From: Zena Cooke, Corporate Director for Finance

To: County Council 11th February 2021

Subject: **Section 25 Assurance Statement**

Classification: **Unrestricted**

Summary:
This report contains the formal recommendations from the Section 151 officer as to the robustness of the budget estimates for 2021-22 and the adequacy of reserves. It includes an evaluation of the background to budget preparations for 2021-22, including risks and uncertainties, deliverability of the proposed budget, and financial sustainability of the Council.

Recommendations:

(a) Pursuant to section 25 of the Local Government Act, the County Council is asked to NOTE this report and AGREE to have due regard to the contents when making decisions about the budget.

1. Introduction

1.1 Section 25 of the Local Government Act 2003 requires the Section 151 officer (for Kent this is the Corporate Director of Finance) to formally give an opinion as to the robustness of the budget estimates and the level of reserves held by the Council. The Act also requires that the Council must give consideration to this report when making decisions about the forthcoming budget.

1.2 The 2021-22 budget proposals have been developed in the most uncertain circumstances the Council has ever faced. In any year there are some uncertainties within the budget, which is a plan of predicted spending and income for the forthcoming year. Even in normal times predicting spending on demand led budgets with a high degree of accuracy is difficult. Consequently, it is important that variations from the plan are identified and reported early, together with remedial actions to ensure a balanced budget can continue to be delivered.

1.3 It is also essential that the budget includes an assessment of the potential financial risks facing the Council and that the Council has adequate reserves should those risks materialise. The Council holds a general reserve for unforeseen and unplanned circumstances and a range of earmarked reserves for specific eventualities.

1.4 In recent years the section 25 assurance statement has noted that the Council has maintained adequate but not generous levels of reserves and has a relatively high level of accumulated debt. The Corporate Director of Finance has undertaken an assessment of the financial resilience of the Council compared to other county councils and has concluded that although KCC has been in the lower half of the resilience range (overall around the lower 25% percentile), the Council is not in imminent danger of financial failure. However, whilst reserve levels are adequate, they require continuous monitoring given the risks the Council is facing. The Council cannot be complacent and must continue to maintain financial rigour, particularly with regard to accumulated debt and associated financing costs, which have in recent years benefitted from internal borrowing to a large degree.

1.5 The Council has a strong record of financial management. 2019-20 was the 20th consecutive year where the Council has managed revenue spending within the approved budget and ended the year with a small surplus. This has been achieved against the backdrop of significant financial restraint over the last 10 years where budgets have included over £700m of savings and additional income in order to offset spending growth and reductions in central government grants. The Council has also maintained a substantial capital programme over this period without adding to external accumulated debt through prudent treasury management enabling infrastructure investment to be supported by internal borrowing from cash reserves.

1.6 Over this same 10 year period the yield from local taxes (council tax and retained business rates) has remained buoyant. The combination of reductions in central government grant, buoyant tax base and modest council tax increases over this period means that councils have become more self-sufficient. Council tax is now by far the most significant source of funding towards the Council's core budget (accounting for 70% of net revenue spending).

1.7 The Council's Constitution specifically defines the role of all Members in determining and agreeing the policy and budgetary framework of the Council in accordance with applicable laws providing sufficiency of resources. The budget approval process includes Cabinet Committee meetings, the Scrutiny Committee meeting and Member briefings leading up to the formal Budget meeting and the recommendations set out in the County Council budget report. These are the mechanisms by which all Members have the opportunity in advance of the full County Council meeting to define, challenge, amend and ultimately vote on the Council's budgetary framework for the next year and medium term, in which all Members have a voice and a vital role to play.

2. Recommendations

2.1 As outlined in the introduction, the 2021-22 budget has been prepared against the backdrop of unprecedented levels of uncertainty. The 2020-21 budget was approved on the basis of a one-year local government finance settlement which meant for much of the year, plans had to be developed without government spending plans for future years or an indicative settlement for local government. This in itself is not unique at the end of a spending review period, and the

Council's Finance function has experience of developing a range of potential funding scenarios.

2.2 In addition to the uncertainty around government spending plans and settlement for local government, the Covid-19 pandemic and subsequent economic recession have had a significant impact in the current year and on the Council's ability to forecast future spending requirements and income levels.

2.3 Before the pandemic, the Council was already experiencing increasing demand for services, including children's social care; home to school and special educational needs transport; and higher demands across adult social care including adults with learning disabilities and older people. The pandemic will inevitably change demand and we will need to monitor and respond to those emerging patterns closely.

2.4 Earlier in the year the Council was asked to agree a formal amendment to the 2020-21 budget in September as at that time the additional spending and income losses related to the Covid-19 pandemic and projected increases in demand would not be offset by the grants received from government.

2.5 The local and national response to the pandemic has evolved significantly since that decision in September. The national and local lockdowns have lasted longer than was previously envisaged. Lockdowns have had a direct impact on short-term and longer-term spending plans. In the short-term the lockdowns mean the Council is spending less on the provision of core services, due to suppressed or delayed demand. Whilst the Council has incurred some areas of significant additional spending such as additional payments to care providers, the establishment of a temporary mortuary facility, procurement of additional personal protective equipment (PPE), setting up the local test and trace and community testing for asymptomatic cases, etc., these have largely been funded from general emergency grant and a number of specific Covid-19 grants that have been received by the Council primarily in the second half of this year. The Council has also provided continuity payments to suppliers where services are not being delivered to the full extent, in order to sustain the market for these services, such as care, transport and early years. However, even after allowing for the additional spending and grants associated with Covid-19 and continuity payments the Council is still forecasting a significant underspend in the current year, primarily due to the reduced demand for core services.

2.6 The latest forecast for 2020-21 was prepared before the impact of tier 4 restrictions in December, and the 3rd national lockdown in January. These further restrictions are likely to result in additional short-term underspends. The proposed budget for 2021-22 already includes £18.5m draw down from the projected 2020-21 underspend to support 2021-22 spending plans. Furthermore, there are some Covid-19 grants in the current year (particularly tranche 4 of emergency grant and Contain Outbreak Management Fund) where Covid related spending plans are still under development in response the changing circumstances.

2.7 In the medium to longer term the Council has to plan for a return to a more normal situation and there are serious concerns that the impact of sustained lockdowns will significantly increase demand for some council services (especially care related services) where the restrictions are currently resulting in suppressed demand and a likely increase in complexity of individual needs. It is an emerging feature of the pandemic that there are short-term time-limited increased spending requirements, income losses and underspends on core services for upper tier councils, but longer term substantial recurring additional spending risks.

2.8 The 2021-22 budget proposals include £33m of recurring spending associated with the 2020-21 budget amendment, approximately £21m additional spending associated with Covid-19 and £12m of core services (largely children's services and adult social care) from revised forecasts for prior years' activity/spend not included in the original budget. The need for this recurring spending in 2021-22 was identified as part of the 2020-21 budget amendment process.

2.9 The proposed 2021-22 budget also includes making permanent provision for recurring spending funded by the one-off use of reserves in the current year, changes to base budget from variations and decisions during the current year, and forecast increases for inflation, increased demand, legislative changes and service improvements. This mix of revising budgets for known variances and forecast spending growth is a robust approach and provides a sound basis for financial planning. This sound financial planning combined with comprehensive in year monitoring have been the key factors in the council's track record of strong financial management over the last 20 years.

2.10 Previous budgets have included estimates for increased demand on council services, referred to for simplicity as demography. These demographic demand forecasts have been based on population projections and previous trends. Whilst this did not always result in a totally reliable forecast (based on the assumption that previous trends were an indication of future demand) the approach was considered fit for purpose at the time.

2.11 The significant disruption during the current year means that the previous approach to forecasting demand cannot be used for 2021-22. Consequently, in the proposed service budgets, spending/activity at pre Covid-19 levels has been assumed for some services where it is likely there is no lasting Covid-19 impact. Others, particularly care services, where there is a risk of a lasting Covid-19 impact, the current activity levels have been projected. This leaves the Council exposed to the risk of the pent-up demand (either from adult social care clients currently still in health or transitional placements) or those yet to be assessed, and the risk of increased complexity. Consequently, a contingency provision for adult social care (originally described as a risk reserve) for these potential demands has been included in the budget to replace the demography calculation. Whilst this provides some cover for these demand risks, it is important to recognise that due to the levels of uncertainty, the amount in the contingency provision cannot have the same assurance as a calculation based on more stable previous trends.

2.12 In addition to these increased demand risks it is essential for the Council to plan for the impact on the financial sustainability of key suppliers of council services. Whilst continuity payments have been made during the pandemic, the business operating models of many providers will have been severely impacted due to increased costs and loss of revenue. The Council's longer-term budget plans will need to include consideration of targeted financial sustainability support to key providers to ensure core services can continue to be delivered. The draft budget proposals also include a contingency provision for market sustainability but this still remains a risk as we cannot estimate the possible impact with any certainty.

2.13 The 2021-22 financial settlement includes over £50m of additional government funding the vast majority of which is one-off funding related to Covid-19. The balanced budget for 2021-22 includes £32m one-off Covid-19 emergency grant, £14m one-off grant for council tax support, and 75% compensation for irrecoverable council tax losses in the current year which will impact on 2021-22 budget. Whilst these one-off grants are welcome and have contributed significantly to balancing the 2021-22 budget, they are funding recurring spending growth and the measures to deal with spending risks and uncertainties outlined above. This means it is highly likely that a structural budget deficit will need to be addressed in 2022-23, although it is not possible to determine the level of that deficit at this point.

2.14 These one-off grants are not in addition to the budget and the overall financial strategy allows for the use of some of this one-off funding to be held in reserves to mitigate the spending risks. This prudent approach will allow in-year flexibility during 2021-22 to respond to further emerging issues and the medium-term uncertainties and potential funding gaps, which should reduce the need for an in-year budget amendment.

2.15 The 2021-22 budget also requires the delivery of a package of £39.5m of savings and income. Whilst these savings plans are as robust as they can be and the Council has a track record of delivering planned savings, delivery risks both in terms of timing and quantum due to the current unpredictable circumstances, are still inevitable. It should be noted that the savings figure has been revised down by £3m since the draft budget was published to reflect the fact that the revenue saving on pothole blitz has been removed to reflect the anticipated lower level of capital grants from the Department for Transport and the consequential need to preserve budget for pothole repairs.

2.16 The Council Tax precept is based on the estimated tax base notified by districts. Those estimates include the impact of current and estimated housing growth, additional working age support discounts for households on low incomes, estimates for future impact on support discounts due to the recession, the end of furlough scheme etc., and lower collection rates. Whilst the 2021-22 financial settlement includes compensation for council tax losses, the overall amount is not sufficient to cover the normal housing growth foregone and the increased value of discounts/lower assumed collection rates. Without the proposed increase in the County Council share of the council tax charge, this shortfall would have required the Council to find significant additional savings, in order to balance the budget on a sound basis.

2.17 The proposed budget represents a compromise between additional spending growth, spending reductions through savings, income losses and planned income generation, the use of additional, primarily one-off government grants, losses on council tax base, and proposed council tax charge increases. It is not the role of the S25 assurance statement to comment on the precise mix providing the overall package results in a balanced budget and the estimates on which the calculation is based are robust.

2.18 In previous years the revenue budget has included surpluses on the previous year's tax collection fund accounts. Due to the recession the surplus has been replaced by a deficit which would normally have had to be recovered as part of the 2021-22 budget. The government has agreed to fund 75% of irrecoverable losses but this still leaves a deficit for the remaining 25% and those losses the government does not consider irrecoverable. In a change from previous years the Government has allowed for the balance of the deficit to be written off over three years. In order to safeguard the medium-term it is proposed this deficit is covered by council tax equalisation reserve rather than the revenue budget and any future surpluses will replenish this reserve.

2.19 All the estimates within the proposed budget are the product of a comprehensive budget process with Cabinet Members, Corporate Directors and Directors resulting in agreement on the level of service delivery within the identified financial resources. In addition, appendix H of the final draft budget sets out the main budget risks that are taken into account in determining the estimates.

2.20 The draft budget also clearly sets out the strategy for the assessment of budget risks and adequacy of reserves (appendix H). As well as the establishment of a contingency provision for social care demand risks and the draw down from underspends in the current year, the proposed budget includes draw down from public health reserves, a one-off contribution to general reserves to reflect the high levels of uncertainty and heightened financial risk in the short and medium term, and an increase in the workforce transformation reserve. It should be noted that whilst there is an increase in general reserves, overall there is a planned net decrease in reserves during 2021-22 of approximately £5m.

2.21 The medium-term plan scenarios for future years indicate a gap between the Council's expected funding streams and the Council's expenditure. After delivering 100% of all existing planned savings, the gap is forecast to be between £8m and £108m depending on the speed of recovery from the pandemic and economic recession in 2022/23 rising by up to £163m by 2024/25. It is therefore imperative that the Council maintains a focus on financial sustainability and continues to identify opportunities for new savings and further income. The Council will need to explore the redesign of services including increased use of technology, more efficient use of premises and different ways of working with partners and local communities to ensure that essential services can be provided within the context of increasing demand and limited resources.

2.22 The latest forecast for usable revenue reserves at the end of 2020-21 is £272m, this represents a small increase of £2m on 2019-20. The forecast takes account of a drawdown of Covid-19 tranche 1 grant which was unspent at the end of 2019-20 and the unallocated balance of later tranches of Covid-19 grants where spending plans have not yet been finalised. The net movement also includes 2020-21 underspends including those planned to support the 2021-22 budget. It is almost inevitable this forecast will change over the remaining months due to the impact of tier 4 and national lockdown already referred to as part of this assessment of the financial standing of the budget plan and adequacy of reserves.

2.23 The proposed capital programme is of a similar magnitude to previous programmes at around £1bn over 3 years. The programme includes £168m of spending that has been rephased from 2020-21, £54m of schemes that have been removed and £19m of new schemes. The programme is funded from a combination of government grants, external funding and borrowing. In line with previous years, it is proposed that borrowing is supported from the Council's cash balances rather than external debt. This not only reduces the cost of borrowing (bearing in mind the low returns on cash investments) but also ensures the Council does not increase accumulated debt based on spending profiles which are subsequently delayed. This strategy of internal borrowing is considered sustainable for the next two to three years providing there is no significant revenue need to draw down reserves and the council has sufficient cash balances. In the medium term this approach will need to be reviewed and revised as it will not be possible to sustain this level of capital investment without the greater achievement of savings, generation of income or increased funding.

2.24 The Treasury Management strategy is a key component of the Council's financial planning. This strategy sets out the proposed approach to borrowing and financial investments of cash reserves (other non-cash investments such as property investment are covered in the Investment Strategy). The Council's strategy seeks to strike an appropriate balance between security, accessibility and returns from managing the Council's cashflow and balances.

3. Conclusions

3.1 As Section 151 officer I can formally report that in my view the budget estimates are robust and the level of reserves adequate, as required by the Local Government Act 2003, on the assumption that the proposed council tax increases up to but not exceeding the 2% referendum threshold and 3% for ASC levy are agreed.

3.2 Council tax is now the most significant source of funding for council services. Any lesser increase than that proposed, without a corresponding reduction in base budget spending would have an adverse impact on the Council's financial resilience and ability to mitigate future spending risks or medium-term uncertainties over the future funding gap. This assessment has focussed on the significant uncertainty around spending and income forecasts for 2021-22 and that the Council has previously had adequate but comparatively less generous reserves for risks at the time.

3.3 A lower council tax increase, including deferment of some or all of the ASC levy until 2022-23 is permitted. In my view this would be a very risky financial strategy for the Council and would almost inevitably lead to the need for an in year draw down from general reserves. Whilst the proposed budget includes a contribution to general reserves this is part of a medium-term strategy that the Council should increase general reserves to 5% of net spending to improve its financial resilience. This target level of general reserves is essential in light of increased financial risks, the increased self-sufficiency of councils and greater reliance on tax income, and medium-term uncertainties. The proposed increase in general reserves in the 2021-22 budget would still not reach the 5% target but would be a step in the right direction. Any draw down from general reserves in 2021-22 would take the Council further from that target, and further weaken the Council's financial resilience. Whilst setting a lower council tax (either general or ASC precept) would not result in an illegal or unbalanced budget, it would in my opinion very likely seriously impair the adequacy of the Council's general reserves and consequently its financial resilience.

3.4 Finally, I draw members attention to the known correlation between those councils which have had the lowest council tax rates, lowest levels of reserves and subsequent concerns about financial management. Whilst reserves and council tax are not the only factors which could give rise to financial management concerns, they remain an important consideration in the assessment of financial resilience and sustainability. KCC's current council tax charge is around the average of all county councils, but levels of debt are well above average compared to levels of reserves which remain well below average. The levels of debt are being addressed through the review of the capital programme and avoiding long-term external borrowing, but the Council also needs to maintain levels of reserves which reflect levels of council spending, financial risks and medium-term uncertainty.

Recommendations:

(a) Pursuant to section 25 of the Local Government Act, the County Council is asked to NOTE this report and AGREE to have due regard to the contents when making decisions about the budget.

3. Contact details

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