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 must 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 2024/25 in the context of Government funding and the service pressures we face.

Members will be acutely aware of the financial pressure within local government as a whole with many informed commentators describing the financial problems as 'systemic'. Despite extensive lobbying from the sector there was nothing included in the Autumn Statement or the provisional local government finance settlement, but further lobbying from MPs and as a result of the many consultation responses to the provisional settlement, the Government announced a late funding package of £600m on 24 January.

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 and School Transport
- 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.

Despite significant increases to cash limits outlined in the December Cabinet report, the main budget setting report sets out a number of additional funding requirements that in my opinion need to be reflected in the main service budgets, underlining the prudent, honest and realistic approach we have to budget setting which has been a key plank of our financial management.

The budget preparation process for 2024/25 has once again 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 stable 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 2024/25 and the forecast to 2025/26 all key elements of the financial picture have been reviewed, including the remaining, Tt2021 and SP23 savings. Whilst there remain risks associated with the delivery of the remainder of the programmes, these are considered to be manageable at this stage and therefore all remaining savings are expected to be achieved.

Budget 2024/25

The budget for 2024/25 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 2024/25 which are set out in detail in the December Cabinet report that set the provisional cash limits for directorates, linked below:

Financial Update and Budget Setting and Provisional Cash Limits

Full account has also been taken of service pressures that have been highlighted during the year and additional funding has been proposed where appropriate in the main budget setting report on the agenda today.

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 2024/25

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.

Since 2022/23, the effect of high inflation is now having a major impact on our budget setting process, which when coupled with high service growth can lead to exponential increases in costs as we are seeing in School Transport, the budget for which is expected to double over a three year period.

These items together with other traditional risks are outlined below:

a) **Government Funding and Policy** – The Autumn Statement announced in 2022 did provide additional resources to the County Council, both for 2023/24 and into 2024/25.

   Whilst we therefore have certainty of funding for next year, the additional grant for 2024/25 is not in any way sufficient to bridge the cost increases that we see. Whilst there were no further increases included within the provisional local government finance settlement, the announcement of a late funding package of £600m in January was welcome and will help to reduce our reliance on reserves, but does not address the underlying issues that we face.

b) **Social Care / SEN Demand Pressures** – These are by far the biggest financial risks that the County Council faces. Increasing numbers of older adults in care coupled with high price rises in a difficult local market is creating pressure in the budget.

   Despite significant increases in the older adult's budget for 2023/24 we are still seeing a pressure of over £10m in the current financial year and that increased cost has therefore been added to cash limits for next year.

   The main budget report outlines a number of Children's Services pressures. Unlike many other councils, these are less within Children Looked After as our Transforming Social Care programme has kept numbers relatively stable. However as in previous years caseloads have continued to climb and a re-balancing is needed for Independent Reviewing Officers to meet the extra demands that they are facing.

   One of the main pressure areas is Special Educational Needs and whilst the direct costs of this are met through Dedicated Schools Grant, the administration of Education and Health and Care Plans (including Education Psychologist input) together with the knock on impact to school transport costs are all met by the General fund and are the biggest growth areas in relative terms in the Council.

All of these factors have been assessed as part of the budget and there is good evidence of how budget amounts have been derived, albeit they are difficult to predict in such a volatile environment. Overall though, I am content that the budget for 2024/25 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 provisional local government finance settlement released in December last year. It should also be noted that this increase is still well below the average rate of inflation for the current year.

   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 with limited options available to generate more savings to help close the gap.

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, a further flat rate increase for 2023/24 coupled with an increase of 3.88% for higher graded staff has created pressure in the budget.

   The forward impact of this has been reflected in the 2024/25 budget together with an assumed 3% award from April 2024 on the assumption that inflation continues to decline and lower graded staff have seen significant increases over the last two years. This does however remain a risk in the budget 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.

   This does not therefore represent a risk for the 2024/25 budget.

f) **Price Inflation** – As outlined above, the impact of inflation on our budget forecasts has been significant since 2022/23 and a bottom up approach is adopted to assess levels of inflation within the key markets in which we operate. Other contracts are linked to RPI and CPI and are therefore easier to predict, but have led to some significant increases over the last two years.

   Given the enhanced risk that this now represents, a sum of £5m has been allowed for within contingences to deal with any in year pressures in a similar way to the current financial year.

With this extra provision and the significant sums added to the budget in the December cash limits report, I am content that a robust and realistic approach has been taken to assessing and providing for inflation.

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.

The Adequacy of Reserves

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 2.8% of net expenditure at the beginning of 2023/24.

Overall the level of earmarked reserves and balances that the County Council holds stood at £845m (including schools and the Enterprise M3 LEP reserve) at the end of March 2023 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. Following a review in summer 2023 some of the reserves were re-purposed and the revised amount reduced to £817m.

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. However, the need to bridge budget gaps in both 2023/24 and 2024/25 means that over £130m is required over the two years to balance the budgets. A predicted reduction in the draw required for this year as part of the revised budget, does mean that there is sufficient funding in the Budget Bridging Reserve to cover off the deficit for 2024/25, but that leaves little available for 2025/26 which is discussed later in the report.

Whilst the reliance on reserves is concerning due to the underlying unsustainability of the forward budget, the very fact that the County Council has a healthy level of reserves means that there are options for using these flexibly should further pressures arise in year. There are options to:

- Use risk reserves such as the insurance reserve to fund expenditure.
- Borrowing to fund the capital programme or reducing the size of the capital programme to release revenue reserves to add to the BBR.
- Utilising funding that has been set aside to provide for future spending requirements such as IT reserves.

None of these options make good financial sense and should be seen as a last resort if there are no other options for balancing the budget. The County Council will also need to consider other ways of supplementing the BBR in the intervening period to increase its size before the 2025/26 financial year begins and the change in policy such that any early delivery of SP25 savings are contributed to the BBR rather than to Directorates cost of change reserves will help in this regard.

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 2025/26 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 which provides further assurance.

CIPFA Financial Resilience Index

The Chartered Institute of Public Finance and Accountancy (CIPFA) produce 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' in relative terms.

The Index for 2022/23 has been published, and the only high risk areas identified for Hampshire are:

- Change in Reserves – This no doubt reflects the fact that Hampshire used £48m of revenue reserves in 2022/23, but this must be set against the fact that Hampshire has one of the highest levels of reserves of any authority.
- Growth above baseline – This measures the extent to which retained business rates have grown over the baseline level set by the Government. Whilst growth is relatively low in Hampshire (3.74% compared to highest growth of 8.39%) retained business rates does not represent a large proportion of our income and ultimately there is little Hampshire can do to influence this indicator.

Of particular importance is the fact that Hampshire's Reserves Sustainability Measure is the joint highest of any County Council. This measures the ratio between the current level of reserves and the average change in reserves over the past 3 years.

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 two areas flagged as high risk.

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 previously 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 2024/25 – 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 up 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 2024/25, but this of course must be set against the context that this is only possible given our level of revenue reserves and I am still very concerned about the ongoing financial sustainability of the County Council, which can only be resolved through Government action.

The Position to 2025/26

The main report outlines the medium term forecast to 2025/26 which has remained consistent at a gap of £132m for some time now, albeit there is more risk in that estimate for the reasons outlined in Section L of the main report.

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.

Following the approval of the Savings Programme to 2025 (SP25) this has shown that effectively the County Council has reached this position with only £90.4m of the required £132m having been found in sustainable savings options.

Whilst a new exercise is being undertaken to consider what further savings could be made to contribute to the remaining £41.6m gap (including options that would only be considered in the face of a Section 114 notice) it is not expected that further recurring savings of £41.6m can be found and therefore the long term position is that the budget can no longer be balanced on a recurring sustainable basis.

I am confident that with the level of reserves that the County Council holds, these can be re-purposed to balance the budget in 2025/26, but this does not address the underlying recurring deficit that we face and therefore we must look to the Government to address this in future settlements.

Local government commentators have now stated that the financial problems facing the sector are ‘systemic’ and each week there are new reports of local authorities in trouble, most notably unitary authorities, who often lack the size and capacity to deal with their underlying problems and also face pressure across both upper tier and lower tier services. Clearly something needs to happen if the sector is not to drift into a financial meltdown.

The late announcement of £600m extra for local government on 24 January is a sign that the Government is starting to listen to some of the concerns and whilst the extra funding is welcome and will help shore up our finances to 2025/26, we will still have a recurring deficit of over £30m in 2025/26 and more fundamentally, it does not address the underlying issue that the funding system for local government is not fit for purpose as it does not adequately recognise the pressure the system is under and the methodology for distributing funding is outdated and unrepresentative of real service needs.

Looking ahead, 2026/27 will be a key year as it may not be possible to balance the budget using reserves, dependent on what support the Government gives to the sector in 2025/26 and 2026/27. Of particular concern is the fact that the Dedicated Schools Grant (DSG) statutory override comes off in 2026/27 and it is certain that if Hampshire is required to address both the cumulative deficit and the ongoing funding shortfall for DSG as part of its General Fund budget then it will be issuing a Section 114 notice for 2026/27.

Rob Carr

Deputy Chief Executive and Director of Corporate Operations

25 January 2024