

**MEDIUM TERM FINANCIAL STRATEGY (MTFS) 2023/24
TO 2025/26****JOINT REPORT OF THE CHIEF FIRE OFFICER AND
TREASURER****For Recommendation****1. PURPOSE OF REPORT**

- 1.1 To provide an update on the Authority's Medium Term Financial Strategy, which integrates the revenue budget, Asset Management Plan and Reserves Strategy, and underpins the delivery of the Community Integrated Risk Management Plan.

2. RECOMMENDATIONS

- 2.1 Refer the report to the Authority meeting on 9th December 2022 to ensure all Members are aware of the increased financial challenges facing the Authority and the timetable for setting the 2023/24 budget and Council Tax level.
- 2.2 Approve the proposal that a strategy to address the budget deficit is developed in line with the principles detailed in paragraph 5.11 once the 2023/24 Local Government funding announcement has been made
- 2.3 Note the Chief Fire Officer will progress the Drill Towers capital project and a funding strategy for the increased costs will be developed as part of the next MTFS report in line with the principles detailed in paragraph 6.6.

3. BACKGROUND

- 3.1 As set out in previous reports it is useful to reflect on where the Authority is starting from and there are three key factors which have a permanent impact on the Authority's financial position:

1) Changes in funding mix

There have been two significant changes which impact on recurring resources:

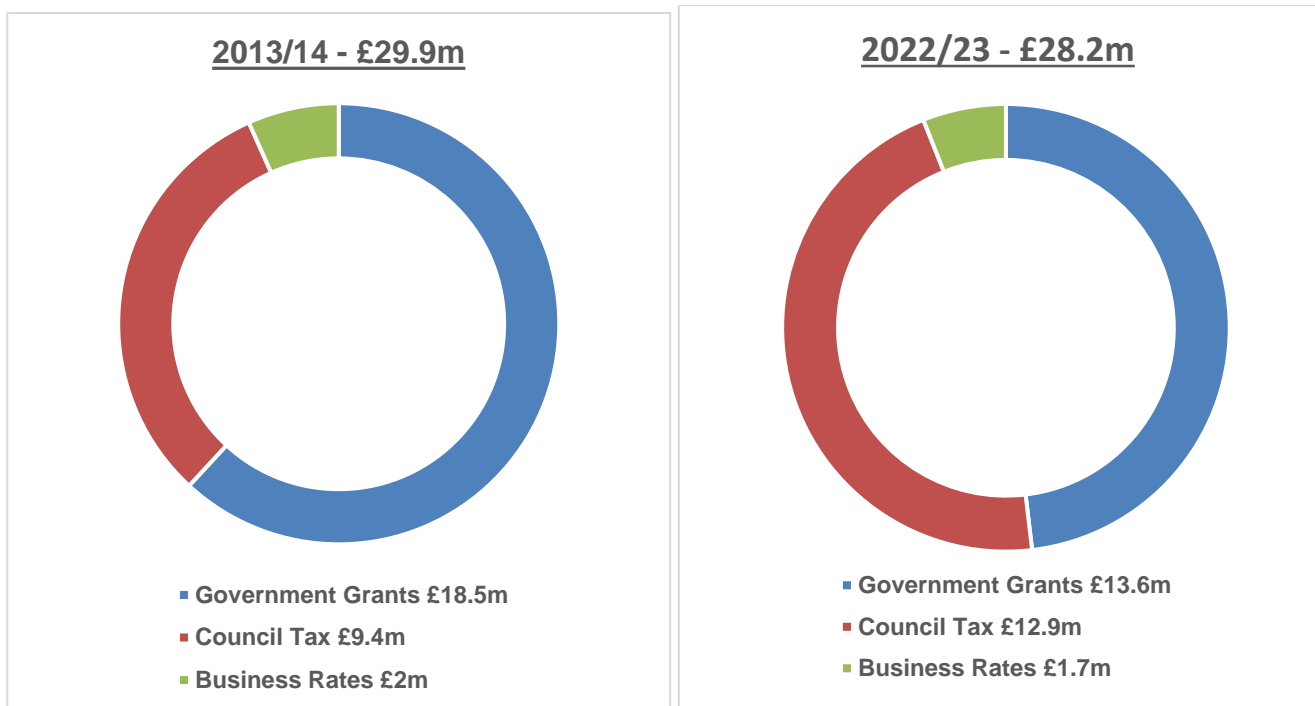
- A reduction in Government funding of **£4.9m** – a reduction of **26%** between 2013/14 and 2022/23.

If the 'New Services Grant' of £0.645m had not been provided in 2022/23 the reduction would be **£5.5m** – a reduction of **29%**. This highlights the importance of this funding continuing beyond 2022/23.

- An increase in the percentage of the recurring resources funded from Council Tax from **31%** in 2013/14 to **46%** in 2021/22 – an increase of **£3.5m**.

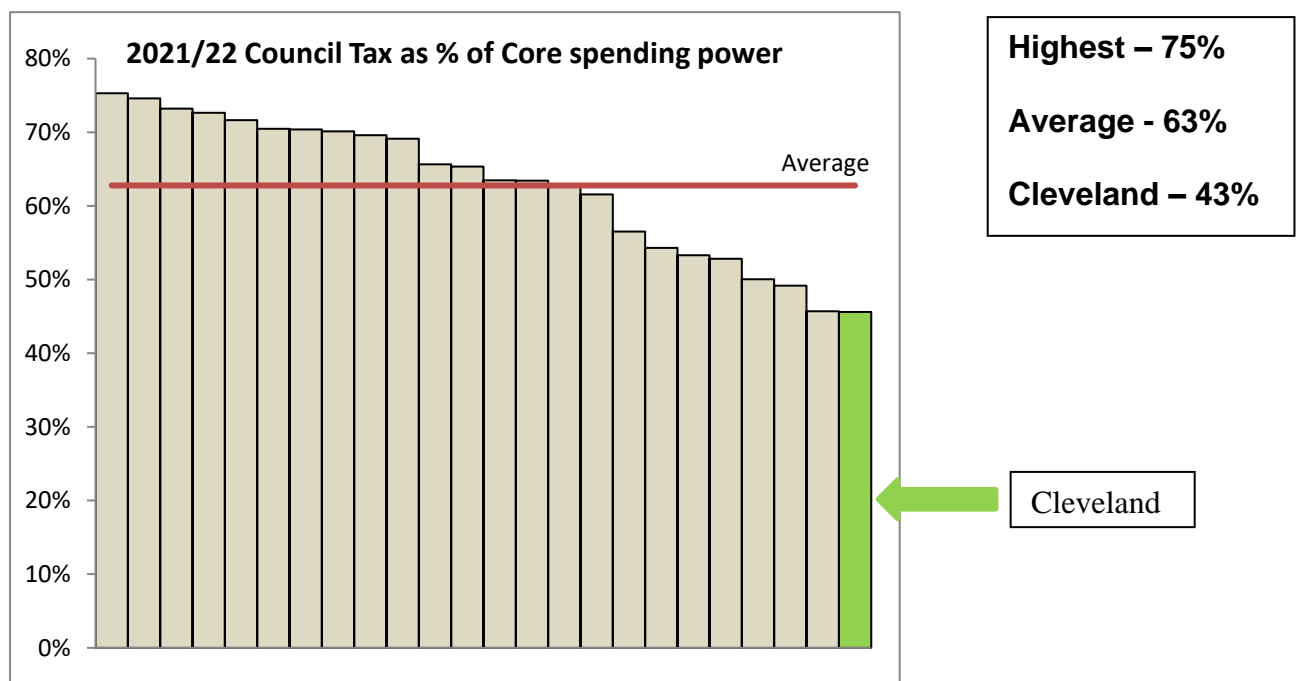
These changes are summarised in the following charts:

Changes in recurring funding 2013/14 to 2022/23



2) Low Council Tax base

The Authority has a low Council Tax base as **46%** of properties are Band A, the lowest Council Tax band, compared to **24%** nationally. This means the Authority raises the lowest proportion of Core Spending Power from Council Tax than any other Fire and Rescue Authority (FRAs), as summarised below:



The Authority has no control over planning decisions to approve new housing developments, which increase the Council Tax base. Councils are responsible for encouraging housing growth. The scope to shift the balance of the Council Tax base towards higher value properties is determined by local economic conditions and the affordability of housing. The reality of the situation is the percentage of our Spending Power funded from Council Tax will remain low and will probably never match the FRA average.

As a consequence of the low Council Tax base the Authority remains reliant on Government grant, technically referred to as Settlement Funding Assessment (SFA), which in 2022/23 is **48% (£13.6m)** of recurring resources. The future level of this funding is therefore critical to the financial sustainability of the services provided by the Authority.

3) Impact of previous budget reductions

As a result of reductions in Government funding and the low Council Tax base the Authority will continue to face ongoing financial challenges. This position needs to take account of previous reductions:

- **33% reduction** in the number of **whole time firefighter posts** from 494 in 2010/11 to 330 in 2021/22.
- **33% increase** in the number of **retained duty system firefighter posts** from 72 in 2010/11 to 96 in 2021/22.
- **38% reduction** in the number of **fire control posts** from 26 in 2010/11 to 16 in 2021/22.
- **14% reduction** in the number of **non-uniformed support posts** from 129.21 in 2010/11 to 110.65 in 2021/22.
- **30% reduction** in number of Elected Members from 23 to 16 – effective from June 2016.

3.2 In summary the Authority is starting 2023/24 with:

- less cash funding than in 2013/14;
- a low Council Tax base which means a much lower proportion of spending is funded from Council Tax than is the case for the average FRA;
- continued reliance on the level of Government funding.

4. IMPACT OF ECONOMIC ENVIRONMENT ON MTFS FORECASTS

4.1 When the 2022/23 budget was prepared the position regarding inflation was uncertain. In November 2021, when most of the budget planning work was completed, the Office for Budget Responsibility was forecasting CPI would be 4.4% for 2022/23 – this was before the energy price increase. For the Authority the greatest impact of higher inflation is how this feeds through to national pay awards, as pay costs account for approximately 80% (£23.5m) of the budget.

- 4.2 Since the budget was set the level of inflation has increased significantly. In a recent speech (given at the G30 Annual International Banking Seminar on 15 October 2022) the Governor of the Bank of England (BoE) reflected on the key financial issues impacting on the UK economy and the level of inflation. Key points from the speech are as follows:
- BoE initial view was that factors driving inflation would be transient. However, this proved not be by the case as further shocks continued to drive inflation. The BoE Governor posed the question “could we have predicted Russia’s behaviour?”
 - BoE assessment was that inflation would peak at around 13%, and then come down sharply – other things equal – to the 2% target in two years’ time, before falling further to 0.8% in three years.
 - The impact of the energy price shock has, throughout Europe and beyond, posed a huge challenge for Governments and for fiscal policy. The consequences of the shock for people are huge and disturbing. Governments have naturally responded which will reduce the inflation peak to a forecast 11%.
 - UK financial markets have experienced some violent moves in the last few weeks particularly at the long-end of the Government debt market. The Bank of England had to intervene to deal with a threat to the stability of the financial system, our other core objective.
 - We will not hesitate to raise interest rates to meet the inflation target. And, as things stand today, my best guess is that inflationary pressures will require a stronger response than we perhaps thought in August.
- 4.3 Over the period January 2022 the BoE increased interest rates three times, with the rate increasing from 0.25% to 1%. Between June and October there were two increases which saw the rates increase to 2.25% in October. In November the rate increased to 3%.
- 4.4 The October 2022 CPI was 11.1% which is the highest for 41 years and up from 10.1% in September 2022. This underlines the scale of the increase in inflation over the last 12 months.
- 4.5 When the 2022/23 budget was prepared the position regarding national pay awards was unknown and uncertain. At that stage it was proposed to retain a 2% increase as the inclusion of a higher percentage would have required the identification of new service efficiencies or cuts. At the time it was recognised there was a risk that actual national pay awards may be higher and this would then require the development of a savings plan.
- 4.6 The national pay award for Green Book (support staff) has recently been agreed as a flat rate increase of £1,925, which provides a higher percentage increase for lower paid staff. For the Authority’s Green Book staff this equates to an average increase of 5.6%. This national pay award exceeds the budget provision of 2% by £162,000

- 4.7 For fire fighters an initial national pay offer of 2% was made and then increased to 5%. This exceeds the budget provision of 2% by £562,000. Following a national consultative ballot the FBU rejected the 5% pay offer and will now ballot their members between 5 December and 23 January on strike action.
- 4.8 The Government has stated that additional funding will not be provide for either of these pay awards. To mitigate these additional costs in the current year (2022/23) officers will continue to manage budgets carefully, including managing vacant posts and deferring expenditure where this does not impact on operational delivery. Additionally, increased temporary investment income has been secured as a result of increased interest rates. At this stage it is anticipated these measures should mitigate the impact in the current year, although there remains a risk that any shortfall will need to be funded from the Budget Support Fund.
- 4.9 The one off measures to address the impact of higher national pay awards in 2022 are not sustainable. Therefore, the recurring impact of these pay awards will increase the budget deficit in 2023/24 and further information is provided in the next section.

5. UPDATE OF MTFS FORECASTS

- 5.1 The planning environment remains extremely challenging and there is significantly uncertainty on both the resources and expenditure sides of the budget. The major factors will continue to be inflation and national pay awards. This uncertainty makes financial planning challenging and will continue to be driven by changing external circumstances covering the following key issues:

a. **Local Government Funding Settlement and Fair Funding Review**

It seems likely that there will only be a one year Local Government Finance Settlement for 2023/24. It is unclear if current funding, including the new Services Grant, will continue into 2023/24. The Government has made it clear there will be no additional funding for higher inflation or national pay awards. Government Departments have been asked to identify efficiencies.

It is also expected that the funding announcement is likely to be delayed until late December – i.e. the week leading up to Christmas. This is owing to the Autumn Statement not being made until 17th November 2022 and a verbal update on this statement will be provided at the meeting.

It also seems unlikely that the Fair Funding Review will be completed for 2024/25 owing to the timing of the next scheduled General Election.

b. **National Pay Awards**

Pay accounts for approximately 80% of the budget and the level of national pay awards has a significant impact on the budget. The reliance of the Authority on Government funding, reflecting the low Council Tax base, **means that higher pay awards increase the budget deficit facing the Authority.**

It is difficult to forecast the national Grey Book pay award for 2023/24 until agreement is reach on pay award for 2022/23. The position for 2024/25

onwards is even more challenging and will be driven by prevailing inflation and private sector pay awards.

At a national level increases in the National Living Wage (NLW) for 2023/24 will have a major impact owing to the high proportion of council staff currently paid not much more than the NLW. This then leads to pressure through the national pay scales which will impact on the Authority's Green Book staff.

The FBU and other public sector unions will take account of the Local Government pay award, the level of inflation and private sector pay awards in their pay claims.

For planning purposes the MTFS has been updated on the basis:

2022/23

- Grey book (Fire fighters) 5% national pay award – this is currently subject to ballot;
- Green book (support staff) – agreed flat rate £1,925

2023/24

- Grey book 5%
- Green book 4%

2024/25 and 2025/26

- Grey book 2%) based on BoE reducing inflation to 2% target
- Green book 2%)

c. Government Funding 2023/24 onwards

The Local Government Finance Settlement will determine the level of funding, which for 2023/24 is 48% of recurring funding.

The previous planning assumption anticipated that this funding will continue in 2023/24 and future years. There is now a risk that the deterioration in the Public Finances may lead to a reduction in this funding. In the absence of the Government bringing forward detailed consultation proposals over the summer it is difficult to assess this risk.

This position is complicated by the components of this funding, as summarised below, and decisions the Government may make in relation to these different grants. An updated will be provided as soon as more information becomes available.

Components of £13.6m Government Funding

	2022/23 Funding £'m
Top Up Grant	7.434
Revenue Support Grant	5.517
New Services Grant	0.645
Total	13.596

d. Pension Grant

For planning purposes the separate Pension grant of £1.4m is expected to continue in 2023/24 and future years.

e. Council Tax Referendum Limits

For planning purposes it is assumed the Government will confirm annual Council Tax referendum limits of 2% and the Authority will implement these increases.

For 2023/24 this would equate to an annual increase for a Band D property of **£1.56**. For a Band A property the annual increase is **£1.04**.

If the Government set a 2023/24 referendum Limit of £5 at Band D for all FRA this would equate to a 6.1% increase for the Authority. This would be £3.33 for a Band A property. The additional annual potential income for the Authority would be £0.540m. If this limit was set for three years (2023/24 to 2025/26) the potential additional recurring by 2025/26 would be nearly £1.7m.

A £5 referendum limit would be more beneficial for FRAs with a high Council Tax base. There would be less benefit to the Authority owing to the low Council Tax base and the Authority would still be at the bottom of the 'spending power' increase league table. The only way to address the impact of the low Council Tax base is through the grant system to equalise the impact of Council tax bases varying between FRAs.

5.2 Revised forecast deficits

- 5.3 On the basis of the updated planning assumptions the Authority faces a significant increase in the previously forecast budget deficits and by 2025/26 the updated baseline forecast is a deficit of **£2.270m** - which equates to **7.4%** of the current budget.
- 5.4 As highlighted in the table below the updated baseline deficit is front loaded owing to the forecast cumulative impact of national pay awards in 2022 and 2023.

Revised Deficits based on Core Planning Assumptions 2023/24 to 2025/26

	2023/24	2024/25	2025/26	Total	Total Deficit as percentage of 2022/23 budget
	£'m	£'m	£'m	£'m	
Previous MTFS forecast deficit	0.192	0.186	0.170	0.548	1.8%
Updated Baseline deficit - scenario 1	1.841	0.222	0.207	2.270	7.4%

- 5.5 The updated baseline deficit is based on the following core planning assumptions:

Core Planning Assumptions 2022/23 to 2025/26

	2022/23	2023/24	2024/25	2025/26
Grey Book pay award	5%	5%	2%	2%
Green Book pay award	£1,925 flat rate	4%	2%	2%
Non pay inflation	5%	9% ##	2%	2%
Government Funding	No change	No change	No change	No change
Pension Grant	No change	No change	No change	No change
Council Tax	N/A	2%	2%	2%

This percentage reflects an initial assessment of the continuing impact of 2022/23 inflation and additional 2023/24 inflation. This will be subject to further review and there is a risk a higher amount may be required, which would increase the current forecast deficit.

- 5.6 There is a risk actual pay awards / inflation may be higher than the core planning forecasts. If both these factors were 1% higher each year this would increase the deficit over three years to **£3.039m – scenario 2.**
- 5.7 There is also a risk of the deficit increasing if reductions in the current level of Government funding are implemented. Annual decreases of 2% would increase the deficit over three years to **£3.056m – scenario 3.**
- 5.8 If the Authority faced both higher pay awards / inflation and a reduction in Government funding the budget deficit would become even more unmanageable and increase the deficit over three years to **£4.058m – scenario 4.**
- 5.9 All planning scenarios are based on the Pensions Grant of £1.409m continuing and the range of deficits are summarised in the following table:

Planning Scenarios - Alternative potential budget deficits 2023/24 to 2025/26

	2023/24 deficit	2024/25 deficit	2025/26 deficit	Total deficit	Total Deficit as percentage of 2022/23 budget
	£'m	£'m	£'m	£'m	
Updated Baseline forecast - scenario 1	1.841	0.222	0.207	2.270	7.4%
Key planning factors					
• Detailed paragraph 5.5					
Mid Case – scenario 2	2.078	0.482	0.479	3.039	9.9%
Key planning factors					
• As per scenario 1					
• <u>Plus impact of 1%</u> additional pay award and inflation per year for three years					
Mid Case – scenario 3	2.106	0.485	0.465	3.056	9.9%
Key planning factors					
• As per scenario 1					
• <u>Plus impact of 2%</u> annual Government funding cuts					
Worst Case – scenario 4	2.446	0.808	0.804	4.058	13.3%
Key planning factors					
• As per scenario 1					
• <u>Plus impact of - 1%</u> additional pay award and inflation per year for three years					
• <u>And impact of - 2%</u> annual Government funding cuts					

5.10 At this stage there is too much uncertainty and variability regarding the actual deficit to be faced by the Authority to enable a detailed strategy to be developed and put forward for Members consideration. The announcement of the provisional 2023/24 Local Government Finance Settlement, including confirmation of the actual Council Tax referendum limit, will be a key milestone and provide funding certainty. Detailed proposals to address the budget deficit will then be developed and reported in line with the budget timetable detailed below:

- 09.12.22 Full Authority – consideration of this report to update all Members;

- 20.01.23 Executive Committee – update of MTFS to reflect 2023/24 Local Government Finance Settlement and to determine proposals to be referred to the Full Authority;
- 10.02.23 Full Authority – consider recommendations from the Executive Committee and approve the strategy to manage the deficit, including 2023/24 Council Tax level.

5.11 The strategy to address the deficit will be based on a combination of factors:

1) Identification of budget saving which can be implemented over the period 2023/24 to 2025/26

The Chief Fire Officer will identify options for achieving permanent savings, although further savings will be extremely difficult to achieve given the significant cuts implemented in previous years.

2) Use of interest income

For over a decade interest rates were low and stable. This meant the opportunity to achieve investment income has been limited. The increase in inflation and the fact this has now changed from being short-term to medium term has resulted in central banks, including the BoE increasing interest rates. Therefore, action has been taken to secure 12 month investments, commencing late October, to provide temporary investment income to support the 2023/24 budget. This benefit may extend into 2024/25, although this requires further work and an assessment of how quickly reserves will be used and the level of future interest rates.

3) Use of the Budget Support Fund

These resources have been set aside to provide a slightly longer lead time to address the actual budget deficits being higher than forecast when the 2022/23 budget was set.

5.12 The use of interest income and the Budget Support Fund does not provide a sustainable basis for the budget as these resources can only be used once. These resources simply provide a slightly longer period to address a budget deficit. However, as the majority of the three year forecast deficit is driven by current inflation and forecast national pay awards this means significant budget cuts can only be deferred from 2023/24 to 2024/25.

6. ASSET MANAGEMENT PLAN (AMP)

6.1 The ongoing AMP covers operational properties, vehicles and equipment. The AMP is underpinned by a funding strategy which will finance capital costs through a combination of using the earmarked Capital Investment Programme reserve and Prudential Borrowing.

6.2 The revenue budget includes provision to meet the interest and principal repayment costs of using Prudential Borrowing. The phasing of these costs is supported from the Capital Phasing Reserve.

- 6.3 Work is ongoing to update the AMP as inflation will increase the cost of the approved programme and details will be reported in line with the budget timetable. Additional costs will need to be funded from a combination of value engineering, re-assessing priorities and potentially additional Prudential Borrowing.
- 6.4 Increasing Prudential Borrowing will be difficult owing to the revenue deficits facing the Authority and the increase in interest rates.
- 6.5 The AMP includes works to drill towers (at Thornaby, Redcar, Billingham, Saltburn and QMC Learning and Development Centre) to ensure these remain available for operational training requirements in relation to fires in multi- storey buildings and line rescue. It has been identified during the current procurement process that the cost of these works will significantly exceed the existing budget provision owing to the impact of construction industry inflation. Part of this increase can be funded from the managed underspend on non pay budgets in the current year, although there is still a residual funding increase of £191,000, as follows:

Summary of Drill Towers revised costs and funding requirement

	£'000
Total revised cost	751
Less approved AMP funding	(270)
Less funded from non pay 2022/23 underspends	(290)
Funding still required	191

- 6.6 It is proposed that a final decision on how this amount is funded is delayed until the final MTFS report is considered, as this will enable a funding decision to be taken in the context of the overall financial position of the Authority. The options available are to either fund from 2022/23 unbudgeted investment income, reverse part of the 2021/22 Voluntary Repayment of Principal or from the Budget Support Fund.

7. CONCLUSION

- 7.1 Prior to 2020/21 the Authority had managed nine years of austerity and cuts in Government grant funding. As the majority of the budget is spent on front line services the Authority has made significant changes, including reductions in the number of whole time firefighter posts, as detailed in section 3.
- 7.2 The one year settlement for 2022/23 provided increased Government funding of **£0.809m**, including the new Services Grant of £0.646m. Whilst this increase was welcome, particularly at a time of increased inflation, it does not address the recurring grant reductions up to 2021/22 of **£5.5m**. Therefore, services changes made in previous years are locked in.
- 7.3 Since the 2022/23 budget was set the level of inflation has increased significantly and in October 2022 CPI was 11.1%. This underlines the scale of the increase in inflation. The main impact on the budget deficit will be how this feeds through to national pay awards as the Government has said additional funding will not be provided. Therefore, the level of national pay awards will determine the size of the budget deficit facing the Authority.

- 7.4 Whilst, pay and non pay inflation are now the greatest financial challenges facing the public sector and the Authority, there remains a risk that the Government may implement further funding cuts.
- 7.5 Against this background it is clear the Authority now faces an even greater financial challenge than previously forecast. A range of budget scenarios have been detailed in the report and these show a potential deficit of between **£2.270m** and **£4.058m** for the period 2023/24 to 2025/26 – which is between **7.4%** and **13.3%** of the current budget.
- 7.6 These figures assume annual Council Tax Referendum Limits of 2% and local increase of 1.9%. Without these increase the budget deficits would all be **£0.75m** higher.
- 7.7 As Members are aware an annual decision is needed to increase the Council Tax level and the income that is then raised. For many other taxes the income raised increases automatically. For example:-
- In a period of inflation if VAT stays at 20% it is paid on the higher cost of goods / services and this increase VAT income received by the Government;
 - Similarly, as wages rise additional income tax receipts are generated by the Treasury if income tax thresholds are frozen. This is known as “Fiscal drag” as people pay either 20% income tax on any pay award they receive, or more people pay 40% income tax if their pay increase push their income above the relevant tax threshold.
- 7.8 At this stage it is recommended that the report is noted and that a strategy to address the budget deficit will be developed once the 2023/24 Local Government funding announcement has been made in line with the principles detail in paragraph 5.11.
- 7.9 It seems very likely that the budget for 2023/24 will need to be set before the national pay award for Grey Book staff for 2022 has been agreed. This means the 2023/24 budget will need to manage this uncertainty AND uncertainty regarding the 2023 national pay awards for both Grey and Green Book staff.

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