

ITEM 16

**REPORT TO: WEST OF ENGLAND COMBINED AUTHORITY
COMMITTEE**

DATE: 23 SEPTEMBER 2022

**REPORT TITLE: WEST OF ENGLAND COMBINED AUTHORITY
HEADLINE ASSESSMENT ON INFLATIONARY
PRESSURES AND MITIGATIONS**

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INVESTMENT AND CORPORATE SERVICES**

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Purpose of Report

- 1 The national fiscal and economic situation is an important consideration for the Combined Authority in setting and managing its revenue and capital budgets. This is work in progress and the Combined authority will need to continue this work and engage with our partner Unitary Authorities in this further work on a continuing basis. This report presents a headline assessment on the inflationary risks on that work to date, and mitigations given the significant economic and inflationary pressures our residents and business in the region and country are facing. This is the first stage of the process. An assessment has been completed for the Combined Authority programmes. The next stage will be to look at the programmes managed through UAs. Inflation and the potential recession are issues that will require quarterly updates to Committee for the foreseeable future.

2. Recommendations

The West of England Combined Authority Committee:

1. Agree that the inflationary impact on the Investment Fund reduces the headroom available by £11.6m as shown in figure 7 in section 5.4.
2. Request officers minimise the impact of inflation by funding within approved budgets and ensuring key outputs are delivered on time.

Voting Arrangements:

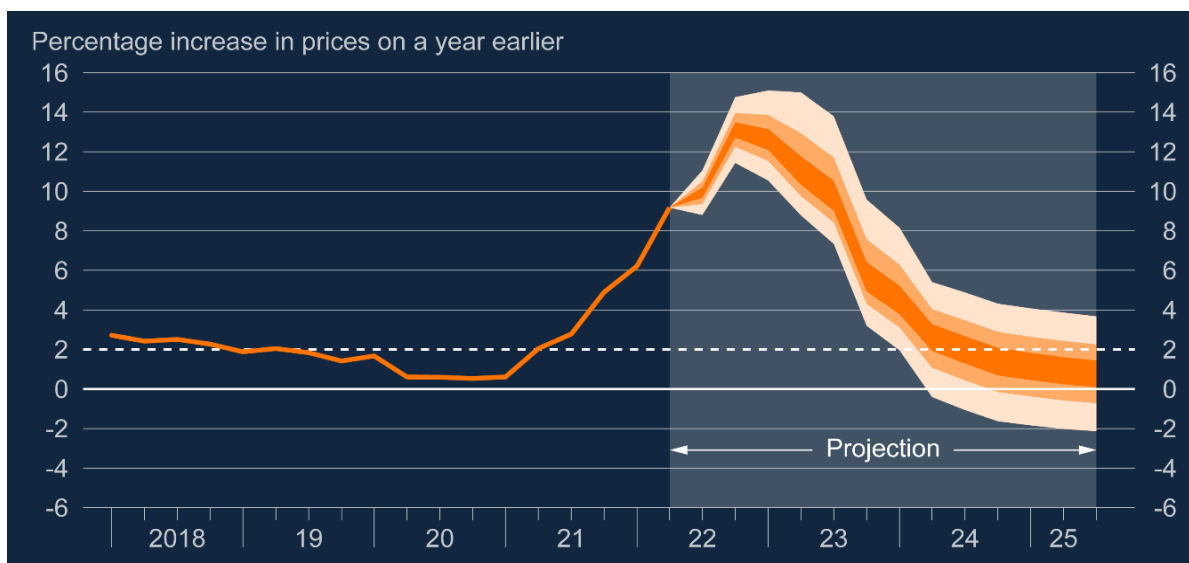
Items 1-2: Decision requires majority agreement of Committee Members in attendance, or their substitutes (one vote representing each Authority) and including the West of England Combined Authority Mayor

3. Strategic Outlook

- 3.1 The impact of Covid has had a significant impact on the region and resulted in changes to the way the Combined Authority funds have been utilised. The UK and global economy are continuing to feel the effects of Covid and broader pressures, with increasing inflation rates impacting families, communities, employers and businesses.
- 3.2 Over 2021-22, the national economy has returned to growth, and output has reached its pre-pandemic level. Unemployment has fallen, notwithstanding the end of the furlough scheme, and recruitment has risen, resulting in a very tight labour market and rising wage rates. The West of England economy has followed, with claimants of unemployment benefits falling to 2.6% and vacancies around 40% higher than in 2019.
- 3.3 However, in recent months the economic outlook has become less positive. The Russian invasion of Ukraine and continuing international supply chain challenges have caused a sharp increase in inflation. Residents and businesses across the region are facing significantly higher prices – inflation was 9.4% in the year to June 2022. The Bank of England’s August Monetary Policy Report forecast that inflation would rise to a peak of 13% in quarter 4 of 2022. Inflation would decline thereafter but would remain around 9% by mid-2023 before falling back to 2% by mid-2024. Forecasts for key items are summarised below:

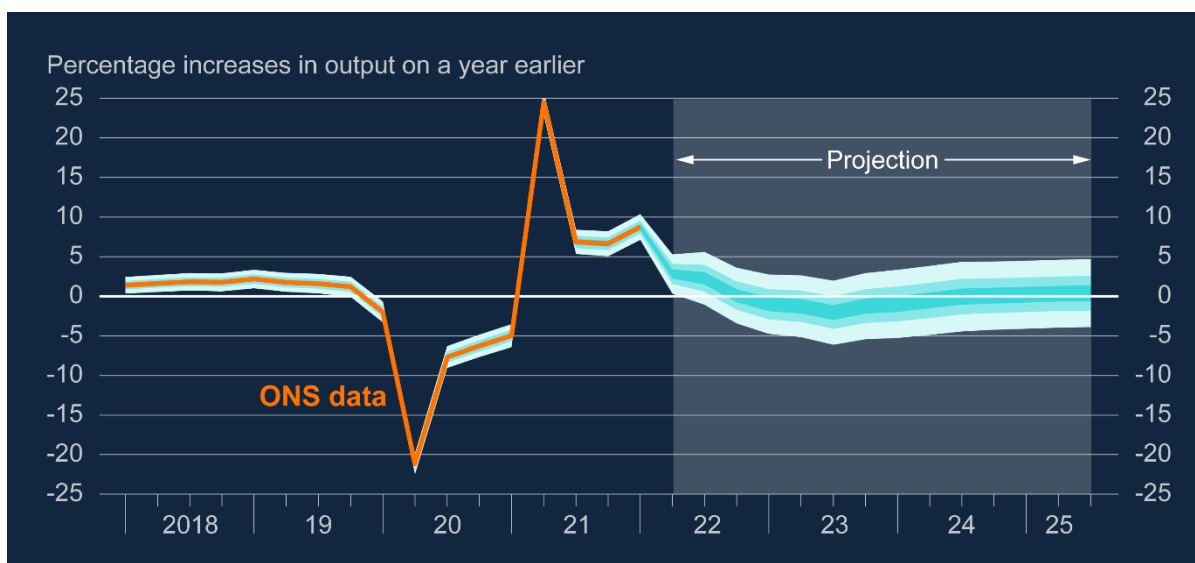
<i>Bank of England projections, August 2022</i>	2022	2023	2024
Inflation (CPI), Q4 each year	13% (Q4)	5.5%	1.5%
Energy prices contribution to inflation	6.5 / 13	0.75 / 5.5	0 / 1.5
Unit labour costs	8%	5%	2%

Figure 1: Bank of England forecasts that inflation (CPI) will rise to 13% in late 2022, before falling to 2% by mid-2024



- 3.4 Of relevance to many of the Combined Authority’s projects, construction industry prices have also risen rapidly in recent months. Construction output prices rose by 9.6% in the year to June 2022, with supply chain issues limiting availability of materials and firms also facing a shortage of labour.
- 3.5 Deteriorating economic conditions are likely to present a new set of challenges for the region’s economy. Observers including the Bank of England and Office for Budget Responsibility have revised downwards their forecasts for economic growth over the next two to three years.

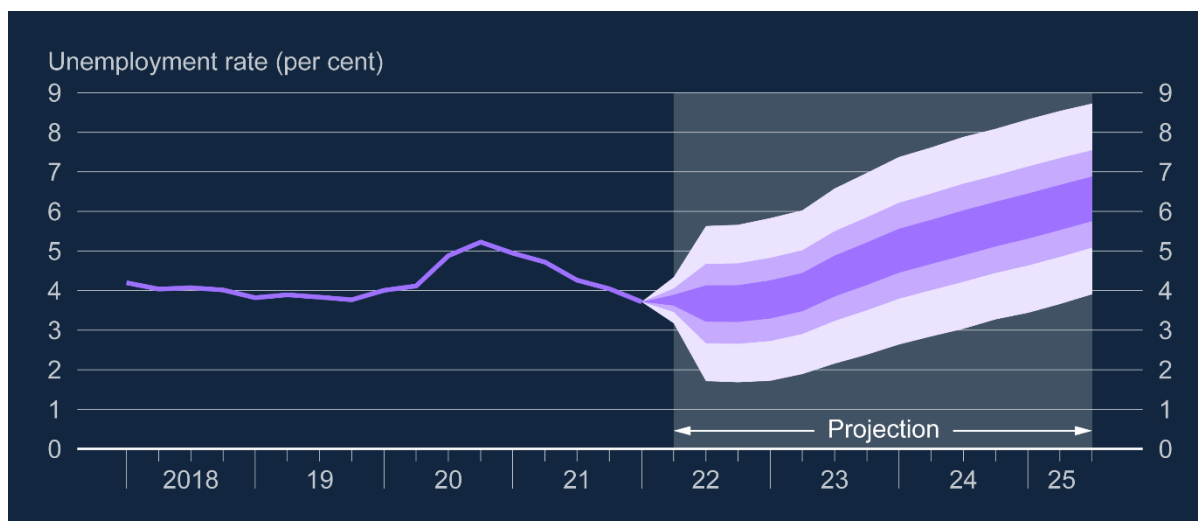
Figure 2: The Bank of England forecasts negative GDP growth from late 2022 throughout 2023



- 3.6 There is likely to be sustained pressure on living standards as the cost of living rises and real incomes fall. The effects are widespread, but these impacts fall disproportionately heavily on low-income households. Unemployment may also begin

to rise significantly in 2023, as the economy slows, and businesses may experience difficult trading conditions.

Figure 3: The Bank of England forecasts that unemployment will rise from mid-2023 towards 6%



- 3.7 For the Combined Authority, inflation, cost of living pressures and a potential recession both increase the costs of delivery, and also shape future priorities as the region's challenges shift.
- 3.8 Further movements in Bank rates are likely to be targeted to manage domestic inflation pressures (such as the pace of wage increases).
- 3.9 With continuing uncertainty around the national economic outlook, a headline review of the Combined Authority funding allocations has been undertaken to consider where additional budget pressures might be felt and to identify action that can be taken to minimise any impact of the current economic climate. The headline assessment has been carried in conjunction with relevant budget managers across the combined authority.

4. Pay

- 4.1 On 27 October 2021, the Autumn Budget and Spending Review 2021 announced that public sector workers would receive "fair and affordable" pay rises across the 2022/23 to 2024/25 Spending Review period.
- 4.2 The Combined Authority is bound by the services pay agreements - having agreed a 1.75% pay increase for public sector workers at the beginning of March 2022 for 2021-22, Unions have already set out their intention to focus on achieving a more substantial, inflation-busting pay rise for 2022/23. The Combined Authority including our local constitutes, have budgeted 2% for pay increases, whilst also budgeting for the 1.25% increase in National Insurance Contributions that became effective from April 2022.
- 4.3 Within, the West of England Combined Authority forecast report based on data for the period April 2022 to July 2022 an indicative 4% has been forecasted to account for the potential increase in this area – representing an impact of £248k compared to the original approved budget. Any increases on project related staffing costs will be

absorbed within the relevant project funding pot and correspondingly potential increases on core staff will be funded from overheads and treasury management surpluses.

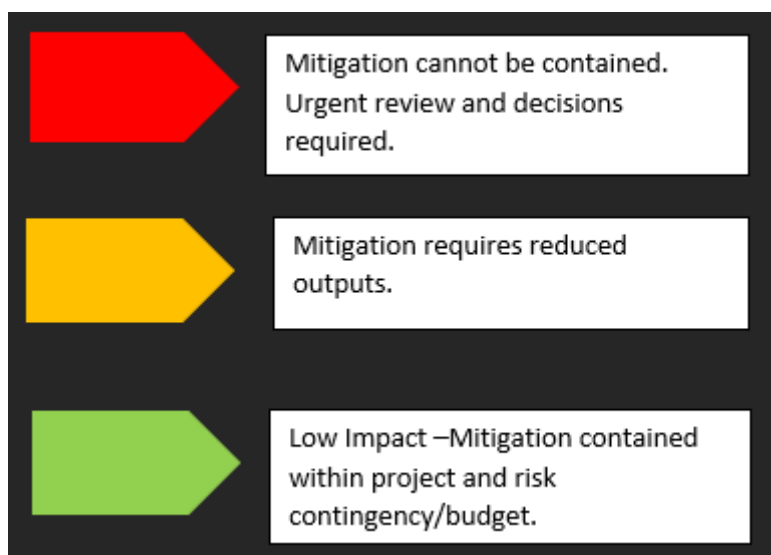
Figure 4: Impact on staff costs by increasing pay by 1%

Inflationary Pay Uplift %	Increase on staff costs		
	Core Staff £	Project Staff £	Total £
4%	95,535	152,556	248,091
5%	143,793	228,736	372,529
6%	192,050	304,916	496,966
7%	240,308	381,096	621,403
8%	288,565	457,275	745,840
9%	336,822	533,455	870,278
10%	385,080	609,635	994,715
11%	433,337	685,815	1,119,152
12%	481,595	761,995	1,243,590

Note: Impact of Inflation above the budgeted inflation assumptions.

5. Headline Impact Assessment

- 5.1 The likely impact of inflation has increased the risks facing the combined authority in terms of delivering against the financial budget for 2022/23, as well as managing the effect of increased costs in future years. The initial assessment work has utilised the rag rating tool shown below.



- 5.2 The table below provides a summary of initial potential inflationary pressures following the assessment. Programmes 1-5 give an indicative pressure using an 8% inflationary forecast whilst programmes within 6 have had some more specific detailed work undertaken.

The summary assessment is detailed in Figure 5.

Project Funding Source	22/23	23/24	24/25	25/26	26/27	Total
	£'000s	£'000s	£'000s	£'000s	£'000s	£'000s
1. CA Revenue Government Grants Funded Programmes	2,173	2,347	2,535	2,738	2,957	12,750
2. Revenue Investment Fund managed by West of England CA	1,763	997	156	0	0	2,916
3. Revenue Investment Fund managed through UAs (subject to further work)	876	340	20	0	0	1,236
4. Capital Investment Fund managed by West of England CA	1,152	693	266	900	376	3,387
5. Capital Investment Fund managed through UAs (subject to further work)	1,898	1,360	675	170	0	4,102
6. West of England CA Other Capital Programmes (£85m relates to CRSTS)	26,546	24,097	16,634	13,338	11,155	91,770
Estimated Totals:	34,407	29,834	20,286	17,146	14,488	116,161

*1-5 include 8% estimates based on a medium inflationary exposure.

Programmes Identified with Significant Inflationary Pressures

5.3 The Programmes identified with significant inflationary pressures are detailed in Figure 6

Programmes Identified with Significant Inflationary Pressures	
Programme	Mitigations
Supported Bus Services (ITA Levy)	Contracts are due for renewal in April 2023, additional inflation cost will arise. Mitigation work will include the use of other government funding such as BSIP.
Metrowest phase 2 (Construction & Operation)	Outputs to be closely monitored.
City Region Sustainable Transport Settlement (CRSTS)*	Revise programme. Undertake deep dives, market testing, value engineering and minimum value product. Outputs to be closely monitored.
Bristol Temple Quarter (BTQ)	Value engineering, review the scope of the project as necessary. Outputs to be closely monitored.

Investment Fund Analysis including Programmes managed by UAs

5.4 The analysis below shows the potential exposure on the Investment Fund Programme including programmes managed by UAs that are not controlled directly by the West of England CA. An exercise to liaise with the UAs will take place as part of the ongoing work. The impact exposure could range from as low as c£7m to as high as c £15.5m.

Figure 7: Investment Fund Analysis

Revenue	Low Estimate		Medium Estimate		High Estimate	
		£'000s		£'000s		£'000s
Investment Fund managed by West of England CA		1,521		2,916		3,931
Investment Fund managed through UAs (Estimate Subject to Further work)	4%	618	8%	1,236	12%	1,854
		2,139		4,152		5,785
Capital						
Investment Fund managed by West of England CA		2,994		3,387		3,584
Investment Fund managed through UAs (Estimate Subject to Further work)	4%	2,051	8%	4,102	12%	6,153
		5,045		7,489		9,737
Total		7,184		11,641		15,522

Investments

- 5.5 The rising bank rate is likely to have a positive impact on investments for the Combined Authority. The Combined Authority does not benefit immediately from the increasing interest rate. Benefits can start to be realised as existing investments mature and deposits can then be reinvested at a higher rate. A significant element of the Combined Authorities investment income is generated from dividend payments on monies invested in property and multi asset funds. The dividends generated on these investments are not wholly linked to the bank rate and therefore the return on these funds is anticipated to remain relatively static over the coming years.
- 5.6 In addition, the surplus cash balances available for investments are forecast to reduce over the coming years as these are utilised to support ongoing revenue and capital expenditure in the coming years. Given the number of variables it is difficult to quantify the impact of the rising interest rates on the investment income and whether it will be higher than the amounts already included in the Medium-Term Financial Forecast (MTFF).

Summary of Actions and Monitoring

- 5.7 The approved reserves policy is an important element of the combined authority's financial governance arrangements. The combined authority maintains a principal in holding a minimum of 5% in the General Fund Working Balances of the annual net revenue budget.

The Combined Authority's revenue budget for 2022/23, as approved by Committee on 28 January 2022, was £64.9m against which 5% would represent **£3.2m**. As such, our current reserve holding is respectively low, and we will continue to review opportunities for further contributions.

Specific programmes that have been identified as having a significant inflationary pressure – will continue with further deep dives and regular monitoring. The Combined Authority's on-going budget reviews and reporting will include specific information on the financial risk highlighted in this report, as more information is known.

Consultation

- 6 Consultation has been carried out with the Monitoring Officer, Chief Executives, and S151 Officers across the three constituent authorities. Regular meetings are held with the Finance Directors across the region in terms of material financial matters.

Other Options Considered

- 7 Value for Money and appropriate use of resources are constantly considered when monitoring and managing all revenue and capital budgets.

Risk Management/Assessment

- 8 This report forms a core part of the West of England Combined Authority's governance

and risk management process. The financials presented in this report takes account of known financial risks and their potential impact on the outturn financial position.

Public Sector Equality Duties

- 9 The public sector equality duty created under the Equality Act 2010 means that public authorities must have due regard to the need to:
- Eliminate unlawful discrimination, harassment and victimization and other conduct prohibited by the Act.
 - Advance equality of opportunity between people who share a protected characteristic and those who do not.
 - Foster good relations between people who share a protected characteristic and those who do not.
- 9.1 The Act explains that having due regard for advancing equality involves:
- Removing or minimising disadvantages suffered by people due to their protected characteristics.
 - Taking steps to meet the needs of people from protected groups where these are different from the needs of other people.
 - Encouraging people from protected groups to participate in public life or in other activities where their participation is disproportionately low.
- 9.2 The general equality duty therefore requires organisations to consider how they could positively contribute to the advancement of equality and good relations. It requires equality considerations to be reflected in the design of policies and the delivery of services, including policies, and for these issues to be kept under review.
- 9.3 All key service delivery functions continue to be delivered by the relevant constituent councils and impact assessments for service delivery, particularly highways and transport are included as appropriate within their individual Budget reports.

Climate Change Implications

- 10 On 19 July 2019, the West of England Combined Authority declared a climate emergency, recognising the huge significance of climate change and its impact on the health, safety and wellbeing of the region's residents. The Combined Authority is committed to taking climate change considerations fully into account as an integral part of its governance and decision-making process.

Each report/proposal submitted for Combined Authority / Joint Committee approval is assessed in terms of the following:

Will the proposal impact positively or negatively on:

- * The emission of climate changing gases?
- * The region's resilience to the effects of climate change?
- * Consumption of non-renewable resources?
- * Pollution to land, water or air?

Particular projects will also be subject to more detailed environmental assessment/

consideration as necessary as part of their detailed project-specific management arrangements

- 10.1 The criteria applied for the drawdown of investment funding incorporates the impact that any proposed project will have on climate change. Spend on infrastructure projects in particular has a strong focus on improving the availability, and coverage, of public transport whilst reducing congestion on the region's roads.

Finance Implications, including economic impact assessment where appropriate:

- 11 The financial implications are contained within the body of the report.
Advice given by: Richard Ennis, Interim Director of Investment & Corporate Services

Legal Implications:

- 12 Reporting is for information only.
Advice given by: Stephen Gerrard, Interim Strategic Director - Legal Services

Human Resources Implications:

- 13 All spend on staffing is within the budget and resources as approved by the West of England Combined Authority committee. Fixed term contracts are applied for staff who are engaged on projects which have time limited funding, (i.e. specific grants).
Advice given by: Alex Holly, Head of Human Resources

Report Author	Contact Details
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Appendices & Background papers:

Combined Authority (Revenue) Budget 2022/23 – West of England CA Committee 28 January 2022
LEP (Revenue) Budget 2022/23 – Joint Committee 28 January 2022
Investment Fund update reports to West of England CA Committee throughout 2022
Capital Strategy (including Treasury Management and Investment Strategies) – West of England CA Committee 28 January 2022
Bank of England Monetary Policy Report August 2022
Mayoral and West of England CA Budget Monitoring reports as presented to each meeting of the West of England CA Committee.
LEP Budget Monitoring Reports as presented to each meeting of the Joint Committee.