Renfrewshire Council

To: Council

On: 17th December 2020

Report by: Director of Finance and Resources

Heading: General Fund Financial Update

1. Overview and Key Messages

1.1 The Council's financial outlook over the relatively short period of the next two years, is subject to significantly increased uncertainty at the end of 2020 in comparison to that which existed at the beginning of 2020. In this context, the next two to three years may represent the most critical period in the financial history of the Council. It is now a necessity that the Council is highly focused on re-mobilising and driving forward the Right for Renfrewshire transformation programme once it is freed from COVID19 demands in order to deliver the targeted £25 million of savings. This is critical to provide confidence that the Council will be positioned to secure the financial sustainability of priority services.

1.2 It is has become increasingly clearer that there is growing collateral damage caused by the COVID19 pandemic to the economic and fiscal position of the UK and Scotland, resulting in the largest economic slump in 300 years, and ultimately the uncertain impact this will have on future public spending.

1.3 The Chancellor of the Exchequer in his recent spending review announcement, outlined that the economic emergency arising from the pandemic has only just begun. Based on the Office of Budget Responsibility (OBR) forecast, economic output across the UK is not expected to recover to pre-pandemic levels until the final quarter of 2022 and long lasting economic scarring is expected to result in the UK economy being 3% lower in 2025 than forecast prior to the pandemic. Additionally, the OBR estimate that the impact of a no deal Brexit should this emerge is forecast to add a further drop in economic output at circa 2%.

1.4 UK Government borrowing during 2020 will reach unprecedented peacetime levels, with in year borrowing expected to be nearly £400bn and debt levels cumulatively now in excess of total annual economic output of the UK and expected to grow from there over the medium term. For context, these debt levels have only been seen in the periods when the UK was recovering from post war periods in the 20th century.

1.5 Such is the ongoing uncertainty at a national level, the UK government as a direct consequence has committed only to a single year spending review. Decisions on tax and borrowing have been put off until the new year and the previous commitment to a multi-year comprehensive spending review postponed until next year at the earliest given the scale of uncertainty.

1.6 Critically however, this unprecedented level of national borrowing is being accessed at equally unprecedented low rates of interest. Consequently, the cost to service the overall UK government debt is forecast to be lower this year than last year. This suggests the UK government may have greater fiscal scope to manage such a high level of debt as well as having scope to accommodate future budget deficits without the financial sustainability of meeting the annual debt servicing costs becoming as significant an issue as it otherwise might have been in a higher interest rate environment. This undoubtedly will provide the UK government with a greater degree of flexibility over the medium term than it would have had were borrowing costs not as low and may therefore limit the extent to which public spending reductions and or tax rises are deemed necessary.

1.7 Early indications would suggest that the impact of the UK spending review on the Scottish Government core block grant settlement, is relatively similar in revenue budget terms to 2020/21, with the block revenue grant growing by £1.1bn (over 4% in cash terms).The capital block grant is however planned to drop by £0.3bn (5%) in contrast to the growth experienced in 2020/21.

1.8 Under fiscal devolution, this block grant settlement from the UK Government represents only a staging post in the process of setting a Scottish Budget for 2021/22 and ultimately the local government settlement. As previously reported to members the Scottish budget is subject to growing risks and uncertainties and this settlement from the UK government, which has maintained a real terms growth of circa 3.5% in the block grant settlement, provides only limited reassurance at this stage. For context, a similar level of growth in the block grant settlement emerged in 2020/21, after which the Council's grant settlement ultimately experienced a like for like cut of 1.1%. Therefore, healthy real terms growth in the block grant nationally does not automatically translate into an expectation of an improved outlook for the local government grant settlement.

1.9 COVID-19 related funding for the Scottish government has been set at this stage at £1.3 billion in 2021-22, compared with the guaranteed minimum amount of £8.2 billion in 2020-21. This suggests that based on current financial plans as set out by the UK government it is anticipated that many of the ongoing interventions that have occurred this year in response to COVID19 will be unwound somewhat and or ultimately removed.

1.10 Based broadly on the central planning scenario over 2021/22 – 23 it is anticipated that the Council is likely to be faced with a funding gap of circa £26 million prior to any decisions on council tax, albeit this is subject to significant uncertainty, predominantly driven by future grant settlements and pay awards.

1.11 The Right for Renfrewshire programme has been heavily disrupted by the capacity of the Council being diverted to support the COVID19 response and this is expected to remain a significant constraint on the programme well into 2021. The current financial planning assumption is that the R4R programme will not provide any further delivery of savings in 2021/22 over and above those linked to the reprofiled savings from the tranche 1 service redesigns.

1.12 Further, it is anticipated that the delivery of the R4R programme is now likely to extend into a 4 year programme (to 2023/24) as opposed to the 3 year programme (to 2022/23) previously planned.

1.13 Consequently, it is anticipated that the Council's financial strategy over the next two years will require to draw heavily on and potentially exhaust the financial flexibilities secured both through national agreement with the Scottish Government, but more significantly through changes to capital financial planning arrangements approved locally by the Council,.

1.14 It is critical for members to note that the use of such financial flexibilities as part of the medium financial term strategy represent a temporary measure, providing the Council with time and space to organisationally recover and re-stabilise post COVID19 and transition back to driving forward delivery of the R4R programme.

1.15 Given the relatively limited window of protection the financial flexibilities are expected to be able to provide the Council, and in the absence of the financial position crystallising at the optimistic end of the two year forecast, should the Council fail to achieve the R4R financial objectives or fail to achieve it at the required pace, there is a severe risk that the acute financial challenge faced by the Council will escalate into a financial crisis over the medium term.

1.16 This significantly heightened financial risk profile reinforces the need for the Council to be decisive, make substantial and at times more challenging decisions than it has previously in order to fully commit to the delivery of significant change and transformation.

1.17 Failure to achieve this transformational progress, will ultimately lead the Council into territory that would involve action to secure rapid reduction in costs, not delivered through managed transformation but by cutting, downsizing or withdrawing services.

1.18 Additionally, given the significantly more challenging economic outlook outlined by the Chancellor of the Exchequer, and ignoring any additional negative impact from a potential no deal Brexit, it now appears certain that the overall UK and Scottish economies will be poorer over the medium term than they otherwise would have been had COVID19 not occurred. This inevitably brings with it, greater downside risks to the outlook for public finances in the UK over the medium term.

1.19 There is therefore is no certainty that this relatively short two year financial planning horizon to the end of 2023, will see the end of the Council being required to deliver significant savings. In this context, it is more critical than ever that the Council from a sustainability perspective is as well placed as possible to address this risk moving beyond 2022/23.

2. Recommendations

2.1 It is recommended that members

- note the update provided in the report,
- note that the next update is anticipated to form part of the budget report to Council based on the planned announcement of the Scottish Government budget and local government financial settlement on the 28th January, and
- agree to the adjustments to the capital planning arrangements as outlined in section 5 of the report.

3. Revenue Summary Update

3.1 COVID19 Impact 2020/21

3.1.1 The financial outlook report to Council in September outlined an expectation that - excluding education, early learning and childcare hubs – the net additional costs expected to be incurred in relation to COVID19 were in the region of £20-£22 million. This position has not changed markedly, with the range of costs potentially reducing marginally to £19 million - £21 million. Some areas of cost have increased as prevention measures have extended over a longer period; while other initial estimates have reduced such as loss of income from commercial waste collection which is once again being undertaken, generating income which had not previously been forecast. These estimates are based broadly on the current environment of restrictions remaining in place until the end of the financial year. Should this change materially, for example with further recurring Tier 4 restrictions applying for prolonged period, there is likely to be a consequential impact on council services and associated costs.

3.1.2 This forecast includes an anticipated impact on net council tax income of around £4m and unachieved savings potentially in the order of £3m; largely attributable to the pausing of the Right for Renfrewshire (RFR) programme and the impact of the pandemic on management capacity to fully deliver departmental savings incorporated in the base budget for 2020/21.

3.1.3 The position above includes an estimated loss of £2.3m for Renfrewshire Leisure (RL), which is an improvement on the previous estimates predominantly owing to RL securing a greater level of furlough income than previously forecast. However, it is noted that this estimate is likely to be impacted negatively due to the recent Tier 4 closure and any further restrictions that may yet emerge over future months.

3.1.4 In line with the approach outlined in previous reports, the Council's financial forecast does not include any net unfunded costs being incurred by Renfrewshire HSCP. This position continues to be informed by the formal Scottish Government commitment that that costs incurred by the HSCP in relation to the pandemic will be fully funded by the Scottish Government.

3.1.5 Costs related to the pandemic which are being incurred in schools/ELC and children's social care are estimated to be £4.3 million. It continues to be the expectation that this cost will be self contained within the additional funding provided by the Scottish Government specifically for teacher recruitment and school mobilisation costs, and from permitted flexibilities in the application of other specific grant funding linked to Early Learning and Childcare expansion and Pupil Equity Funding.

3.1.6 Since the September Council report, further funding announcements and distributions to individual council level have been confirmed by the Scottish Government, and these have been largely in line with expectations. A total of £13m of revenue funding has been confirmed to date (excluding funding specifically for additional teachers the costs of which are not reflected above), with further allocations still to be confirmed. It is estimated a further £1-2m in total may be allocated to Renfrewshire from these funds, taking the total funding to circa £15 million – again broadly in line with the position outlined in the financial outlook report in September.

3.1.7 Based on the existing forecasts of additional COVID19 related costs and funding for the 2020/21 period outlined above, the net cost to be funded by the Council is estimated to be within the range of £4 million - £7 million. General fund unallocated reserves as at the end of 2019/20 were £6.6m and it is expected these may be fully deployed in order to meet this net cost on the closure of the 2020/21 accounts.

3.1.8 As approved by Council in September, unallocated reserves will be replenished to £10 million moving into 2021/22, funded from the application of the financial flexibilities available to the Council. This will replenish unallocated balances to a position which is approximately 2.3% of the Council's net revenue expenditure, which remains well within accepted planning parameters. This is a necessary step in order to re-establish the immediate financial resilience of the Council and is reflective of the heightened financial risks the Council will continue to face from the pandemic, in terms of its ongoing impact pending the vaccine programme, legacy risks and the recovery period, but also from the wider impact on the Council's financial strategy and additional financial risks caused by the disruption to the Right for Renfrewshire transformation programme.

3.2 <u>Updated Outlook for 2021/22 – 2022/23</u>

3.2.1 Since the previous update provided to Council in September, a significant amount of work has been progressed to further update the assessment of the Council's financial outlook moving into 2021/22 and thereafter into 2022/23, which represent years 2 and 3 of the current 3 year financial strategy.

3.2.2 Since September, the developing consequential impact of the COVID19 pandemic has continued to escalate the level of financial uncertainty facing the Council over this two year period, particularly in relation to government grant prospects, future pay settlements and the consequential delay to the Right for Renfrewshire programme due to managing the COVID19 response.

3.2.3 Government Grant

Prior to the pandemic the Council's financial outlook forecast a continued year on year reduction in like for like government grant levels over the medium term. At the beginning of 2020 following the publication of the 2020/21 Scottish Government budget and wider economic and fiscal outlook at a national position in Scotland, there was limited encouragement or justification to alter this current medium term forecast for the Council's future government grant prospects. The central planning expectation was that existing core revenue grant levels made available to local government were likely to experience a further like for like cuts, with 1.25% per annum adopted as the central assumption. This forecast was reflective of three key influencing factors at that time:

- The fiscal and economic outlook nationally for Scotland continuing to anticipate relatively limited growth by historic standards and lagging that of the UK with the Scottish Government's overall budget anticipated to face significant challenges moving forward under the workings of the fiscal framework. This backdrop was expected to place an increasing constraint in the overall level of growth in public sector spending across Scotland.

- Additionally, the Scottish Government has on several occasions re-affirmed clear policy commitments to real terms growth or protection to major areas of the Scottish Budget, most notably to the NHS, Police and education (excluding schools) which constitute the majority of overall devolved spending. Local Government forms the significant proportion of the unprotected area of the budget and as such would be required to fit within the resources available to the Scottish Government. Taken together, these factors suggested limited prospects for overall growth in local government resources.

- At the same time, local government has been and continues to take on new responsibilities which require new funding, such as the ongoing expansion of early learning and childcare. Moving forward there continues to be significant additional resources tied into the delivery of early learning and childcare expansion that will require to be funded, significantly increasing the risk that the core local government grant may continue to experience a reduction on a like for like basis once adjustments are made for such new burden funding. The most recent announcement by the Scottish Government relates to a future commitment, if they are re-elected for a new parliamentary term, to expand free school meal provision to all primary school pupils from August 2022, at a reported annual cost of £230 million, suggesting a potential continuation of this risk factor over the medium term.

The most recent influencing event for the Council's future grant prospects occurred on Wednesday the 25th of November, when the Chancellor of the Exchequer announced a single year spending review for the UK. This follows confirmation of the growing collateral economic and fiscal damage caused by the COVID19 pandemic to the UK and Scotland, resulting in the greatest economic slump in 300 years.

The Chancellor's announcement outlined that the economic emergency arising from the pandemic has only just begun. Based on the Office of Budget Responsibility (OBR), economic output across the UK is not expected to recover to pre-pandemic levels until the final quarter of 2022 and long lasting economic scarring is expected to result in the UK economy being 3% lower in 2025 than forecast prior to the pandemic. Additionally, the OBR estimate that the impact of a no deal Brexit should this emerge is forecast to drive a further drop in economic output of circa 2%.

UK Government borrowing in 2020 is at unprecedented peacetime levels, with in year borrowing expected to reach nearly £400bn and debt levels cumulatively now in excess of total annual UK economic output and expected to grow from there over the medium term. For context, these are debt levels only experienced in the post World Wars recovery periods.

Such is the ongoing uncertainty at a national level, the UK government as a direct consequence has committed only to a single year spending announcement. Decisions on tax and borrowing have been put off until the new year and the previous commitment to a multi-year comprehensive spending review postponed until next year given the scale of uncertainty.

However, within such a widespread context of negative factors there is one area which provides some critical benefit to the current circumstances. The immense level of borrowing being undertaken by the UK government is being accessed at unprecedented low rates of interest. Consequently, the annual cost to public spending to service the overall UK government debt is forecast to be lower this year than last year.

This supports the prospect that the UK fiscal position may have greater financial scope to sustainably carry such high debt levels, as well as capacity to shoulder further borrowing to support future UK level budget deficits. This undoubtedly will provide the UK government with a greater degree of flexibility over the medium term than it would have were borrowing costs not so low and may therefore limit the extent to which public spending reductions and or tax rises may be required.

Early indications would suggest that the impact of the UK spending review on the Scottish Government core settlement, is relatively similar in revenue budget terms to 2020/21, with the block revenue grant growing by £1.1bn (over 4% in cash terms).The capital block grant is however planned to drop by £0.3bn in contrast to the growth experienced in 2020/21.

Under the scale of fiscal devolution now operating in Scotland, this spending settlement from the UK Government represents only a staging post in the process of setting a Scottish Budget for 2021/22 and ultimately the local government settlement. As previously reported to members the Scottish Government budget is subject to growing risks and uncertainties and this settlement from the UK government, which appears to have maintained a real terms growth of circa 3.5% in the block grant settlement, provides only limited reassurance at this stage.

Additionally, and for member's context, with a very similar level of real terms growth in the block grant in 2020/21, the Council's grant settlement ultimately experienced a like for like cut of 1.1%. So, growth in the block grant nationally does not necessarily translate into a positive outlook for the like for like change in the local government grant settlement.

COVID-19 related funding for the Scottish government is set at £1.3 billion in 2021-22, compared with the guaranteed minimum amount of £8.2 billion in 2020-21 suggesting the UK government financial plans at this stage anticipate many of the ongoing interventions that have occurred this year will be unwound and or removed completely. It is not clear at this stage whether the Council is likely to have access to any COVID19 specific funding to support the ongoing demands from COVID19 and specifically the longer term recovery period.

3.2.4 Future Pay Settlements

Across all pay groups, 2020/21 represents the final year of the current multi-year pay settlements covering 2018/19 - 2020/21. This current 3 year pay deal followed a period of sustained pay restraint that operated across the UK public sector and which was characterised by periods of both pay freezes and capped below inflation increases. The current pay agreement reflected a multi-year above inflation annual settlement for all local government employee groups in Scotland, providing a degree of real terms restoration of pay levels.

Pay negotiations in local government in Scotland are complex, and for teachers constitutes a tri-partite negotiation between employers, employee representative groups and the Scottish Government with the non-teaching workforce a more direct negotiation between employer and employee representative groups. Although operating within these collective negotiating frameworks, such negotiations are inevitably influenced by wider economic, fiscal and social conditions as well as any national government announcements on pay policy.

Moving into 2021/22, the UK and Scottish fiscal, economic and financial backdrop has changed significantly from that which existed at the beginning of 2020/21 and will present critical context to future pay negotiations.

In this context, the UK Government has published as part of its Spending Review announcement, a public sector pay policy which places pay restraint firmly back in the centre of the overall public spending response to help address the significant longer term cost associated with the COVID19. The Chancellor of the Exchequer also stated clearly that this policy sought to ensure that any increase in public sector pay levels, needed to be appropriately sympathetic to the reported squeeze on pay level across the private sector over the course of 2020. The UK Government's stated position is to apply a "pause" on any pay growth across the public sector with the exception of front line NHS nurses and doctors and those earning less than £24,000 across public service.

The Scottish Government have yet to commit to a public sector pay policy for Scotland and this will not be formally confirmed until they publish their draft budget on the 28th January. However, the Cabinet Secretary for Finance has already publicly stated they do not intend to follow a similar path to that of the UK government, suggesting a national pay policy in Scotland may yet emerge that envisages wider pay growth.

Although not directly influencing local government's pay negotiations, the re-emergence of pay restraint as a clear national policy commitment by the UK government represents important context and will ultimately be reflected in their spending plans and resources made available to devolved governments. Similarly, the decisions that will be taken by the Scottish Government on pay policy will equally be reflected in the scale of financial settlement provided to local government and will therefore represent critical backdrop to future pay negotiations.

Although at present negotiations have yet to formally commence, it is anticipated that trade union groups by contrast will continue to promote their stated ambition of real terms pay restoration. In addition, public sector unions are increasingly calling for the significant contribution of the public sector workforce to help the country respond to and cope with COVID19, to be formally rewarded and reflected in the pay settlement for 2021/22. Both these ambitions will run counter to any form of pay restraint and indeed affordability considerations in the context of anticipated financial settlement prospects for local government in Scotland.

Given this backdrop, pay negotiations for 2021/22 will be particularly challenging and potentially difficult to achieve a reconciled position of agreement over a short period of time. There is therefore a strong possibility that the Council will need to set a budget for 2021/22 in the absence of an agreed pay settlement and will therefore be required to manage and provide for this uncertainty moving into next financial year.

3.2.5 Right for Renfrewshire

The Council's three year financial strategy 2020 – 2023 is underpinned by a requirement for the R4R transformation programme to support the delivery of £25 million of recurring revenue savings over the medium term period to 2023. An initial phasing assumption of savings of £7 million, £13 million and £5 million was made for each financial year through to 2023. The approved 2020/21 budget ultimately planned for £3.5 million of recurring savings to be released in 2020/21 with a further £2.3 million of linked full year effect savings in 2021/22 from the Tranche 1 service redesigns. To remain broadly in line with the financial strategy at that time, a further £14 million of transformation savings would require to be secured as part of the 2021/22 budget and a further £5 million in 2022/23.

Members will however be aware, that at the onset of the coronavirus pandemic, a decision was taken to formally pause the R4R programme, recognising the capacity of the Council was required to be fully diverted to support the emergency response. The Council continues to remain on an emergency footing in line with the new Strategic Framework now operating significant restrictions across Scotland as part of the ongoing response to managing what is now recognised as the second wave of the pandemic over the winter period. Additionally, it is expected that demands on the Council will continue to emerge moving well into 2021 as the country moves toward managing the logistical challenge of delivering a mass vaccination programme over the first half of the year.

As reported to the Leadership Board, it is recognised that the R4R programme has and is likely to continue to suffer significant delay in the context of the original three year financial strategy planning horizon. There remains a significant risk that even once remobilised and restarted, the pace at which transformation work can progress will continue to be hampered and constrained by the capacity of the organisation continuing to flex to support the changeable demands that emerge from the ongoing COVID19 emergency response, vaccination and ultimate recovery process.

At this stage, it is now inevitable that the phasing of the targeted R4R savings of £25 million will change significantly from that previously assumed as part of the medium term financial plan.

The scope and scale of a second tranche for R4R is expected to be brought forward to the Leadership Board in February. However, it is expected that this will be relatively smaller in scale and focused on areas less immediately impacted by the COVID19 demands. Such opportunities will not have been sufficiently developed by this stage to allow any further savings to be planned for and incorporated into the 2021/22 budget process.

It is now inevitable that the delivery of the majority of planned savings from R4R will now push back into 2022/23 and extend into a fourth year in 2023/24. Given this outlook, the budget strategy for 2021/22 requires to be progressed based on no further savings emerging from R4R. This, along with the expectation of R4R savings being pushed back into a fourth year in 2023/24, adds significant pressure to the Councils financial strategy over the next two years.

3.2.6 Updated Financial Outlook 2021-23

As referred to above, work has been progressed since September to update the financial outlook over the period 2021 – 23. In addition to the uncertainties linked to grant and pay as outlined above, there are further uncertainties connected to the scale of future cost pressures over the next two financial years associated with the impact of the COVID19 pandemic, the vaccination period and ultimately the social and economic recovery. Additionally, there is uncertainty as to how quickly direct impacts will recover, particularly around income levels and Council Tax.

The updated outlook continues to consider a range of scenarios which suggest that over the next two year period, the Council will continue to be required to deliver significant budget savings to achieve a balanced budget, albeit the scale of this requirement is subject to potentially greater uncertainty than before and likely to fall within a range of £14 million - £36 million. These estimates are prior to the impact of any Council tax increases in each year. Members will recall that Council Tax provides a critical but limited avenue to increase resources. For illustrative purposes these lower and upper forecasts would reduce to circa £7 million - £29 million after adjusting for an exemplar 4% per annum increase in Council Tax levels each year.

This two year forecast continues to represent a wide variation in potential lower and upper planning scenarios and it is probable that over the two year period the actual outcome has a greater likelihood of falling closer to the central scenario of circa £26 million (circa £19 million after adjusting for the illustrative Council tax increase).

At present, the financial strategy assumes a further £19 million of savings to be identified and secured from the R4R programme. At this juncture, this continues to be a broadly valid financial objective. Over the course of the following months, the budget announcements by both the UK and Scottish Governments will provide greater certainty for 2021/22, however given the ongoing economic uncertainty, there may be limited insight as to how this may inform what 2022/23 and beyond holds for the Council's financial outlook.

4. Planned Use of Financial Flexibility and Criticality of the R4R Programme

4.1 As outlined to the September Council meeting, following national level engagement between COSLA and the Scottish Government, temporary one off flexibilities in relation to the application of capital receipts, a payment holiday on capital financing principle repayments and changes to accounting arrangements linked to PPP contracts have been made available to the Council. These are expected to provide limited one off flexibility for the Council. In addition, adjustments made by the Council to capital financial planning arrangements, as approved at the September Council meeting, provides at this stage a more substantial level of one off financial capacity for the Council, that will be critical to the medium term financial plan.

4.2 As approved by Council, this flexibility, will be utilised in the first instance to replenish unallocated balances moving into 2021/22. The remaining capacity will be available to support the Council to mitigate any short term unplanned volatility but more significantly manage the gap in the financial strategy that has emerged from the delayed delivery of the R4R programme. It is estimated that this overall flexibility may be fully utilised to support the financial strategy in this manner over the next two year period.

4.3 It is critical for members to recognise that use of such flexibility provides only temporary financial support and does not represent a permanent funding solution to the underlying budget gap that is expected to emerge over the next two years. The availability of this flexibility provides the Council with scope to re-establish immediate financial resilience and stability moving into 2021/22, which is critical given the significant shift in the Council's financial risk profile. But more significantly, it provides a temporary financial buffer to offset the delay in the delivery of R4R savings. This provides the Council with a valuable window, to organisationally re-stabilise and recover from the demands of COVID19 and transition back to being capable of fully remobilising the R4R programme. It is increasingly becoming clear, that achieving this transition is likely by itself to be a major challenge for the organisation.

4.4 In this context, the next two to three years may represent the most critical period in the financial history of the Council. It is now a necessity that the Council is highly focused on re-mobilising and driving forward the R4R transformation programme once it is freed from COVID19 demands in order to deliver the targeted £25 million of savings. This is critical to provide confidence that the Council will be positioned to secure the financial sustainability of priority services.

4.5 The direct and indirect financial impact of COVID19 is expected to exhaust available financial flexibilities at the Council's disposal over the next two years and therefore achieving financial sustainability over the medium term has now become a greater and more acute challenge for the organisation than it was pre-COVID.

4.6 In the absence of the Council's financial position crystallising at the optimistic end of the two year forecast outlined above, and given the relatively limited window of protection financial flexibilities are expected to be able to provide, should the Council fail to achieve the R4R financial objectives or fail to achieve it at the required pace, there is a severe risk that this acute challenge will quickly escalate in scale.

4.7 This significantly heightened financial risk profile reinforces the need for the Council to be decisive and make substantial and at times more challenging decisions than it has previously in order to fully commit to the delivery of significant change and transformation. In the absence of substantial levels of managed transformation, change and associated savings delivered at pace, the Council will risk drifting into a financial crisis.

4.8 Such territory would place the Council in an unavoidable position of being required to rapidly reduce costs, not through managed transformation but through cutting, downsizing and withdrawing services in order to address the recurring financial gap and meet its legal requirement to achieve a balanced budget. Recently, increasing experience in England is demonstrating that councils operating in such territory become less stable, less resilient and less able to fundamentally address the underlying structural financial deficit of the organisation. In some instance this has ultimately led to financial failure of individual councils demonstrating the scale of risk that can develop.

4.9 Further, given the Chancellor of the Exchequer has outlined that the economic challenge from COVID19 has just begun, it is clear that the UK economic and fiscal outlook over the medium term is anticipated to be materially poorer than forecast prior to the arrival of COVID19. This inevitably suggests there is a greater risk of the outlook for public finances in the UK over the medium term, being significantly less positive than previously envisaged. There is therefore no certainty that this relatively short two year financial planning horizon to 2023, will see the end of the Council being required to deliver significant annual savings. In this context, it is more critical than ever that the Council is as well placed as possible, both from a financial and organisational perspective to address the risk of a further period of significant financial challenge moving into the medium term period beyond 2022/23.

4.10 Revenue Investment Capacity

Since 2010/11 the Council's rolling three year financial strategy has focused on maintaining a medium term view when progressing transformation and savings plans. This has supported the Council to consistently secure recurring savings in advance of immediate need which has both provided confidence in addressing the medium term financial challenge that has persisted over the last decade but also critically facilitated both recurring and non-recurring investment capacity in emerging priorities for the Council.

However, the significant and rapid shift in the Council's financial strategy due to the direct and indirect impact of COVID19 has effectively removed such opportunities moving forward.

Rather than remaining ahead of the curve of required savings, the Council is now likely to remain behind the curve over the medium term and be reliant upon financial flexibilities to support the annual budget process. In this context, it is anticipated that the Council will have no revenue funded investment capacity to support new service developments or initiatives or indeed capital investment funded by prudential borrowing over the medium term. The financial challenge over the next two to three years for the Council, is most likely to be focused first and foremost on achieving a balanced budget position each year and progressing the medium term target to secure financial and service sustainability, whilst protecting the delivery of the range of significant investment commitments the Council has already made.

5. Capital Investment Programme

5.1 The Council agreed in March capital investment plans for housing and general services for the period 2020/21 to 2023/24 which included investment totalling £368 million. In the current financial year, it was planned that spend of £130 million of investment would take place.

5.2 The short-term cessation of construction sites and subsequent social distancing and other requirements as sites have re-opened has and continues to impact on the Council's capital plan over 2020/21 and potentially over the medium term.

5.3 As previously reported to members, a significant pro-active exercise was commenced earlier in the year with all active contractors to seek early engagement to achieve mutually agreeable adjustments to contract arrangements and avoid potentially expensive, disruptive and protracted legal disputes. This process has and continues to be significant in terms of both scale and complexity and subject to ongoing management with contractors.

5.4 Work completed to date suggest the immediate financial impact of COVID19 has exposed the Council's investment programmes to circa £5 million - £6 million of additional cost. Broadly this potential impact is spread equally across the General Fund investment programme and Housing investment programme. In relation to the Housing programme, there exists sufficient flexibility within the Housing Revenue Account debt management arrangements to accommodate the impact of this level of cost exposure without unduly disrupting the revenue or capital programme and it is proposed that appropriate adjustments are made in this regard as part of the Housing financial planning arrangements looking ahead to the 2021/22 budget.

5.5 In relation to the General Fund investment programme, £2.5 million of resource capacity has been identified through the following routes to provide financial coverage to manage these additional COVID19 cost exposures in addition to the associated contingencies that exist within individual projects.

- The capital lifecycle maintenance programme was heavily disrupted by the closedown of construction activity over the course of 2020 and summer period in particular, which will result in a level of re-profiling of planned maintenance work to future years. As part of this process it is proposed to release £1 million of resources from the 2020/21 programme recognising the degree of constraint that exists in organisational capacity to manage a significant slippage in the programme at this scale.

- In previous budgets the Council has earmarked up to £1 million of resources to support the digital switchover of traffic signals across Renfrewshire. In this context, the Council has been successful in securing support for this programme through the wider SPT capital programme and in this context £0.7 million of resources can be released from the original £1 million without impacting on the delivery of the original project scope.

- In response to a long standing contractual issues linked to the investment delivered in the Lagoon Leisure Centre as part of the Council's Building Better Communities programme a number of years ago, a financial settlement was reached with the main contractor which has resulted circa £0.8 million of resources being paid to the Council. These resources have not been committed and are therefore available to support the wider capital programme.

5.6 As part of this wider review exercise the city deal project financial arrangements have been reassessed. The Council's long-term financial commitment in relation to the delivery of the city deal projects extends to the element of investment that requires to be funded outwith the national government grant contributions. This is funded by the Council via prudential borrowing which ultimately results in a long term annual debt servicing cost charged to the revenue budget. In this regard, a level of provision has been built into the Council's revenue planning arrangements for some time to ensure this financial requirement is appropriately accommodated. The scale of borrowing that is assessed as being required to be undertaken by the Council to deliver the projects is set at £37 million. This requirement can be comfortably accommodated within the existing revenue provision that has already been built into the Council's financial plans through matching the Council's borrowing to those elements of the projects with the longest asset life coupled with a low interest rate environment that currently exists. It is proposed that this adjustment be incorporated into the council's capital programme moving forward.

5.7 In addition, as previously outlined to members the medium term impact on the construction sector and supporting supply chains from the wider economic disruption at this stage remains unclear. Early indications suggest that in the wider construction market, inflation forecasts over the short term have softened slightly suggesting that there are no imminent risks in this regard. This may however only be a temporary position and reflective of a less buoyant market as private sector led investment in particular has been paused during the period of COVID19 and associated economic disruption.

5.8 There remains the risk that over the medium term, construction inflation may yet begin to spike as the development and investment market fully remobilises, as national government investment activity as part of the wider economic response accelerates as well as the developing impact from Brexit becomes clearer. Such a scenario would impact on the financial deliverability of the capital programme as currently constituted. In the context of the challenge to be addressed on the revenue budget, scope to manage such cost growth in the capital investment programme in the future is likely to be more constrained. Additionally, there is also a risk that general capital grant settlements from the Scottish Government may continue to reduce placing increased pressure on the deliverability of future recurring maintenance programmes.

5.9 In this context of uncertainty, it would be prudent that as part of the full refresh of the capital programme in early 2021, the opportunity is taken at that stage to assess the medium term pipeline of planned investment activity and ensure that an appropriate level of flexibility is established to provide, if required, the opportunity to scale back the scope of investment activity in a planned manner. Full details in respect to the proposed adjustments will be presented as part of the capital investment programme report to the Council budget meeting.

Implications of the Report

1. **Financial** – the report highlights the significant shift in the Council's immediate financial exposure as well as the scale and shape of the medium term financial challenge facing the Council. Delivery of the R4R programme and associated savings are critical to ultimately supporting the Council secure a financially sustainable position and financial flexibility capacity secured will in the short term provide the Council with a level of temporary financial support to stabilise, recover from the COVID19 disruption and restart the medium term transformation programme.

2. **HR & Organisational Development** – the medium term financial position and associated plans require to align with workforce and service plans to ensure the size and composition of the Council workforce remains appropriate and affordable.

3. **Community/Council Planning –** the Council requires to remain financially sustainable in order to deliver on its priorities as outlined in the Council and Community Plans.

4. **Legal** - none

5. **Property/Assets** - none

6. **Information Technology** - none

7. **Equality & Human Rights –** n/a at this stage and any implications will be assessed as part of associated proposals taken forward as part of the financial strategy and wider Right for Renfrewshire programme.

8. **Health & Safety** - none

9. **Procurement** – none

10. **Risk** – as outlined in the report, the Council's financial risk exposure both in the immediate term and over the medium term has increased significantly. The report outlines the ongoing uncertainty as well as a range of key measures to be implemented as part of the medium term financial planning arrangements to protect the Council's immediate financial stability and resilience but also continue to progress toward medium term financial sustainability.

11. **Privacy Impact** - none

12. **Cosla Policy Position** – none

13. **Climate Risk** - none

Author: *Alan Russell, Director of Finance & Resources*