Medway Council: Resilience Review

Final Report

January 2024

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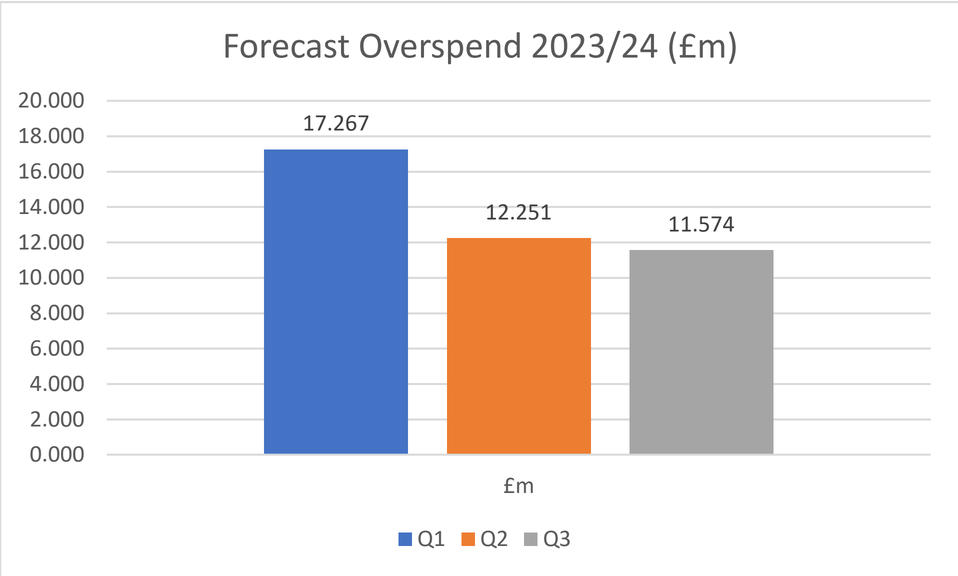
1. Executive Summary

Medway Council is in a grave situation in relation to its financial sustainability.

The Council is forecasting a significant overspend in 2023/24 on the budget agreed by the previous administration in February 2023. Whilst the forecast overspend has come down substantially since Q1, little downward movement has been achieved between Q2 and Q3 (based on the early indications for Q3).



In total, £10.947m in General Reserves was required to balance the revenue budget in 2022/23. This has left Medway with only £10.155m in General Reserves, which is not sufficient to cover the forecast overspend. Consequently, the Authority has begun developing a proposal to reclassify £5.727m of Earmarked Reserves as General Reserves taking the total of General Reserves to £15.882m. Whilst this would provide a sufficient level of General Reserves to fund the forecast overspend in 2023/24, it would leave Medway with only £4.308m in General Reserves (less than 1% of the 2024/25 budget requirement) at the start of the 2024/25 financial year.

The outlook for 2024/25 and subsequent years is even more challenging. The Medium Term Financial Outlook in September 2023 forecast a budget gap in 2024/25 of £38.745m rising to £71.840m in 2027/28. Whilst this gap reduced to £35.798m when the Draft Revenue Budget 2024/25 was produced in November 2023, there is little time in early 2024 to develop robust and credible proposals to close this gap before the start of the 2024/25 financial year.

This short timeframe, combined with the low level of General Reserves and the low rate of Council Tax in Medway (the lowest in Kent and below the English average) means Medway's room for manoeuvre is severely limited, especially given the Council consider that the Local Government Finance Settlement could further exacerbate the challenge facing Medway by an estimated £1.673m.

We acknowledge there is a great deal of activity ongoing in Medway to come up with proposals that will close the projected budget gap in 2024/25. However, our assessment is that it will not be possible to set a balanced budget that is credible and does not result in an overspend in 2024/25 without some form of intervention from Government.

The approach set out in the Draft Revenue Budgets 2024/25 states “This report reflects the introduction of a new approach to balancing the Council’s budget, whereby each Directorate will operate within an agreed budget allocation for 2024/25. The Directorate budget allocations reflected in this Draft Budget therefore assume the delivery of savings and additional income equal to the potential budget gap identified”.

In our opinion, this approach is extremely challenging as it tasks Directorates with absorbing the pressures which have been identified as part of the budgeting process. Even with some additional resources being directed, this still leaves the Children and Adult Services Directorate with a budget gap of £22.676m

There is a history of overspending in Children and Adult Services and most of the net overspend forecast in 2023/24 relates to this Directorate (£11.4m).

As part of this review we took an in-depth look at Adult Social Care and Children’s Services. In our view, paring back interventions to core responsibilities and tighter controlling of costs in these areas depends on structural and cultural change which will take time and may require investment. In the short-term, expecting the Directorate to close significant budget gaps is not sustainable.

Grant Thornton, in their Interim Auditor’s Annual Report 2022/23 in November 2023, say the Council needs a “realignment of priorities” including making “politically unattractive decisions” in “the interest of the Authority’s future viability”. We agree.

Urgent action is needed which recognises the need for this realignment and supports the case for intervention. Our perception is there has been an historic focus on Regeneration Culture and Environment, including place related activities and in sustaining what has been described as a “Rolls Royce” waste service. This is where many of the “politically unattractive” decisions lie. Without negating the value of these services to the residents of Medway, it is time to reconsider priorities and how they are delivered.

In order to secure intervention from DLUHC and avoid a S.114 notice and the potential appointment of Commissioners, Medway needs a robust, credible strategy to secure longer-term financial sustainability that shows the Council is prepared to act boldly and make those "politically unattractive" decisions. Medway will need to:

1. Estimate how much is required and over what period:
    - There needs to be sufficient to cover anticipated revenue cost pressures for 2024-25 and subsequent years until financial sustainability can be achieved
    - It should include the additional costs required to implement a recovery plan
    - The Authority needs to determine what assets it might sell and how it might scale back its capital programme to reduce the cost of borrowing
2. Develop an outline recovery plan that sets out how the Council will achieve financial sustainability in future. The Council will need to:
    - Develop a proposed plan for structural and cultural change in Adults and Children's services
    - Develop a plan for significant shorter-term cost reductions and income generation in the Regeneration, Culture and Environment Directorate
    - Review capital commitments to reduce impact on revenue budget – stop, delay, mothball
    - Identify those assets that are no longer cost effective to maintain or can help mitigate the costs of additional borrowing
3. Demonstrate that the Council is committed to delivering the changes required. The Council will need to:
    - Incorporate the importance of securing financial sustainability into a revised corporate plan
    - Introduce a more structured approach to developing and implementing savings plans
    - Build expertise in project management and change management to support the Directors
    - Consider the appointment of a Director of Change or external partner to drive and oversee the programme
    - Establish suitable governance arrangements to ensure the support and commitment of Members

If successful, intervention could take the form of:

- A Capitalisation Order
- Permission to raise Council Tax above the maximum allowable

There is limited time available in order to achieve this before the schedule of meetings of the Council and the Cabinet to agree a 2024/25 budget. It should be treated with the utmost urgency.

2. Introduction

Medway Council (Medway) identified a significant threat to its financial sustainability in relation to the current financial year, 2023/24, but more especially to 2024/25 and in subsequent years. As a consequence, it invited CIPFA to undertake a review of its financial position and to make recommendations on what might be done to remedy the issue.

We undertook a similar approach to that we have used with DLUHC commissioned reviews so that, if necessary, the report could be shared with DLUHC. Our approach was based on the DHLUC approach but included a deeper look at Children's Services, and Adult Social Care as these have been two major areas of expenditure with historic overspends.

This report covers the following areas:

- **Section 3: Financial Management and Sustainability**: An assessment of Medway's financial management and management of risk, financial pressures, deliverability of savings plans and efficiency in delivering services.
- **Section 4: Children and Adult Services**: An assessment of Children and Adult Services including a review of their current and future demand model, a review of key pressures budgets and improvement plans.
- **Section 5: Commercial Assets/Debt**: An assessment of Medway's assets and investments including dependence on commercial income, debt costs and other risks.
- **Section 6: Capital Programme/Companies**: An assessment of Medway's capital programme and management of related risks including arrangements with the three Medway-owned companies.
- **Section 7: Governance and Culture**: An assessment of Medway's governance/management processes, leadership, operational culture, whether it has the appropriate governance procedures in place, and the capability and capacity to make any necessary transformation.
- **Section 8: Roadmap**: A recommended direction the Council should take to resolving the outcome of our assessment.

3. Financial Management and Sustainability

Introduction

In relation to financial sustainability, Medway is in a grave situation. Overspending in 2023/24 will denude Medway of General Reserves going into the 2024/25 financial year; a year for which it will be extremely challenging to set a balanced budget that is both realistic in reflecting budget pressures and affordable given the resources available to the Council.

Financial Trajectory 2021/22 – 2023/24

Revenue Budget Outturn 2021/22

At its meeting on 18th February 2021, the Council set a total revenue budget requirement of £351.862m for 2021/22. Subsequent to this, additional grant funding related to the Covid-19 pandemic was received, primarily to deliver the Restart Grants scheme to support Medway's businesses, taking the final budget requirement to £371.472m.

Medway reported an underspend of £3.911m in 2021/22. There were underspends across all Directorates except Children and Adult Services, which accounted for 69% of the 2021/22 revenue budget, and reported an overspend of £9.646m. This was an increase in the forecast overspend in Children and Adult Services at Q3 of £1.025m (the overall position for Medway worsening by £1.711m from the Q3 forecast to outturn).

As set out in the report to Cabinet on 7th June 2022 (Revenue and Capital Budget Outturn 2021/22), overspends in Children and Adult Services related to:

- Adult Social Care - overspend of £1.269m;
- Children's Services - overspend of £7.447m;
- Education - overspend of £2.500m.

However, there was a significant underspend on Interest & Financing of £5.451m including £4.1m that had been budgeted for Minimum Revenue Provision (MRP) which was not required as it was determined there had been overprovision in prior years. In addition, there was a substantial underspend in Regeneration Culture and Environment (RCE) of £12.864m. Collectively, despite the overspend in Children and Adult Services, the underspends enabled Medway to avoid the £4.001m budgeted use of reserves to support the 2021/22 revenue budget.

Revenue Budget Outturn 2022/23

At its meeting on 24th February 2022, the Council set a total budget requirement of £351.982m for 2022/23. Subsequently, additional grant funding was received, primarily related to Council Tax Support for Energy Bills, taking the final total budget requirement to a total of £386.353m.

In 2022/23, Medway reported an overspend of £6.094m. This was an improvement of £6.239m compared to the Q3 forecast outturn. This overspend was met from General Reserves. Since the revenue budget already included the use of £4.853m of General Reserves, a total of £10.947m in General Reserves was required to balance the revenue budget in 2022/23.

Children and Adult Services accounted for 72.5% of the total 2022/23 revenue budget (£280.077m) and was overspent by £18.041m (6.4%). This was offset by underspends in Regeneration Culture and Environment (£3.349m), Business Support (£1.676m), Additional Government Support Grant Expenditure (£1.013m) and an improved position on Interest & Financing (£6.801m).

As set out in the report to Cabinet on 13th June 2023 (Revenue and Capital Budget Outturn and Annual Write Off Report 2022/23), overspends in Children and Adult Services related to:

- Adult Social Care - overspend of £5.868m;
- Children’s Services - overspend of £7.724m;
- Education - overspend of £4.947m.

Forecast Revenue Budget Outturn 2023/24

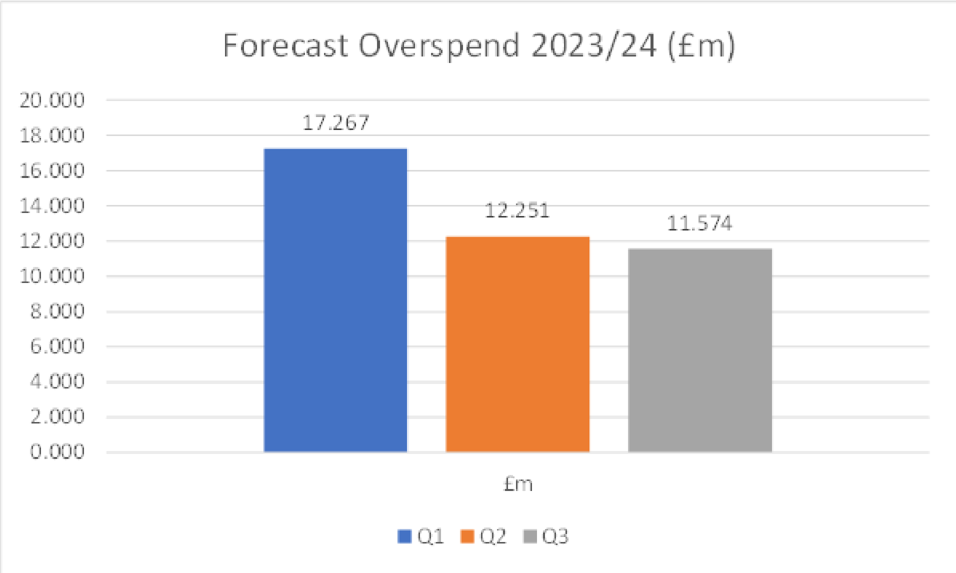
At its meeting on 23rd February 2023, the Council set a total budget requirement of £388.269m. Since then, additional grant funding was announced taking the Q2 budget requirement to a total of £392.543million. This includes the use of £2.985m of Earmarked Reserves (the Rate Equalisation Reserve) in relation to Interest & Financing. The budget set in February 2023 was inherited by the new administration in May 2023.

At Q1 the forecast outturn was an overspend of £17, 267m. By Q2 this had reduced to £12.251m with Children and Adult Services accounting for £10.831m of this forecast overspend in relation to:

- Adult Social Care - overspend of £7.312m;
- Children’s Services - overspend of £1.866m;
- Education - overspend of £1.713m.

In addition, at Q2 there were forecast overspends in Regeneration Culture and Environment (£0.816m) and Business Support (£2.568m).

Whilst the Q3 forecast outturn is yet to be finalised, the current indication (as at 18th December 2023) is that the forecast outturn overspend has reduced only marginally, by £0.677m to £11.574m, as is illustrated below.



Forecast outturns have worsened for Children and Adult Services (£0.500m) and Regeneration Culture and Environment (£0.152m) have worsened since Q2. This is offset by a reduction in the forecast overspend in Business Support (£0.430m). It is also offset by an increased forecast underspend in Business Support Centralised Services (£0.921m) though this does include a further £0.990m from the Rate Equalisation Reserve, which will reduce to zero.

There had been some optimism when CIPFA first engaged with Medway that there would be a more substantial fall in the forecast overspend at Q3. It does not appear such a substantial fall will materialise, although there remains some optimism amongst interviewees that the overspend can be further contained by the end of the financial year.

As a precautionary measure, work has been going on to review Earmarked Reserves to identify the extent to which specific Earmarked Reserves could be reclassified to support the General Reserves position.

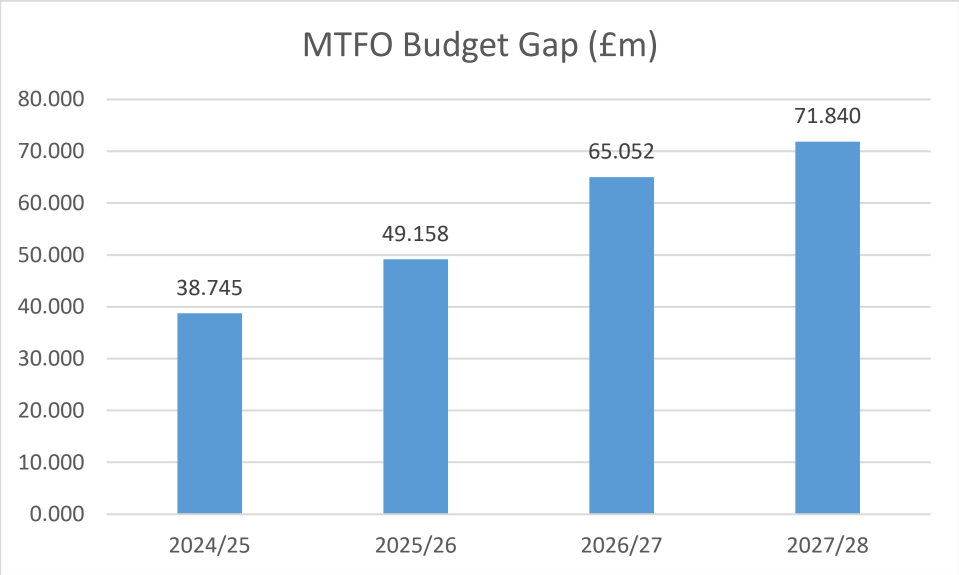
Interviewees stated that the emerging proposal is to reclassify £5.727m of Earmarked Reserves as General Reserves, taking the total of General Reserves to £15.882m and these proposals will be presented to Members for approval in February 2024, at the same time the draft 2024/25 budget is presented.

Whilst such a reclassification of Earmarked Reserves will provide a sufficient level of General Reserves to fund the forecast overspend in 2023/24, on the basis of the current Q3 forecast, this would leave Medway with only £4.308m in General Reserves at the start of the 2024/25 financial year.

MTFO 2024 – 2028 and Draft Revenue Budget 2024/25

Medium Term Financial Outlook 2024 - 2028

The Medium Term Financial Outlook 2024 - 2028 report to Cabinet on 26th September 2023 indicated a far worse position going forward with a budget gap of £38.745m in 2024/25 rising to £71,840m in 2027/28, as is illustrated below.



At the time the 2023/24 revenue budget was agreed in February 2023, Cabinet and Council considered the projected budget requirement and resources for future years. At that time, a potential budget gap of between £7.156m and £15.429m for 2024/25 was projected, less than half that indicated in the Medium Term Financial Outlook 2024 – 2028 only seven months later in September 2023.

We do note that a similarly stark warning had been given in October 2022 to Cabinet when it had considered the Financial Outlook 2023/24 when a budget gap for 2023/24 for 2023/24 of between £32.626m and £56.243m had been projected. This had been reduced to a projected budget gap of £28.683m by November 2022 when the Draft 2023/24 budget was presented to the Cabinet. In the event a balanced budget was set in February 2023 albeit the draft budget considered by the Council had a remaining gap of £1.937m whereupon a series of savings were approved in order to fund newly announced initiatives and close the remaining budget deficit.

Draft Revenue Budget 2024/25

The Draft Capital and Revenue Budgets 2024/25 presented to Cabinet on 21st November 2023 identified a projected budget gap of £35.798m, a reduction of £2.947m compared to the Medium Term Financial Outlook in September 2023. £22.676m of this draft budget gap is in relation to Children and Adult Services, £7.621m is in relation to Regeneration Culture and Environment and £5.502m is in relation to Interest & Financing.

The Draft Capital and Revenue Budgets 2024/25 states ""This report reflects the introduction of new approach to balancing the Council's budget, whereby each Directorate will operate within an agreed budget allocation for 2024/25. The Directorate budget allocations reflected in this Draft Budget therefore assume the delivery of savings and additional income equal to the potential budget gap identified". It also states "In the meantime, Portfolio Holders and senior officers are working to identify a range of measures to balance the budget".

This approach assumes that the budget gap identified can be contained despite the significant budget pressures driving this gap, particularly in Children and Adult Services where almost two thirds of the budget gap lies.

The Draft Capital and Revenue Budgets 2024/25 identifies the risk of Medway failing to deliver a balanced budget for 2024/25 and it being necessary for the S.151 Officer to issue a S.114 report as BII (likely probability and major impact – the second highest impact category). In the Medium Term Financial Outlook 2024 - 2028 report to Cabinet on 26th September 2023 this same risk has been identified as AII (very likely probability and major impact). In neither case was the impact of this risk materialising considered to be catastrophic – the highest impact category.

Reserves Position

In considering the draft budget for 2024/25 and the medium-term financial outlook it is important to be cognisant of Medway's reserves position.

Medway's reserve position at 31st March 2023 as set out in the Draft Capital and Revenue Budgets report presented to Cabinet on 21st November 2023 was:

Type of Reserve	Closing Balance 31/03/2019 £000	Closing Balance 31/03/2020 £000	Closing Balance 31/03/2021 £000	Closing Balance 31/03/2022 DRAFT £000	Closing Balance 31/03/2023 DRAFT £000
General Fund Balance	5,000	10,000	10,000	10,000	10,000
General Fund Earmarked Reserves	18,045	28,562	53,526	40,141	32,040
General Reserves	4,039	9,197	12,689	16,551	155
Insurance Fund	1,216	960	2,459	2,483	3,179
Schools Balances	2,004	1,356	1,414	1,750	1,756
HRA Balances	5,114	5,145	5,395	5,283	6,373
Capital Grants / Contributions	10,988	18,764	25,916	21,092	44,151
Capital Receipts Reserves	1,110	5,463	6,674	8,113	4,067
HRA Major Repairs Reserve	100	0	0	0	0
Total Usable Reserves	**47,616**	**79,447**	**118,073**	**105,413**	**101,720**
Unusable Reserve – DSG Adjustment Account	(4,139)	(9,346)	(16,261)	(24,729)	(26,843)

Whilst General Reserves had risen from £9.039m at 31st March 2019 to £26.551m by 31st March 2022, they had fallen to £10.155m by 31st March 2023, £10.947m being used to fund the 2022/23 outturn position. At 31st March 2023, the level of General Reserves equated to just 2.6% of the 2023/24 revenue budget requirement.

The S.151 Officer's Section 25 Statement in the Capital and Revenue Budget report to Council on 23rd February 2023 states "whilst the current level of reserves does not point to the Council's longer-term sustainability, there are sufficient general reserves available to the Council to balance the budget for 2023/24". In the event, the current level of General Reserves is insufficient to fund the Q3 forecast over-spend of £11.574m.

At 31st March 2023 General Fund Earmarked Reserves totalled £32.040m, having fallen from £53.525m at 31st March 2021. £2.985m of the Rate Equalisation Reserve was included in the 2023/24 budget in relation to Interest & Financing.

As we have mentioned above, Medway is undertaking an exercise to review Earmarked Reserves in order to identify the potential for reclassification as General Reserves, £5.727m of such reclassification being proposed to support the forecast overspend in 2023/24.

A local authority relies on its financial reserves to provide funding for investment in future activities and to act as a safety net in case of short-term financial challenges. It is important to note that Earmarked Reserves are set aside for specific purposes and cannot necessarily be used to bridge budget gaps unless the intended use of such reserves is no longer applicable.

Assuming the reclassification of the £5.727 of Earmarked Reserves as General Reserves goes ahead and given the Q3 forecast overspend of £11.574m, this would leave only

£4.308m in General Reserves at the start of the 2024/25 financial year which is less than 1% of the 2024/25 budget requirement.

CIPFA guidance states that using reserves to fund otherwise unsustainable services or to defer the need to make difficult decisions about service delivery should be avoided. Such an approach does nothing to enhance financial resilience. It also serves to make those difficult decisions even more difficult when they inevitably have to be made in the future.

Financial Management, Risk Management and Compliance

Financial Management

CIPFA has not undertaken a formal assessment of financial management at Medway through, for example, CIPFA's FM Model. We are not aware of Medway having undertaken a self-assessment using this model.

Our observation is that Medway has well established financial management processes that result in detailed reports to the Cabinet and to the Council as a basis for decision-making. Grant Thornton, Medway's External Auditor, note in their Interim Auditor's Annual Report 2022/23 (dated November 2023) that the overspend in 2022/23 and forecast overspend in 2023/24 have been predominantly driven by rising costs and demand for Children and Adult Services but that in other areas of the business reasonable budget processes are in place.

Grant Thornton also note that monthly monitoring occurs at budget holder level throughout the year with reporting on (forecast) outturn to Cabinet on a quarterly basis.

Given the financial position of the Council, we question whether quarterly forecasting is frequent enough. There is a lack of "in-flight" information during the course of the financial year especially when the timing of current quarterly forecasts is taken into account.

The Q2 forecast went to Cabinet in November 2023 and Cabinet will not see the Q3 forecast until February 2024. Whilst we recognise that an early indication of direction of travel is possible with the current arrangements, more frequent (monthly) forecasting would provide a more robust foundation for financial management especially given the size of the challenge facing Medway moving forward.

In addition, in our opinion, alignment of the timing of the production of a Medium Term Financial Plan at the same time as the Budget is approved, would support a more strategic approach to resolving the financial challenge facing Medway; articulating the plans to attain and maintain financial sustainability in the upcoming financial year and in subsequent years.

This does not preclude the production of a Medium Term Financial Outlook in the Autumn, as a basis for identifying the scale of the challenge, which can then be developed and refined for approval at the same time as the Budget.

We are aware that a great deal of effort is going into identifying savings proposals for 2024/25 and subsequent years. It is vitally important that these form a robust programme which is closely monitored in a visible/transparent way.

It is difficult currently to track progress on savings since these are absorbed into the budget. In their Interim Auditor's Annual Report 2022/23 (dated November 2023), Grant Thornton recommend that Medway should introduce separate monitoring of savings proposals.

We concur with Grant Thornton's recommendation. This, together with our recommendations on more frequent (monthly) forecasting and alignment of a Medium Term Financial Plan with Budget setting are important enhancements to the current financial management arrangements which will support Medway in achieving a financially sustainable position.

Risk Management

Grant Thornton also state in their Interim Auditor's Annual Report 2022/23 that Medway has in place effective processes for risk management and internal control.

Internal audit take a risk based approach which, since 2022/23, has incorporated financial risk, fraud risk and corporate strategic priorities for determining their programme of work.

Key financial reports include a section on risk management which includes a risk rating of the specific risk identified (likelihood) and impact) together with actions to avoid or mitigate the risk. Likelihood and Impact categories are set out below.

Likelihood	**Impact:**
A Very likely B Likely C Unlikely D Rare	I Catastrophic II Major III Moderate IV Minor

Compliance with Local Government accounting codes and international financial reporting standards

As set out in the draft Statement of Accounts 2021/22, the financial statements are prepared and published in accordance with the Accounts and Audit Regulations 2015 and the Code of Practice on Local Authority Accounting in the United Kingdom issued by the Chartered Institute of Public Finance and Accountancy. The Code is based on International Financial

Reporting Standards, as adapted for the UK public sector under the oversight of the Financial Reporting Advisory Board.

The accounting policies applied by the Council in preparing and presenting its financial statements confirm that the Authority complies with the Accounting Code and relevant statutory reporting requirements.

However, Medway has only recently published its unaudited draft Statement of Accounts 2021/22 and the draft Statement of Accounts 2022/23 has not yet been prepared, though it is planned to complete this by February 2024. Medway will, thus, commence the new financial year with two years of accounts remaining to be audited.

Conclusion

Whilst it appears Medway has the ability to survive 2023/24 through the use of reserves, including Earmarked Reserves reclassified as General Reserves, the situation is quite different in 2024/25 and in subsequent years.

There is little time to develop robust and credible proposals to close this gap before the start of the 2024/25 financial year. This short timeframe, combined with the low level of General Reserves and the low rate of Council Tax in Medway (the lowest in Kent and below the English average) means Medway's room for manoeuvre is severely limited, especially given the Council consider that the Local Government Finance Settlement could further exacerbate the challenge facing Medway by an estimated £1.673m.

We acknowledge there is a great deal of activity ongoing in Medway to come up with proposals that will close the projected budget gap in 2024/25. However, our assessment is that it will not be possible to set a balanced budget that is credible and does not result in an overspend in 2024/25 without some form of intervention from Government.

Grant Thornton, in their Interim Auditor's Annual Report 2022/23, say the Council needs a "realignment of priorities" including making "politically unattractive decisions" in "the interest of the Authority's future viability".

There is an expectation within the Authority that Children's and Adult Services can make the £22.676m savings needed to close their budget gap in 2024/25. Our analysis in Section 4 suggests that costs can only be contained in the longer run though both structural and cultural change.

There seem more immediate opportunities in Regeneration Culture and Environment where many of those "politically unattractive" decisions lie.

4. Children and Adult Services

Overview

The Children and Adult Services Directorate encompasses Adult Social Care, Children's Services, Education and Public Health. The most significant financial challenge and hence threat to Medway's financial sustainability arises in relation to Children and Adult Services, more particularly in relation to Adult Social Care and Children's Services.

At a Directorate level there has been an overspend in three consecutive years from 2021/22 to 2023/24 (based on the Q2 forecast outturn as is set out below:

Children and Adult Services	**2021/22**	**2022/23**	**2023/24**
Budget £m	256.174	280.077	298.161
Outturn (Q2 Forecast for 2023/24) £m	265.820	298.118	308.992
Overspend £m	**9.646**	**18.041**	**10.831**

Accounting for 76% of the budget requirement in 2023/24, the Q3 forecast outturn, whilst not finalised, indicates the overspend in 2023/24 is now likely to be in the region of £11.4m.

The Medium Term Financial Outlook in respect of the Children and Adult Services Directorate presents further challenge. The Draft Revenue and Capital Budgets 2024/25 identify a budget requirement for the Directorate of £321.363m and a proposed budget allocation of £298.687m, implying that £22.676m needs to be absorbed or saved in order for Children and Adult Services to support Medway in achieving a balanced budget. The Medium Term Financial Outlook indicates further substantial pressures of circa £16m per year in each of the subsequent years to 2027/28.

Children's Services was rated 'Inadequate' in 2019 and only achieved 'Good' in July 2023 following substantial investment, circa £32m, over a number of years. CQC are scheduled to inspect Adult Social Care in 2024/25 and the views expressed to us is that an assessment of 'Requires Improvement' or possibly 'Good' is likely but this is speculative.

This simply underlines the continuing challenge facing Medway in attempting to contain costs whilst coping with both demand and inflationary pressures in services which have a statutory basis and where failure can have serious consequences for vulnerable individuals, families and for the Council itself.

It is in this context that decisions regarding future funding of Adult Social Care and Children's Services need to be made, including what realistic contribution these services can make to achieving financial sustainability and over what time period.

The current social care practice model is largely risk-based in its approach. The current management plan is to move it towards a more family support model that will reduce the influx of new cases, but this will take time. In the circumstances, the following sections focus on the current pressures and the potential to mitigate these pressures in Adult Social care and Children's Services.

Adult Social Care

There has been an overspend in Adult Social Care for three consecutive years from 2021/22 to 2023/24 (based on the Q2 forecast outturn) as is set out below:

Adult Social Care	**2021/22**	**2022/23**	**2023/24**
Budget £m	77.041	80.100	88.247
Outturn (Q2 Forecast for 2023/24) £m	78.310	85.968	95.559
Overspend £m	**1.269**	**5.868**	**7.312**

There are just over 278,000 people living in Medway (278,556 in 2019). Of these, 61,725 are children and young people aged 0 to 16, and 174,674 are working age adults (16-65), and 42,157 are older people (65+). The Authority had previously reported that by 2023 the number of people aged over 65 years would increase by over four thousand (10%) and the number aged over 85 years would increase by 900 (18%). Whilst these estimates are difficult to substantiate, ONS data forecast a steady increase in the proportion of the Medway population aged 65 or over, from 16.7 per cent of the population in 2023 to 17.6 per cent by 2027 – equivalent to nearly an extra 2,000 people based on 2021 census data.

The Authority has assumed a three per cent increase in demand for adult social care in 2024-25 and subsequent years, partly to reflect the ageing population and the expectation that the complexity of cases will also increase. Inflation and other cost pressures on providers are also expected to increase costs by a further 5.4 per cent in 2024-25. Together these factors are estimated to generate a cost pressure of £8.325 million in adult social care between 2023-24 and 2024-25.

When the recurring estimated cost over-run from 2023-24 of £7.3 million (based on Q2 data) is added in, alongside other identified cost pressures of some £1.5 million, the pressures in 2024-25 are likely to add around an extra £17 million to the budget requirement for 2024-25. More precise estimates are dependent on visibility of more up to date forecast out-turn data for 2023-24.

These cost pressures do not take into account the additional costs otherwise planned to be incurred in 2024-25 to implement wider reforms, such as the 'right sizing' initiative to build capacity and permanent rather than temporary staff. Furthermore, an initial self-assessment prior to an anticipated CQC review has identified that transition arrangements from children's services to adult services are likely to require improvement; the changes required and associated costs have yet to be determined.

CIPFA's benchmarking data indicates that Medway Council has historically spent less per capita on adult social care than other similar authorities. Nevertheless, mitigating the impending cost pressures in 2024-25 is dependent on identifying and delivering cost savings and more strategic reforms to avoid the position worsening in subsequent years.

More immediate cost reductions planned for 2024-25 comprise:

- Actions to mitigate the recurring cost over-runs in 2023-24. The Directorate have been proactive in setting up panels to review the value for money of assessments, and a stipulation that any costs over £400 a week have to be authorised by senior staff.
- Enabling social care staff to be more proactive in encouraging families to be more independent.
- Driving efficiencies in brokerage.
- Ongoing panel reviews to ensure that clients are only offered the minimum provision necessary.

Such measures will help to mitigate the cost pressures, but we do not consider that they are sufficient to eliminate the existing quantified pressures let alone the other potential costs that may be required to address any issues that might be raised in the CQC inspection.

- **A review of the commissioning arrangements for young people with mental health issues**. We understand that the NHS is willing to engage with a discussion about sufficiency and pressures, financial contributions, and targets but to date there do not seem to be settled protocols about joint funding.
- **Better performance data to strengthen the transition arrangements from children's services to adult social care**. Effective transition and budget control, are dependent on enabling earlier reviews and plans so that cost effective arrangements can be organised from the outset.
- **Sufficiency planning**. A strategic review of the possibility of Medway developing a greater in-house care market to reduce the costs of external provision.
- **Workforce restructuring**. Building in-house capacity to reduce the reliance on temporary staff.

The Authority is also consulting more widely through the LGA on the scope for further cost reductions in adult social care.

It was evident from our interviews that the service has a strong understanding of the financial pressures within the service and have shown a commitment to driving performance improvements. Some further in-year savings might be achievable, but the cultural changes required to ensure that provision is kept to the minimum necessary, and the structural changes needed to improve the efficiency of provision and workforce management will require up-front investment and are likely to take time before they can be realised.

Children's Services

There has been an overspend in Children's Services for three consecutive years from 2021/22 to 2023/24 (based on the Q2 forecast outturn) as is set out below:

Children's Services	**2021/22**	**2022/23**	**2023/24**
Budget £m	54,835.000	58,835.000	70,848.000
Outturn (Q2 Forecast for 2023/24) £m	62,283.000	66,559.000	72,714.000
Overspend £m	**7,448.000**	**7,724.000**	**1,866.000**

The financial position in Children's Services appears to have stabilised somewhat following significant overspends in prior years. Medway has made significant investment in the Children's Services budget since the service was assessed by Ofsted as inadequate though this is in the context that CIPFA's benchmarking data indicates that Medway historically spent less per capita on Children's Services than other similar authorities.

Increases in the budget in 2023/24 were offset in part by a series of proposed cost avoidance measures to reduce the net increase:

- Efficiencies in the planning and tracking of support packages to save £2.500m
- Savings from increased residential capacity of £1.561m
- Capacity improvements for care leavers to save £0.837m
- Facilitating greater parental support to save £0.509m

The Directorate has monitored progress in the delivery of planned savings and overall expects to achieve the targets set for 2023-24. Interviewees also stated to us that initiatives are beginning to make a difference. The introduction of a 'Pause' type model to address repeat pregnancy has apparently brought in-year savings with more predicted next year.

There are actions in place to reduce the number of children on a child protection plan and we understand that work has been done at the front door to ensure that referrals to assessments are increasingly efficient.

Whilst the financial position in 2023-24 for Children's services has been more stable than previously, pressures remain. The Council's demand management plan (October 2023) confirms that referral rates have continued to rise with consequent impacts on the numbers of children in need and those requiring protection and care. There were 676 open children in need plans in October 2023, compared to 518 twelve months previously.

The growth in new cases has meant that the open caseload in Children's Services had reached 1,131 cases by October 2023. The increased demand for social workers in response to such pressures necessitated the recruitment of project teams. Despite this, the staffing establishment remains light. By October 2023 there were eight teams of 48 social workers with nine vacant posts and two Social Workers off on sickness absence (one long term) all of which are covered by agency Social Workers. On the basis that the typical caseload should be 20 cases, this suggests that the authority either needs to increase throughput to reduce numbers and costs of those in care, or to recruit another eight to nine social worker posts.

On reducing throughput, we understand that all existing children in need cases where the child has been open for 9 months or more are being subject to review in 2023 to explore whether it is possible to pursue a step down or to close the case.

In relation to the cost of care, the Service has indicated that improvements in post-16 step down could save £400,000 a year and that removing the need for three high-cost placements could save a further £405,000 a year. It is not yet clear whether the review is likely to achieve such savings, but we did note from our document review that we could not find a strong narrative about the emergent practice model needed to achieve such impacts.

Existing savings plans include little on the costs of commissioning and procuring placements, although we understand that there is currently a focus on Fostering where the service is experiencing a net loss of foster carers to retirement and to independent providers. Nevertheless, interviews suggest that commissioning strategies for placements and partnership work could be more developed. Many councils are now developing a working assumption of standard percentages of shared costs to be contributed which reduces lengthy negotiations and achieve budget savings.

In the shorter-term, workforce savings are largely focused on freezing the recruitment of posts to fill vacancies. For 2024-25, however, the Service aims to draw on its improved reputation associated with a ‘Good’ rating from the latest Ofsted inspection and the increased pay award plans to improve recruitment and retention and lessen the reliance and cost of agency and interim staff. In particular, it plans to remove the three project teams (two of which are over establishment) and to reduce costs and reliance on agency staff.

It is too early to assess progress, but the chances of success might be improved by offering some sort of ‘golden hello’ measure, and a stronger review strategy to secure the future employment of social workers in their first three years of practice. A commitment to a gradual reduction of caseloads as numbers of children who are in care reduce will assist retention.

In conclusion, opportunities to reduce costs in the shorter-term in Children’s Services need to be balanced against the importance of not falling behind on the improvements needed to sustain a ‘Good’ rating from OFSTED through rising caseloads. The more significant savings from reducing the numbers of referrals and increasing throughput and step down is dependent on building a cadre of committed and experienced in-house social workers. This is more likely to require up-front investment for longer term gain.

Conclusion

The forecast overspend for the Children and Adult Services Directorate in 2023/24 has increased by £0.5m between Q2 and Q3. The draft Revenue Budget 2024/25 indicates that, even with additional resources being directed toward the Children and Adult Services Directorate, that £22.676m needs to be absorbed or saved in order for Children and Adult Services to support Medway in achieving a balanced budget. Further pressures in the subsequent years to 2027/26 of circa £16m per year are identified in the Medium Term Financial Outlook.

Based on our assessment, whilst there might be some short-term savings to be achieved in 2024/25, closing the projected budget gap for 2024/25 will be extremely challenging. There is an ongoing need to secure as many savings as possible. Nevertheless, the introduction of a budget allocation which assumes achievement of the £22.676m savings in 2024/25 is highly likely to result in an overspend in 2024/25 and undermine the integrity of any balanced budget the Council approves.

Instead, medium to longer-term structural and cultural change is needed to pare back interventions to core responsibilities and to tighten controls over costs, thereby securing greater certainty and budgetary control to support the financial sustainability of the Council.

5. Commercial Investments and Debt

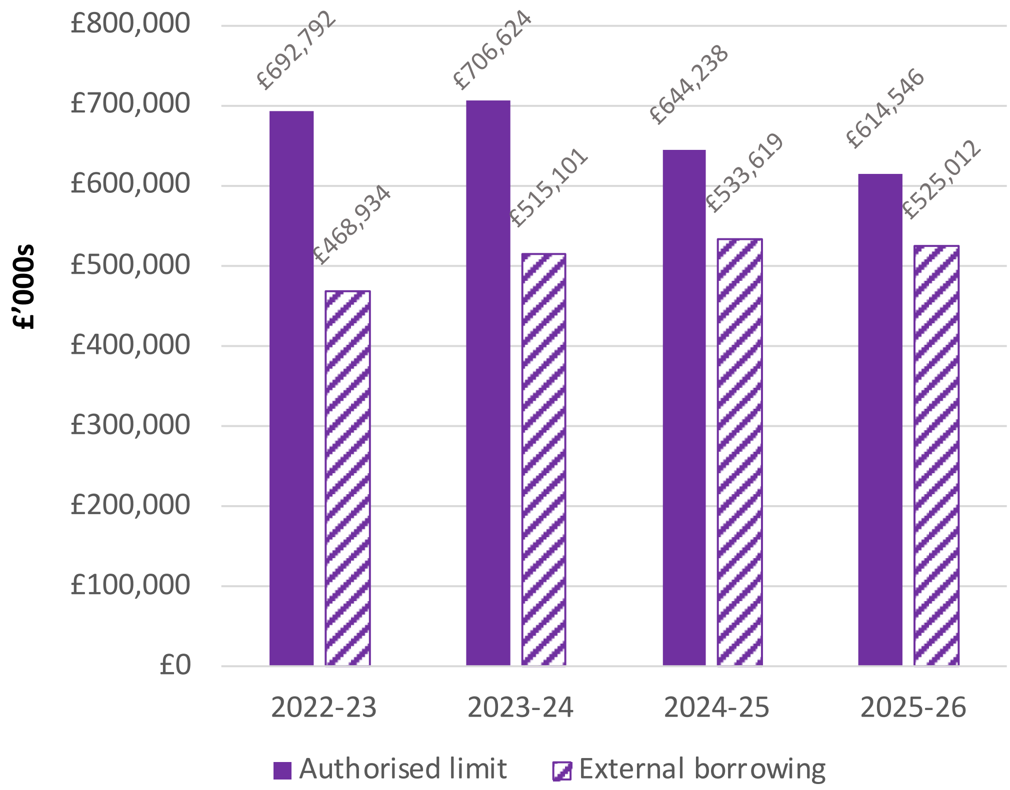
Level of Debt

The purpose of the Capital Financing Requirement (CFR) is to demonstrate that Council borrowing is undertaken to fund capital expenditure only. An updated estimate of the CFR and borrowing position compared with the estimate included in the Treasury Strategy as set out in the Treasury Management Strategy Mid-Year Review Report 2023/24 to the Audit Committee on 29th November 2023 is shown in the table below:

CFR & Borrowing	Per Strategy £000	Revised Estimate £000
CFR 31 March 2024	540,386	537,903
External Debt	463,363	515,101
Under-borrowing	77,023	22,802
Estimated In Year Borrowing Required	12,575	54,428

The S.151 Officer reported to the Audit Committee that no difficulties are envisaged for the current or future years in ensuring that borrowing does not exceed CFR.

The Authorised Limit is a prudential indicator which controls the overall level of borrowing and is the limit beyond which borrowing is prohibited.



The Council's authorised borrowing limit for 2023/24 is £706.624 million and it will not exceed this limit. External debt compared to the Authorised Limit is set below from 2022/23 to 2025/26.

Medway's Treasury Management Strategy planned to keep external borrowing between 62% and 65% of the Authorised Limit and below the operational boundary of £640.4 million for 2023-24. Medway's strategy was predicated, however, on the assumption that it would maintain a strongly under-borrowed financial position. Some £77m of reserves and capital receipts were expected to be used to offset the CFR, thereby decreasing the need for further borrowing. By November 2023, however, the £52m of anticipated capital receipts due in 2023-24 are no longer expected and the capital financing requirement has consequently increased.

The estimated in-year borrowing requirement for 2023-24 has increased from £12.575m million to £54.428 million. External borrowing is now expected to increase to 85% of the Authorised Limit by 2025-26. Whilst this is still within the Authorised Limit and prudential indicators set by the Council, it does reduce Medway's headroom for any additional borrowing.

Medway is not at risk of breaching the Authorised Limit and, thus, has the flexibility to borrow more if required. Nevertheless, the rising costs of borrowing and the associated impact on the revenue budget means that it would be prudent to minimise the need for further loans where possible and reduce the level of borrowing if possible.

Interest & Financing Costs

A breakdown of the Interest and Financing budget is shown below:

	Budget 2023/24 £000
Interest Earned	(5,841)
Interest Paid	13,430
KCC Principal	1,204
MRP	6,442
Treasury Costs	65
Total	**15,300**

Spend of £21.141m is offset by income of £5.841m. £2.985million of the £15.300 net budget is funded from Earmarked Reserves (the Rate Equalisation Fund).

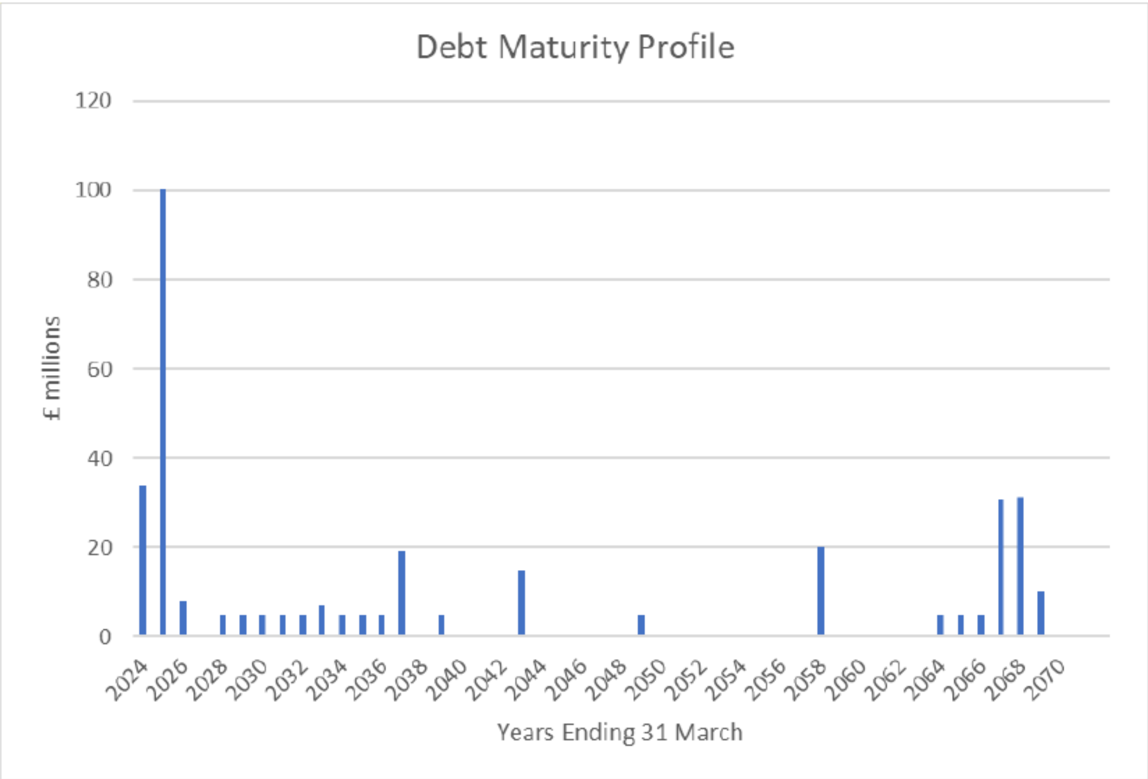
The Q2 forecast outturn for Interest and Financing is £13.639m, an underspend of £1.661m. However, the Draft Revenue Budget 2024/25 indicates a budget requirement in 2024/25 of

£20.082m and a budget gap of £5.502m compared to the proposed budget allocation of £15.300m (the same as in 2023/24).

The draft Revenue Budget 2024/25 states "Work to address this pressure and deliver within the budget allocation for Interest & Financing of £15.300m is focused on a review of the capital programme, seeking to reduce, refinance or curtail any schemes that are not essential to the delivery of the Council's objectives. A review of the Council's assets is also underway, with capital receipts generated from the sale of any assets that are surplus to requirements being used to fund schemes and reduce the borrowing requirement".

Refinancing Risks

The Treasury Management Strategy Mid-Year Review Report 2023/24 to the Audit Committee on 29th November 2023 illustrated the debt portfolio repayment profile as at 13 November 2023.



There is an inherent interest rate risk in relation to refinancing, which is enhanced when a large proportion of the debt portfolio matures at the same time. Medway is facing such a risk in 2024/25 when circa £100m in debt is due to mature.

Medway's position is exacerbated due to a high proportion of the debt relating to LOBO's (Lender Option Borrower Option) where there can be a greater degree of uncertainty since have a variety of "call" periods from as little as six months. As is stated in the report to the

Audit Committee “The risk of a call occurring is higher than before due to the rise in interest but at the time of writing no approaches have been made by the lenders”. However, one LOBO of £5m was repaid on a call date in August 2023 following notice of an increase in the interest rate payable to 6.35%. The loan was refinanced at 5%.

Medway’s recent strategy has been to reduce interest rate risk and smooth the borrowing repayment profile by taking out new borrowing for longer repayment terms. However, this has proven to be difficult to date. However, the Treasury Management Strategy Mid-Year Review Report 2023/24 states “The aim over the next few months will be to avoid increasing the overall amount due for repayment in 2024/25 and concentrate new borrowing for repayment in 2025/26 and 2026/27. Many of the new loans are likely to be taken from the Public Works Loans Board (PWLB). Any further smoothing would require the use of longer-term funding from PWLB but the continued high levels in interest rates mean this would be expensive”.

Medway has used an Earmarked Reserve, the Rate Equalisation Fund, to mitigate risk. However, £2.985m of this has been used in 2023/24 to support the Interest & Financing budget and the remaining £0.990m in this fund is part of the Earmarked Reserves that the Authority expects to use to support the forecast overspend in 2023/24.

Given the debt portfolio maturity profile and Medway’s potential exposure, in addition to scaling back the borrowing requirement through the ongoing review of the capital programme and work to identify a programme of asset sales.

Asset Disposal Plan

As is referred to above, the Draft Revenue Budget 2024/25 does identify that a review is ongoing into potential asset disposals to reduce the borrowing requirement. Surplus assets, those no longer held for operational purposes, have been identified but a comprehensive programme of divestment has not yet been determined which might include other assets beyond those defined as “surplus” that are attractive to the market where their sale could contribute to Medway’s longer-term financial sustainability.

Commercial Investment Portfolio

The Treasury Management Strategy Mid-Year Review Report 2023/24 states “In accordance with the Code, it is the Council’s priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council’s risk appetite”. A full list of investments held as at 13 November 2023 is shown below:

Investments: Core Investments	**Principal 13 November 2023 £**	**Interest %**
CCLA Property Fund (September 2023 market value)	11,693,715	n/a
Patriza Hannover Property UT (September 2023 market value)	4,973,700	n/a
Lothbury Property Trust (September 2023 market value)	3,948,758	n/a
Total Core Investments	**20,616,173**	n/a
Investments: Liquid investments	**Principal 13 November 2023 £**	**Interest] %**
Svenska Handelsbanken	1,152	0.00%
Lloyds	283,779	5.14%
Barclays	4,427	0.00%
Santander	0	3.43%
CCLA Public Sector Deposit Fund	8,763,822	5.19%
Total Liquid Investment	**9,053,179**	n/a

Investments	**Principal 13 November 2023 £**	**Interest %**
Total In house Investments	29,669,352	n/a

The overall performance of the investment in property funds since purchase as shown below.

Detail	**£**	**£**
Invested 2015/16	3,000,000	
Invested 2017/18	19,999,365	
Total Cost of Investment		22,999,365
Current Valuation (as above)		20,616,173
Capital (Loss) to Date		(2,383,192)
Dividends Received 2015/16 to 2020/22	4,233,381	
Dividends 23/24 to Date*	415,175	
Total Dividends to Date		4,648,556
Total Return to Date		2,265,364

*Patriza has yet to declare the dividend for the second quarter. The dividend for the first quarter was £48,607. The amount of £415,175 reflects only the amounts actually received.

Whilst property funds are a relatively secure investment, performance has been adversely impacted in 2023 due to higher inflation rates, interest rate rises and changes in demand due to the post-Covid reduction in demand for office accommodation. It can be more difficult to transfer monies in and out of property funds compared to stocks or bonds, meaning that such funds tend to have more restrictions on the timing of such requests.

The Treasury Management Strategy Mid-Year Review Report 2023/24 states “The Redemptions in Lothbury Property Fund are suspended. The fund managers have issued a Notice of Termination under which, unless an alternative solution can be found, the Fund will be would up on 31 December 2023. This may crystalise a loss of around £1.05m which will need to be recognised in the Council’s revenue account. However, the latest information from Lothbury indicates that the fund may merge with one operated by another fund manager, which may avoid crystallisation. If no merger is possible, the managers have stated that it is not necessary to sell all the properties held by the Fund by the termination date and that distributions of capital will take place over time”.

This situation was caused by a large number of redemption applications due to poor performance. No suspensions are expected in relation to the other two property funds.

However, as was reported to the Audit Committee, capital values of property funds have continued to decline and there are no current plans to divest. Given Medway’s financial position, divestment might have to be reconsidered if a financial case can be made for it.

Conclusion

Whilst borrowing is within the Authorised Limit and the S.151 Officer has given assurances that borrowing will not exceed CFR, securing the future sustainability of Medway necessitates a concerted effort to reduce the borrowing requirement in relation to Medway’s capital programme together with a structured and timely disposal of assets

This is particularly the case given other potential pressures that might increase the borrowing requirement including the cost of repairing the RAAC/renovating Gun Wharf which is estimated to be in the region of £15m - £20m and the proposal to acquire temporary accommodation to combat homelessness costs which is in the region of £40m

Medway will need to be mindful of the need to create headroom in the case of applying for a Capitalisation Order which would be funded through borrowing unless capital receipts can be generated to at least part fund it.

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6. Capital Programme and Companies

Scale of the Capital Programme

The Capital Budget Monitoring Q2 report to Cabinet on 21st November 2023 sets out the currently agreed capital programme/

Directorate	Total Approved Cost £000s	Total Expenditure to 31/03/23 £000s	Remaining Budget £000s	Forecast Spend 2023/24 £000s	Forecast Spend in Future Years £000s	Forecast (Under)/ overspend £000s
Children and Adults (including Public Health)	77,506	34,200	42,984	16,217	26,762	(5)
Regeneration, Culture and Environment	401,529	214,004	187,520	65,935	121,846	**261**
Housing Revenue Account	65,537	28,921	36,615	20,257	16,358	**0**
Business Support Department	3,116	2,645	471	421	50	**0**
Members Priorities	98	12	86	46	0	(40)
Total	**547,785**	**279,781**	**267,677**	**102,876**	**165,017**	**216**

Medway has a substantial capital programme with planned spend post 2023/24 totalling £165.017m. The largest element of the capital programme relates to Regeneration Culture and Environment with forecast spend in future years of £121.846m. The overall forecast overspend is £0.216m, with a forecast overspend of £0.261 in Regeneration Culture and Environment. Anticipated Funding of the capital programme for 2023/24 and post 2023/24 is set out below.

Funding Source	Total £000s	C&A £000s	RCE £000s	HRA £000s	BSD £000s	Members Priorities £000s
Capital Grants	79,404	35,597	40,407	3,999	1	0
Developer Contributions	4,928	3,967	961	0	0	0
Capital Receipts	1,649	0	1,267	0	296	86
RTB Receipts	6,972	0	0	6,972	0	0
Revenue / Reserves	11,187	0	156	11,031	0	0
Prudential Borrowing	100,620	3,420	81,811	15,213	175	0
Borrowing in lieu of Capital Receipts	20,679	0	20,679	0	0	0
Borrowing in lieu of Future Business Rates	19,993	0	19,993	0	0	0
Borrowing in lieu of Future Rent	11,760	0	11,760	0	0	0
Borrowing in lieu of Future Section 106 Contributions	137	0	137	0	0	0
Borrowing in lieu of Future NHS Grant	10,348	0	10,348	0	0	0
Total	**267,677**	**42,984**	**187,520**	**36,615**	**471**	**86**

Prudential borrowing is the largest source of funding with Regeneration Culture and Environment most reliant on borrowing for the completion of their schemes.

Governance

The Capital Strategy 2024/25 was considered by the Cabinet on 24th October 2023. It articulates Medway's best estimate of the capital investment needed to deliver corporate priorities, across the following four themes:

- Regeneration and placemaking,
- Investing in our services to meet growth in demand including Education, Social Care and Environmental Services,
- Technology and digital solutions driving more efficient and effective service delivery,
- Maintaining our assets.

The capital programme is regularly amended with additions and virements routinely progressed in-year as external funding is announced, or as business cases are considered by Members. Cabinet is responsible for ensuring the delivery of the capital programme within agreed budgets.

Before formal decisions are sought from Members, officers develop capital proposals for consideration by the relevant internal groups for instance the Corporate Management Team, Corporate Property Board and Officer Project Board. These are responsible for ensuring that proposals align with the Council Strategy, are affordable, demonstrate good value for money and that there is capacity and capability in the Council to manage and deliver the schemes.

There are no indications that the Council is classifying investments within its capital programme incorrectly, pursuing investments primarily for yield or without regard for wider socio-economic benefit.

Commercial Property Investments

The 2024/25 Capital Strategy states "Investment property is defined as property that is used solely to generate revenue from rents or for capital appreciation. Investment properties are not depreciated; however they are revalued annually to reflect their fair value based on market conditions. The Council's asset register identifies 14 investment properties, with a market value of £15.969million, and together with the Pentagon Centre, which cost £37million, they are budgeted to generate around £3.140million per annum in rents.

Medway is solely focusing on opportunities within Medway's boundary and which are consistent with Medway's regeneration ambitions, Such investments are not for purely commercial gain.

Minimum Revenue Provision (MRP)

Medway's treasury advisors, Link Asset Services, identified an £18m overprovision of MRP. This drastically reduced MRP to virtually zero for a number of years, with this 'MRP holiday' coming to an end in 2022/23. As is indicated in the Section on Commercial Investments and Debt, MRP is £6.442m in the 2023/24 budget and is included in Interest & Financing.

We understand that MRP is not calculated in respect of loans currently circa £72m to Medway Development Company which Medway has funded through borrowing. The argument is that this is because the loans are to fund the development of assets (housing units) for sale and the loans (together with accrued interest) will be repaid when the assets are sold. The intention was that the loans would be fully repaid by 31st March 2027.

Some housing units are not going to be let through MDC and it is planned that circa £8.1m of the outstanding loans will be refinanced through the PWLB. This will lengthen the repayment period for this element of MDC's debt.

It could be argued that it would have been more prudent to calculate MRP on the whole of the debt. If the proposal to fund units to let through the PWLB is successful, it would seem prudent to calculate MRP on this element at least.

In any event, a consultation on MRP has now been launched which is broader in scope than had been expected and might suggest changes to requirements in respect of loans to subsidiaries. This could have a significant effect in Medway which is matter for concern though the timing of any outcome from the consultation is uncertain.

Medway Companies

A separate report is being prepared in relation to the three companies in which Medway has an interest. In this report we focus on the link between these companies and Medway's financial sustainability.

Medway Norse

Medway Norse Ltd is a joint venture company, owned by Medway Council and the Norse Group Ltd, a company wholly owned by Norfolk County Council, that commenced operating services in 2013. The Joint Venture's core business is in providing the following services:

- Waste Management and Environment
- Cleaning
- Catering
- Facilities Management

Medway is the main customer of Medway Norse and since waste management was transferred to the company in October 2019, the cost to the Council has grown to £27.242m in 2022/23. In 2022/23 external revenue was £2.604m (9% of total revenues).

There is currently no formal contract with the Council although both parties are working towards an extension of the current arrangements. Given the current financial outlook this is an opportune time to consider reconsider the specification of the services the Council wishes to purchase from Medway Norse to reduce cost.

In particular in relation to waste management, the Council needs to consider how the service to the public will be configured in the future to achieve savings and thereby contribute to securing financial sustainability.

Medway Norse also provides Special Educational Needs Transport through a subsidiary. This operates at a loss though Medway Council has an agreement to underwrite these losses..

Medway Development Company

MDC was formed to develop housing units in Medway, enabling the development of Council owned sites.

MDC's financial strategy was predicated on a loan facility from Medway Council, capped at £120m, which the company pays back over time with accrued interest. As at October 2023, there was an outstanding loan balance of £71.873m. It was the intention that the whole of the loan plus accrued interest would be repaid to the Council by the 31st March 2027 though the company's accounts state it is repayable on demand.

However, this model depends on sales of the housing units which have been built. Market conditions have been challenging due to inflation and the cost-of-living crisis. These have been compounded by multiple rises in interest rates which is driving the market towards the private rented sector.

As a consequence some units are going to be let, at least in the short-term, rather than being sold. It is planned that circa £8.1m of the loan is to be refinanced in relation to the units that are going to be rented out, funded through the PWLB. The Council's margin on these loans will be lower than the existing borrowing and the period of repayment will be much longer.

Whilst the decision to fund MDC is driven by regeneration the financial implications for the Council also need to be considered. A key issue is when the loans will be repaid since this will allow Medway to reduce its borrowing requirement. At the moment there is uncertainty over when the Council will be repaid. A more certain timing would support measures to improve the financial sustainability of the Council.

Kyndi Limited

Formerly Medway Commercial Group Limited, Kyndi provides CCTV Monitoring and Telecare Services to Medway and to external customers. The P&L for Kyndi shows that after a series of losses the company has moved into profit for the last three years. However, with the recruitment service previously provided by Kyndi being brought back in-house the turnover and profit level in 2022/23 has significantly reduced.

	2017	2018	2019	2020	2021	2022	2023*
Turnover	2,285,953	6,215,981	15,554,248	12,806,292	14,185,480	13,185,277	2,537,126
Cost of sales	-2,271,273	-5,525,615	-16,220,418	-10,912,438	-11,802,059	-10,607,887	-745,197
GROSS PROFIT	**14,680**	**690,366**	**-666,170**	**1,893,854**	**2,383,421**	**2,577,390**	**1,791,929**
Admin Expenses	-14,535	-713,259	-1,050,029	-2,091,342	-2,027,942	-1,781,819	-1,542,692
OPERATING PROFT	**145**	**-22,893**	**-1,716,199**	**-197,488**	**355,479**	**795,571**	**249,237**
Interest receivable and similar income	1,394	49	12	0	0	0	0
Interest payable and expenses	0	0	-9,735	-9,152	-9,708	-133,508	-79,330
PROFIT BEFORE TAX	**1,539**	**-22,844**	**-1,725,922**	**-206,640**	**345,771**	**662,063**	**169,907**
Tax on Profit	-1,001	234	180,533	0	0	172,859	-15,153
PROFIT AFTER TAX	**538**	**-22,610**	**-1,545,389**	**-206,640**	**345,771**	**834,922**	**154,754**
Profit margin	0.0%	-0.4%	-9.9%	-1.6%	2.4%	6.3%	6.1%

**2023 Figures are taken from the draft accounts produced on 1/12/2023*

In March 2021, to help strengthen the business, the Council loaned Kyndi Limited £2.5million on a 10-year repayment term at a fixed 5% interest rate for the term. The company has increased the monthly repayment amount to shorten the term of the loan and made several capital payments to further reduce the outstanding value. As at November 2023 the outstanding balance of £1.24m is due to be repaid by May 2028.

A key issue is that, with the removal of the recruitment service provided to the Council, the company will not comply with the Teckal exemption in June 2024. There have been discussions about adding complementary Medway services to Kyndi's. This would protect the Teckal exemption. However a robust business case will need to be developed that demonstrates value for money for the Council. Kyndi is currently developing a new 5-year Business Plan so it is essential that there is alignment between Medway and Kyndi on how the company might be developed.

This would help further secure repayment of the loan and potentially, subject to continuing profitability allow a dividend to be paid by the company in the longer term.

Conclusion

As is referred to above, the draft Revenue Budget 2024/25 states “Work to address this pressure and deliver within the budget allocation for Interest & Financing of £15.300m is focused on a review of the capital programme, seeking to reduce, refinance or curtail any schemes that are not essential to the delivery of the Council’s objectives”.

We understand that CMT and Members have agreed that wherever possible Medway will pause or slow capital works, particularly those funded from borrowing. Work is ongoing to determine which schemes might be reducing, curtailed or for which alternative financing is available.

In addition, Medway needs to consider the financial objectives it has in relation to its interests in companies in order that they can contribute to the Council securing financial sustainability.

7. Governance and Culture

Alignment of the Council’s financial planning with its corporate priorities

We are aware that Medway is working on a new Council Plan, the One Medway Council Plan 2024-2028. This will be formally approved by Overview and Scrutiny, Cabinet and then ultimately Full Council in May 2024. Our comments relate to Medway’s Corporate Strategy and Plan for 2023-24, approved by the previous administration, which we consider is not adequately aligned to the financial challenges facing the Council.

It is not especially clear from our document review how the financial plans set out in the Medium-Term Financial Outlook for 2023-2028 align with the Council’s strategy and associated plan for 2023-24 and the latter make no reference to the financial challenges facing the Authority.

The Council’s existing Strategy and Corporate Plan for 2023-24 are strongly weighted towards creating opportunities for residents and businesses. There are three priorities:

- Supporting residents to realise their potential.
- Enabling Medway to be a place that people are proud of.
- Maximising regeneration and economic growth.

There is no specific reference to the Corporate Strategy or Plan in the Medium Term Financial Outlook and it is not clear how the plans around regeneration have been incorporated or how the associated investments can be justified given the challenges in setting a balanced budget for 2024-25. The Council’s draft capital and revenue budgets for 2024-25, presented to Cabinet in October 2023, set out the capital investment required to deliver corporate priorities, across four themes:

- Regeneration and placemaking.
- Investing in services to meet growth in demand including Education, Social Care and Environmental Services.
- Technology and digital solutions driving more efficient and effective service delivery.
- Maintaining the Council’s assets.

These themes do not readily align with the corporate strategy and the planned investment is broken down into only two categories: ‘forecast spend in 2023-24' and ‘forecast spend in future years.

Medway has recognised the need for a new, longer-term plan and work is ongoing on the One Medway Council Plan 2024-2028. The Council also recognises the need to ensure that this plan has as a core priority the attainment and maintenance of financial sustainability, enabling the Council to prioritise more effectively its longer-term strategic aims for the area and its residents against the financial limitations that it faces.

The adequacy of existing governance and oversight arrangements

Whilst there was a change in the control and leadership of Medway Council in 2023, there continue to be robust and clear governance arrangements:

- The Council meeting is where all 59 Councillors discuss and decide the Council's policy framework and budget. The Council meets approximately six times a year.
- The Cabinet is responsible for proposing the policy framework and budget to Full Council and for taking in-year decisions on resources and priorities. The Cabinet then delivers and implements the budget and policies decided by Full Council.
- The Council's Overview and Scrutiny Committees play a key role in developing and reviewing policy and holding the Cabinet to account through a facility to call-in Cabinet decisions for review or undertaking pre-decision scrutiny. There are four Overview and Scrutiny Committees: Business Support, Children and Young People, Health and Adult Social Care, Regeneration Culture and Environment, plus a Joint NHS Overview and Scrutiny Committee with Kent County Council.
- There are also a number of regulatory committees that deal with the functions of the Council that cannot be dealt with by the Cabinet. The Audit Committee, or example, provides independent assurance of the adequacy of the Council's risk management framework and the associated control environment. It also undertakes independent scrutiny of the Authority's financial and non-financial performance and oversees the financial reporting process.

The operational elements of the Council's governance framework are the responsibility of the Chief Operating Officer (S151 Officer) and the Monitoring Officer within their statutory roles.

The annual review by Internal Audit for 2022-23 confirmed that the Council's Local Code of Corporate Governance is operating effectively and that Medway Council's framework of governance, risk management, and system of internal control were sufficient and effective, and contributed to the proper, economic, efficient, and effective use of resources in achieving the council's objectives.

The suitability of the budget setting timelines

The Council's constitution sets out clear timelines for the budget setting process. The key steps involve:

- At least three months before the Council's budget meeting, the Cabinet will publish initial proposals for the budget, including details of the consultation process and the outcomes of any prior reviews by the Oversight and Scrutiny Committee
- The Cabinet's initial budget proposals will then go to the relevant Overview and Scrutiny Committees for further consideration. The Overview and Scrutiny Committees have six weeks to advise the Cabinet of their views of the proposed budget.
- The Cabinet may amend its budget proposals before submitting them to the Council budget setting meeting for consideration, reporting on how it has taken into account the recommendations from the Overview and Scrutiny Committee.
- At the Council budget setting meeting, the Council will consider the Cabinet's budget proposals and any report from the Overview and Scrutiny Committee.

Despite the clear procedures in place, we have raised concerns in our discussions with senior Officers on the capacity of the Authority to meet these timelines to establish a balanced budget for 2024-25. Key members of the finance team are understandably experiencing some stress on how this might be achieved, given the scale of the gaps as they currently stand.

External audit have previously highlighted the urgent need to "... make politically unattractive or undesirable decisions in the interest of the Authority's future viability" (November 2023), and the Council confirmed in response that it was working to reduce the 2023-24 overspend, balance the budget for 2024-25 and identify those assets that might be sold. We are aware that work is ongoing on these and we have commented on them above.

We have strongly advocated in interim briefing sessions that the Authority should consider drawing up plans to request a capitalisation direction from the Secretary of State for Levelling Up, Homes and Communities in case it is required.

The cultural barriers that need to be addressed

Given the change in leadership within the Council in 2023, we recognise that the new administration is having to face some very difficult decisions from the outset of their term. It is incumbent on Officers, however, to give clear advice on the issues facing the Authority and what might be done to address them.

Many of the interviews and discussions that we have had with officers have raised the perception that the Council has previously identified overspends, but always managed to address them by year end. This has led to an overly optimistic view of what can be achieved, though there now seems a much greater awareness and understanding of the seriousness of the situation Medway is in. Similarly, there is a strong view that much of this is driven by profligacy in Children's Services and Adult Social Care. Neither of these views is helpful in securing financial sustainability:

- Previous overspends have had to be addressed by stripping back central functions, such as finance, that mean the Authority lacks the capacity to support the financial and wider performance of each directorate effectively.
- There may be opportunities to pare back spend in Adult Social care or Children's services, but in our experience large scale cuts are usually very difficult without risking longer term financial difficulties. Short–term savings typically require work force reductions, which lead to problems in case load management that will ultimately cost an Authority more through increased referrals and placement costs. Instead, the emphasis needs to be on transformational change that will bring longer-term sustainable savings.
- Previous budget gaps and overspends have been resolved through the use of reserves. Those available to the Council for 2024-25 are likely to be critically low and this option is no longer available.
- Officers need to flag up difficult issues to the new Administration. Our reading of the financial papers submitted to Cabinet or Council noted that there is very little reference to the challenging issues on financial sustainability facing the Council. For example, the draft Revenue Budget for 2024-25 does note that there is a projected budget gap of £35.798 million, but there is an implicit suggestion that this will be addressed through the formulation of savings proposals. The paper does not make clear what the options available might be if such savings cannot be found or when such a situation needs to be remedied.

8. Roadmap

Medway wants to avoid having to issue a S.114 and the potential appointment of Commissioners which would substantially strip the Council of the power to make decisions and set its own course.

If Medway were to set a balanced budget on the basis of the approach set out in the Draft Revenue Budget 2024/25 (setting budget allocations to close the gap), we feel it would not be credible and would inevitably lead to a S.114 notice during 2024/25.

The alternative is to seek intervention from DLUHC in the form of:

- A Capitalisation Order
- Permission to raise Council Tax above the maximum allowable

In order to do this Medway needs a credible strategy to secure longer-term financial sustainability that shows the Council is prepared to act boldly and make those "politically unattractive" decisions.

Medway will need to:

2. Estimate how much is required and over what period:
    - There needs to be sufficient to cover anticipated revenue cost pressures for 2024-25 and subsequent years until financial sustainability can be achieved
    - It should include the additional costs required to implement a recovery plan
    - The Authority needs to determine what assets it might sell and how it might scale back its capital programme to reduce the cost of borrowing
3. Develop an outline recovery plan that sets out how the Council will achieve financial sustainability in future. The Council will need to:
    - Develop a proposed plan for structural and cultural change in Adults and Children's services
    - Develop a plan for significant shorter-term cost reductions and income generation in the Regeneration, Culture and Environment Directorate
    - Review capital commitments to reduce impact on revenue budget – stop, delay, mothball
    - Identify those assets that are no longer cost effective to maintain or can help mitigate the costs of additional borrowing

4. Demonstrate that the Council is committed to delivering the changes required. The Council will need to:

    - Incorporate the importance of securing financial sustainability into a revised corporate plan
    - Introduce a more structured approach to developing and implementing savings plans
    - Build expertise in project management and change management to support the Directors
    - Consider the appointment of a Director of Change or external partner to drive and oversee the programme
    - Establish suitable governance arrangements to ensure the support and commitment of Members

There is limited time available in order to achieve this before the scheduled meetings of the Council and the Cabinet to agree a 2024/25 budget. It should be treated with the utmost urgency.