term safer solution and be in line with Athletics England guidelines.
- A final decision on timing will be taken in the next few weeks. The Budget permitting, the optimum time to commence works is March 2023 as this will minimise disruption and allow the track to be laid in the optimum conditions. To facilitate this, it is essential to raise an order for the track works in November 2022. There are long lead-in times and approval needs to be obtained prior to the order being placed for the track as this will enable a period of coordination of works with the appointed contractor. The works are

scheduled to take place between March and May 2023 with a resulting loss of income during the period estimated to be £4k.

- The cost of the track and external upgrades is estimated as £350k.
- It is agreed elsewhere on this agenda to use £300k of S106 contribution towards the resourcing of improvements at CSAC.
- The net capital cost to the Council after applying the S106 will be £50k. This could be reduced further, once a review of Section 106 contributions is undertaken as part of financial year-end.
- The loss of interest to the Council is £14k per annum. Should external borrowing be used to fund for the potential net cost of £50k (£350k scheme cost less the £300k S106 funding) there will be £5k per annum cost for interest and repayments.
- A further request will be made for improvements to the gym and studio and will be included with the requests for new capital schemes at January Cabinet.

1.24 **Actions – Investment Project Costs**: Recommendation to Cabinet to approve the following:

Increases in Budgets:- Theatres Front of House Improvements £500k and Tindal Square £485k
An additional scheme for the replacement Track at CSAC £350k.

And to note the following:-

- Increase to budget for Commercial Leasehold Property Refurbishment £1.1m for which approval will be sought under Urgency due to level of increase being over £1m
- the risk of higher costs for the Waterside redevelopment.

1.25 **General Inflation.** The Council has suffered from inflation on various supplies and services, e.g. software licences, maintenance contracts, postage, etc. Allowance was made (£0.2m) in the MTFS for some inflation and it will only become clear in the next 2 months whether that provision was enough.

1.26 **Action – General Inflation** Determine within the budget process whether service budgets have sufficient provision to cover inflation on general items of expenditure.

2.1 Interest Rates

2.2 The Council is exposed to the effects of rising interest rates in two ways

- The Council currently has cash holdings, mostly from having revenue reserves and capital contributions received (e.g. Community Infrastructure Levy). This cash is invested to generate income. The budget for 2022/23 was some £700k on income but is now expected to be at least £1.2m. This shows the benefit of rising interest rates. For 2023/24 budgets, the Council has to forecast cash holdings and expected interest rates. This is a process that is currently taking place. It should be noted that deferring expenditure would mean higher cash balances and therefore higher income.

- ➢ The Council currently funds its investment (capital programme) mostly from cash which is 'internally borrowed'. In the next 2 years, the Council is expected to exhaust the supply of internal borrowing and will have to borrow externally. This is quite normal for local authorities. The cost of undertaking capital schemes should now be assessed against external borrowing rates to enable a smooth transition to external borrowing. As interest rates have increased, the cost of capital projects has therefore increased.

2.3 The extent that interest rates will rise is relatively unpredictable. Most commentators appear to believe 6% is the maximum level likely in the short term. However, they may subsequently settle to perhaps 2.5% to 3% in the medium term as inflation falls.

2.4 **Actions – Interest Rates:** For now, the Council should plan on the cost of interest increasing to 5-6% for its projects (internal or external borrowing). The Council will review its capital investment plans to ensure that they remain affordable and any recommendations will be made in the Budget process.

3.5 Government Support for Energy Costs

3.6 Assuming the Council were to buy all its 2023/24 energy at September 2023 prices, the additional cost over 2022/23 contract prices would be £3m. However, the Government has announced some support to non-residential energy users.

3.7 At the time of writing, what we know of the support package is as follows:

- The government has proposed a 6-month scheme, with a review after 3 months. The support for the 2023/24 budget is only likely to be known to the Council just as or after it sets the budget. This makes budgeting almost impossible given the size of the cost increases.
- The 6-month cap covers organisations against a capped wholesale price. Our energy supplier has not yet provided sufficient data to allow a calculation of any potential benefits.
- The guidance indicates that support will likely only continue for "the most vulnerable non-domestic customers" and highlights that "It is important that users who are less vulnerable to energy price increases (particularly larger businesses that are not energy-intensive) use the 6 months support provided by the scheme to identify measures they can take to protect themselves against high energy prices".
- Access to the government support depends on meeting certain criteria. We do not yet know whether the Council contract falls within these criteria.

3.8 When more information is known, it may be possible to make an assumption on the extent of the budget pressure next year. Meantime, there are two options for financial planning:

- Make an assumption about 2023/24 energy prices and the levels of Government support. Set the budget on the assumption that Government support for the Council will cease by March 2023. This of course carries the risk of budget cuts being made that are either too low or too high.
- Use reserves to cover some or all the risk of higher costs. The Council reserves would likely fall below the level recommended by the Section 151 Officer (£9m), though not catastrophically. Additionally, use of reserves is a time-limited option which may defer the financial consequences of higher energy bills until longer-term solutions are found nationally. Clearly, the use of reserves could defer the problem.

3.9 Currently the unknown costs of energy, the six-month life of the scheme and the lack of clarity over ongoing arrangements mean the Council cannot set a budget for 2023/24 and wait a whole year before revisiting the issues of affordability. The use of reserves would seem the best solution at this time to fund excessive energy costs. This should be reviewed in the July 2023 MTFS in light of more certainty about Government support and prevailing energy prices. A regular review may need to become a feature of in-year budget monitoring.

3.10 **Action – Energy**: That financial planning allows for reserves to be used to manage additional financial risk on energy. This assumption will be revised as necessary during the budget process and during the year 2023/24.

4.1 Government Funding

4.2 The Government committed to reviewing local Government funding for 2023/24, however, the commitment cannot be met as consultations would need to have started by July to make major changes. In appendix 2, there is an explanation of how the Government measures the financial resource of each local authority. This is called core spending power.

4.3 Up to the time of the publication of the MTFS, the Government had committed to reviewing Local Authority funding for 2023/24. However, these consultations did not take place. Given there should be no major review of funding allocations, it was possible for officers to re-consider the forecast for 2023/24 Government funding over the summer. Officers consider it likely that the Government would keep to its commitment to fund councils in line with core spending power. This would enable, at least for 2023/24, £1.8m of additional funding to be built into the base budget to help meet the projected budget shortfall. This judgement reflects Government statements in 2021, including: “Core Spending Power for local authorities is estimated to increase by an average of 3% in real terms each year, including investment in Adult Social Care reform. By 2024-25 it is expected to rise to £58.9 billion. This increase in Core Spending Power follows year-on-year real terms increases since Spending Review 2019.”

4.4 The internal planning for the 2023/24 budget since August has included this additional £1.8m of funding which helps offset the increased financial pressures on income and energy/pay/inflation identified since the MTFS.

4.5 However, the Government’s very recent announcements seem to indicate a need in Government to find efficiency savings whilst sticking to cash-limited spending totals. The position therefore is now less certain and a further financial statement is planned by the Government on 31 October.

4.6 The City Council may not know its funding position for 2023/24 until late December 2022. The budget therefore will be created on an assumption regarding funding that could be significantly different to the actual funding provided. It may be necessary during 2023/24 to find savings to deal with reduced funding, as currently identifying and implementing £1.8m of savings would be premature and damaging to the public, potentially requiring significant reduction in services.

4.7 Business rate retention. The Government sets a baseline level of business rate income for an area. If business rate income is above that level, a council gets to share some of that growth. The Government had proposed resetting the baseline as part of a national review of the scheme in 2023/24. That change is now deferred. The Council's MTFS assumed £500k of business rate retention would cease on reset. This funding is now assumed to continue in 2023/24. The amount of Business Rate Retention income will be reviewed again in the next 2 months and allowed for in the 2023/24 budget.

4.8 The amount of Government funding may be affected by the recent changes to National Insurance. The reversal of the previous employer NI increases should reduce costs by £230k per year.

4.9 Local government can also expect to receive additional income in 2024-25 from the Extended Producer Responsibility scheme for managing packaging for waste. Initial indications suggest income of circa £1.0m a year. As the legislative detail has not been published in full, this City Council estimate may need to be revised.

5.0 Post Pandemic economic activity and Risk of Economic Recession

5.1 Approximately 45% (£27m) of the Council's expenditure is funded from discretionary income (sales, fees and other charges). Another 14% comes from rent income (including Housing properties). So, nearly 60% of the City Council's funding is self-generated; another 25% comes from Council tax. The Council is therefore very exposed in the event of an economic recession or pandemic to falls in the 60% self-generated income.

5.2 A fall in this self-generated income cannot be easily matched by reducing Council costs. For example, in a cost-of-living crisis, income from car parking and rental income from shopping centres may fall. But these do not correspond with any fall in Council costs as bins still need to be emptied.

5.3 The Cabinet will receive a Mid-Year review of capital and revenue budgets in November as normal. However, to provide members with a substantive update on the 2022/23 budget, it is important to be aware of:

- Car Parking. Current monitoring suggests car parking income could be £1.0m-£1.3m below the 2022/23 budget. This is nearly £2m below the pre-pandemic budget levels. The 2022/23 budget assumed a return to an average 83% against pre-pandemic activity level and also allowed for increases in fees and charges. Given the weakness in income in 2022/23, the MTFS assumed a reduction against the budget level of £600k. The risk of recession and lack of full recovery of income mean the 2023/24 budget is for planning purposes assumed to be £1.3m lower than the 2022/23 budget.
- Leisure Income. The 2022/23 income budget is likely to be achieved but this is still several hundred thousand pounds less than the pre-pandemic expectation. For planning purposes, the income is expected to recover fully. Another factor in leisure income is that the Council was successful in its litigation with HMRC concerning the VAT liability of leisure charges. This should in practice be worth £760k in the 2023/24 budget. However, the Council is still in dialogue with HMRC about this. It is unclear when this is likely to be resolved. The financial planning will include an assumption that this is resolved in the Council's favour. This carries risk of the Council having to refund HMRC if the remaining technical matter is resolved in favour of HMRC. The balance of risks would seem to indicate that making cuts to services when there is a potential VAT adjustment is not the appropriate action. The

Council will therefore cover the risk of loss from its reserves. This issue will be reviewed regularly as part of the budget process and any change reported to members.

5.4 **Actions**: That the risks to income are recognised and appropriate provision is made in the revenue estimates for lower income expectations. The budget process means income estimates will be reviewed up to December 2022, before setting the 2023/24 budget.

6.0 Current Projection of Budget Position for 2023/24

6.1 The projected budget gap for 2023/24 has increased from £4.2m (MTFS in July) to £7.9m. The higher gap is broadly a result of increases in pay (assumed 2.5% 2022/23 and 2% 2023/24 but now 7% 2022/23 and 3% 2023/24), energy £3m and further reduced assumption for car parking income £0.6m.

6.2 The 2023/24 gap can be reduced by making significant financial assumptions about items that cannot be considered certain (as discussed in this report)

- Core spending power – retain £1.8m of funding (see Appendix 2 for details)
- Use of reserves and/or Government funding for £2.96m of energy costs
- Take the benefit of the VAT litigation (£760k) as it is final in the Tribunal albeit subject to dialogue with HMRC concerning one remaining technical matter.

6.3 The 2023/24 projected budget gap after these assumptions is circa £2.1m.

7.0 Conclusion

This report provides an update on a very challenging financial position, which officers believe is reflected nationally for local authorities.

The report identifies a number of actions which need to be undertaken.

The level of projected gap will change but currently represents a significant challenge, particularly as many of the significant favourable assumptions made are far from certain.

The budget process will continue to run in the normal way and further reports will be made as necessary.

CORE SPENDING POWER **APPENDIX 2**

Chelmsford

Illustrative Core Spending Power of Local Government:

	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	Estimate 2023-24
	£ millions	£ millions	£ millions	£ millions	£ millions	£ millions	£ millions	£ millions	£ millions
Settlement Funding Assessment	5.5	4.3	3.4	3.3	3.4	3.4	3.408	3.409	3.409
Compensation for under-indexing the business rates multiplier	0.0	0.0	0.0	0.1	0.1	0.1	0.178	0.348	0.348
Council Tax Requirement excluding parish precepts[1]	10.9	11.3	11.8	12.4	12.9	13.6	13.987	14.557	14.900
New Homes Bonus	1.6	2.3	2.7	3.2	3.8	4.4	3.130	2.155	0.000
Lower Tier Services Grant	0.0	0.0	0.0	0.0	0.0	0.0	0.645	0.645	0.645
Replacement Funding estimate 2023/24									1.812
2022/23 Services Grant	0.0	0.0	0.0	0.0	0.0	0.0	0.000	0.235	0.235
Core Spending Power	**18.1**	**18.2**	**18.2**	**18.9**	**20.2**	**21.6**	**21.348**	**21.349**	**21.349**
Change since 2015-16 (£ millions)								3.3	
Change since 2015-16 excluding Council Tax (£ millions)								**-0.4**	
Change since 2015-16 (% change)								18.1	
Change since 2015-16 (% change) excluding Council Tax increases								**-6.1**	

Notes:

Settlement funding assessment is the amount of money that the City Council receives through the Government's funding formula. The City collects approximately £78m of Business rates and receives £3.4m back from Government in the form of grant. The formula grant is distributed based on data that is in some cases 20 years old. At the last revision of the formula an additional cut of £0.9m in Chelmsford's funding was proposed by Government but not implemented, as the impact of the changes nationally was seen as detrimental to a significant number of County Councils. If such a change were implemented this would be especially adverse to Chelmsford.

Compensation for under indexing the BRM - We receive a grant known as a section 31 grant to compensate us for the Business Rates multiplier not being increased line with inflation.

Council Tax requirement - is the total collected in Council Tax. Government assumes in its calculation that we increase our Council Tax by the maximum permitted and assumes growth in our taxbase from building additional houses. This means that in reality as Council tax income increases annually Government can reduce their funding but maintain our spending power in cash terms.

New Homes Bonus - This is an amount given to Districts for each new home developed. This sum has reduced significantly over the last few years as Gov has reduced the period over which the 'reward' will be paid from 7 years to 1 year and also now assumes a set level of growth in our taxbase (building new homes) must be achieved before any funding is provided. The Government has made clear for the last few years that a major review of this funding stream will happen, this review has not yet taken place however as it still looms over local authorities and therefore means that our spending decisions can only reflect one year of funding.

Lower tier services grant - given to Districts to partially protect them from a significant reduction in the level of Core spending when New homes bonus was cut. NHB was reduced by £285m nationally and authorities were partially compensated via the new lower tier services grant of £111m when it was introduced in 2021/22

2022/23 Services Grant this has been described as a one off grant for 2022/23 and had to be provided to ensure that all authorities maintained their core spending power in cash terms. In real terms we have experienced a significant reduction in our spending power and this problem will be exacerbated by the current level of inflation unless the Government act to provide additional on going protection.

Estimate 2023/24 assumes - service grant is increased to offset New Homes Bonus falling, which maintain core spending power. New Homes Bonus continues