Renfrewshire Council

To: Council

On: 15 December 2022

Report by: Director of Finance & Resources

Heading: Financial Sustainability and General Fund Financial Outlook

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1. **Summary**

1.1 Successive reports to the Council over the course of 2022 have highlighted the increasingly challenging financial and economic environment the Council is facing. The recent publication by the UK Government of their ‘mini-budget’, subsequent policy reversals and then a new package of tax and spending measures in the Autumn Statement has added to volatility in financial markets which were already dealing with very high levels of inflation, high energy prices and a looming economic recession. This results in a financial and economic environment within which the Council is operating characterised by rapidly increasing levels of risk; placing the Council’s financial stability and ongoing sustainability under much greater pressure than that experienced over the past decade.

1.2 Previous financial updates to Council outlined the requirement for the Council to restart transformation activity which would underpin a level of savings which would address sustainability concerns, along with a range of financial sustainability workstreams which would support the delivery of savings at the scale required.

1.3 This report provides an update with regards progress with these workstreams, and also provides an update with regards the current year financial position as cost pressures – largely driven by high levels of inflation, but also service demand – continue to build.

1.4 The report outlines a potential 'central' scenario for the medium term financial position, and the risks to this. Highlighted is the need for the Council to prioritise a range of measures to maintain financial sustainability in the short and medium term, and the use of financial flexibilities including the use of reserve balances to address a projected financial gap over the medium term; including principles around the use of reserve balances.

2. Recommendations

2.1 Note the economic outlook provided in the report

2.2 Note the update provided in relation to the current financial year and the potential use of reserve balances – both in year and over the medium term

2.3 Note the update provided in section 7 in relation to the net forecast financial position, the importance of Council understanding that the use of reserve balances to support the Council's financial position is a short term tool only; and agree the principles outlined in relation to the planned use of reserves.

3. Economic outlook

3.1 The main event which provides context for the current and future economic outlook was the UK Government Autumn Statement which was published on 17 November, accompanied by economic and fiscal forecast updates from the Office of Budget Responsibility (OBR). The main task of the Autumn Statement was to provide a way forward for UK public finances which satisfied expectations - of the OBR and markets - that the UK Government had a plausible plan to deal with the difficulties brought about by rising inflation, interest rates and a slowing economy. Such difficulties may be traced back to a mixture of COVID, the war in Ukraine and Brexit.

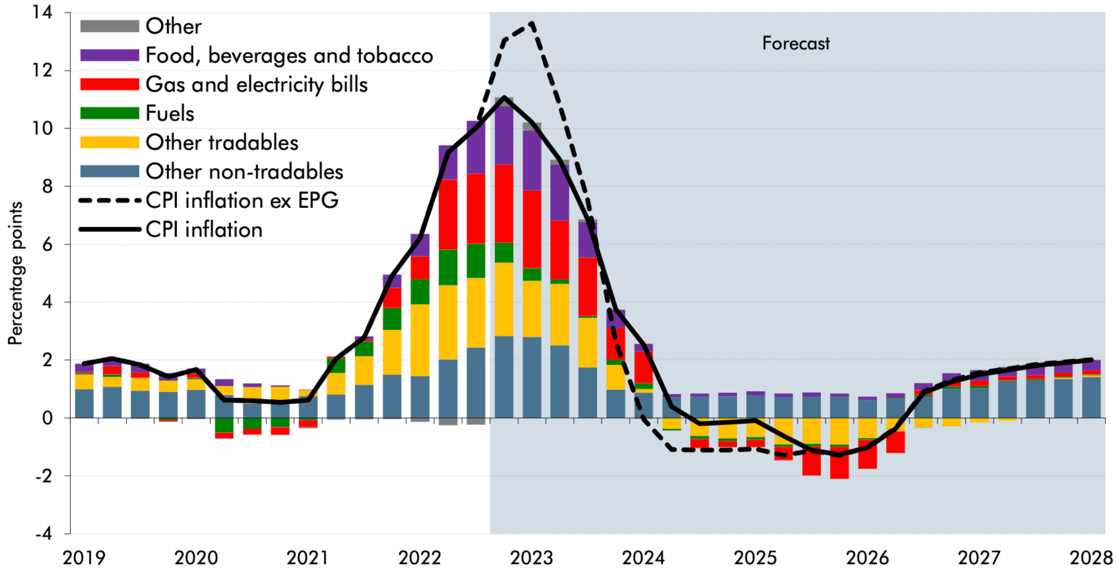
3.2 The Chancellor outlined a number of measures across a range of policy areas, with the impact being planned to take effect in some instances out until 2028:

- increasing tax: this came from a variety of sources, with a big contribution from energy related levies on companies. In terms of income related taxes, the significant freezing of income tax thresholds contribution will likely only partially compensated for the decision to not go ahead with the health and social care levy on National Insurance contributions;
- increasing payments to households: to compensate for higher inflation, including specifically to help with energy costs and generally with regards to most benefit payments, including pensions;
- squeezing departmental budgets: whilst some areas are protected to some degree from inflationary pressures, most are not. This means that what had been relatively promising real terms increases outlined in the October 2021 Spending Review are now much reduced, with the outlook now for real terms cuts to unprotected budgets.

3.3 In terms of the economic outlook, the combined announcements from the Treasury and OBR may be summarised as follows:

- **The Economy (GDP):** a recession is forecast to have started in the third quarter of 2022 and to last for just over a year. This is followed by a stronger, migration led, bounce back than before;
- **Inflation (CPI):** is now forecast to peak at 11.1% in the 4th quarter of 2022 (14.1% in the case of RPI) and to remain high in 2023 but falling. The speed of decline is such that there is negative inflation by 2025 and it is still very low in 2026, as shown in Figure 1 below. Clearly these forecasts are heavily dependent on future energy, and other, prices, as well as wage settlements Note that different inflation measures - CPI, RPI, GDP deflator - can vary considerably in some years due to recent exceptional circumstances. This helps explain why it is difficult to be definitive about real, rather than cash, terms changes in the OBR forecasts;

Figure 1: Contributions to CPI inflation



Source: ONS, OBR

- **Interest rates**: are based on market expectations and are expected to peak, briefly, at around 5% in the second half of 2023, then to fall back but remain around 4% until the end of the forecast;
- **Unemployment**: rises by just over half a million, peaking at 4.9% in the third quarter of 2024 before starting to slowly fall back;
- **Living standards**: are set to decline by a cumulative 7% in real terms over the next two financial years, by some margin the biggest recorded fall on record.

3.4 In terms of the impact for the Scottish Budget, Barnett consequentials cumulatively amount to around £1.5 billion for the two years 2023-24 and 2024-25, with much of this sum relating to the NHS, adult social care and education. The Scottish Government has announced that it will pass on all health consequentials but has made no such commitment for education. The real terms budget position for 2023-24 is unclear but the Deputy First Minister has suggested it was likely to be a real terms cut. Calculation of the actual position in real terms is made difficult by the large variation in deflator measures which could be applied.

3.5 Changes to the threshold for the UK additional rate of tax may also negatively impact on the Scottish Budget if copied by the Scottish Government as the sum raised in Scotland is relatively smaller than for the UK given fewer households in this tax bracket. However, the net impact will depend on where that extra UK money is spent. The next key Budget event will be the Scottish Government's Draft Budget**,** due on December 15th, with publication of the detail of the local government settlement following some days thereafter. It is likely to be into the New Year before clarity is achieved with regards the Budget implications for the Council.

3.6 In a recent report Audit Scotland highlighted the risk of overspend in the Scottish Budget for 2022-23, with the possible consequence of this money being clawed back by the UK Government in the financial year 2023-24. The Scottish Government has revised its 2022/23 budget over two recent announcements; with significant reallocation of resource within budget headings in order to fund the increased cost of public sector pay awards.

3.7 In light of the above events, the Council's financial strategy remains dynamic and is constantly updated to reflect emerging new pressures or changing levels of existing pressure. This position underlines the necessity for the Council to take steps to address the immediate financial position, while also prioritising the development and implementation at pace of the financial sustainability and potentially other savings measures outlined later in this report.

4 2022/23 Financial Position

4.1 Members are aware of the current very high levels of inflation being experienced in the economy, driven in large part by the dramatic increase in energy costs. These cost increases are impacting on families and household finances, as well as the Council and associated bodies, community organisations and businesses. While the outlook for inflation has moderated slightly in recent weeks - the Bank of England has reduced its forecast for CPI inflation in December 2022 from 13% to 11%, remaining at high levels of around 10% possibly for the first half of 2023. This is obviously manifesting itself in a cost of living crisis for many households with many already in or facing the prospect of fuel poverty; however food prices are also increasing at a very high rate.

4.2 As has been previously reported, the Council is equally facing a surge in supplies costs – energy costs obviously - but also food, transportation and diesel costs. Vehicle parts costs are increasingly an issue, while building and construction cost pressures remain an ongoing concern. This volatile cost environment, while undoubtedly driven by soaring energy costs, is also affected by supply constraints.

4.3 In addition to cost increases, and as has been reported regularly throughout the year, the council is also experiencing higher demand for some services – most pressingly in children and families' social care following the pandemic. Despite intensive social work support, there has been an increase in the level of risk for some children and young adults, resulting in them being placed in kinship care, accommodated in foster care or residential accommodation. For some, this entails highly-intensive care packages which are increasingly expensive. This position has been building over the past 12-18 months with an overspend being incurred in 2021/22 which was offset to some degree by the availability of Covid-related resource. However, in 2022/23, the service is – based on current levels of demand – forecasting an overspend of £4-5 million. The service anticipates that the level of demand being experienced is unlikely to reduce significantly over the medium term, therefore Council will require to make financial provision over this period in order to fund these unavoidable costs. As members are aware, increased social care funding has in recent years been passed in full to the HSCP as a specific condition of the local government settlement. This position is not sustainable moving forward. Council will continue to work through COSLA to emphasise the restrictive financial impact of such conditions. There remain other Covid-related pressures, with parking income still well below pre-pandemic levels and household waste levels remaining high but beginning to moderate.

4.4 The Council Overview finance report to the recent Finance, Resources and Customer Services Policy Board outlined a 2022/23 projected overspend (excluding the underspend projected in adult social care) of £8.4 million. This projection is exclusive of a number of other risks to the 2022/23 financial position:

- The 2022/23 pay award has been agreed for those employees on local government and craft terms & conditions. The agreement reached for these groups is broadly a combination of a core pay increase of 5% with further consolidated elements to support the lowest paid in the workforce who will receive a maximum £2,000 increase (based on a 36 hour working week, equivalent to a 10.2% increase for the lowest paid), and a £3,000 cap for those on salaries in excess of £60,000. An additional day of annual leave was also agreed on a consolidated basis. In setting the 2022/23 base budget, Council agreed a provision for pay awards based on the Scottish public sector pay policy, which broadly equates to a 2% level of provision. While additional Scottish Government funding has been provided to support the pay settlement, the amount allocated will be insufficient to meet the expected total cost, requiring the Council to fund the differential (estimated at c£3m) and to build this substantial deficit in to future base budgets.

- The position for teachers remains to be formally agreed, with trades unions seeking a pay settlement of 10%. Negotiations remain ongoing and having successfully balloted members with regards industrial action, a number of teachers strike days have been announced. Agreement on the 22/23 pay award has also still to be concluded with the chief officer group.
- As outlined above, energy costs are surging and while the Council made provision for increased costs in 2022/23, it is clear that this will not now be sufficient to meet the anticipated costs given spiralling gas prices. It is estimated that an additional £2m cost will be incurred in 2022/23 over existing energy budgets – a position again that will require to be incorporated into future base budgets. It is also now likely that additional financial support will require to be provided to OneRen, who are also experiencing dramatically increased energy costs despite taking proactive measures to try and mitigate this cost.
- There are a range of other cost pressures the Council is facing in relation to reduced parking income, increased streetlighting maintenance costs, higher levels of overtime due to annual leave which was accrued over the pandemic period now being taken and under-recovery of planning fees. While much of these cost pressures are incorporated into the forecast outturn figure above, there is a risk that other pressures may emerge over the winter period.
- The projection does not include any variance relating to the collection of Council Tax. Current forecasts suggest a slightly lower yield than 2021/22; however, it is recognised that the full impact of the cost-of-living crisis is yet to materialise which could have significant effect on yield.

4.5 One of the actions agreed by Council in September 2022 was to exercise in year the financial flexibility permitted by the Scottish Government in relation to accounting for service concession arrangements – in effect a revised approach to accounting for PPP contracts. This will allow an in year saving estimated at £1.5m to be generated, with reduced costs also being possible in future years out to 2036/37 which will be incorporated into the base budget. However, this revised approach will mean costs will be incurred in years after 2036/37 which were not previously, and the Council’s longer term financial plans will require to take account of these. In addition, the decision by the UK Government to reverse the increase in National Insurance contributions (the Health and Social Care Levy) from November 2022 will part release the provision made for this cost in the 2022/23 base budget, providing in year capacity estimated at £0.5 million.

4.6 The sum of these pressures and in year savings, on top of the £8.4m outlined above, could result in the Council delivering a £10-12 million gross revenue overspend by the end of the 2022/23 financial year – some 2.5% of total spend. Directors and management teams are closely monitoring their costs, restricting spend to essential spend only and are aiming to mitigate increases where possible in line with agreement of Council. However, even taking this action, given the above pressures it is certain the Council will require to utilise reserve balances to fund the projected overspend and support a break even position at year end.

4.7 In terms of reserves use, Council has prudently held a number of reserve balances and made additional provision at the close of the 2021/22 financial year to support what was forecast to be a very challenging medium term outlook. This included the ringfencing of funding related to the Covid-19 pandemic, in anticipation that there would be both longer term costs incurred over the final stages of the pandemic, but also recognising that there was likely to be long term behavioural change by residents and communities which would have a financial impact on the Council.

4.8 A number of these reserves will require to be drawn down in order to achieve a breakeven position at year end, with the following reserves likely to be those utilised:

Table 1

Ringfenced reserve	Opening balance £m	Potential drawdown £m
COVID construction recovery	10	4
COVID Education recovery	6.3	2-3
COVID general recovery	9.1	4-5
Inflation mitigation	5	2-4

It should be noted the estimates above are subject to significant change given the current volatile financial environment. It should also be noted that the £4m drawdown from the construction recovery fund relates to the 2022/23 pay award funding provided by the Scottish Government as capital resource, and which Council agreed in September would be switched from this reserve ie this drawdown is not related to funding the £10-12 million potential overspend.

4.9 Members will note that the above potential use of reserves is on a scale which is not sustainable over the medium term, and reinforces the need for the Council to address its projected core funding deficit over this period as soon as possible. Members will also note that – at this point – there is no requirement to utilise unallocated reserves in 2022/23; however this has only been possible due to the prudent ringfencing of resources in prior years. Given the heightened financial risk environment, maintaining unallocated reserves at least at their current level is recommended.

Medium Term Financial Pressures

5.1 Previous reports to Council have outlined a central scenario potential funding gap over the medium term (ie 2023/24 – 2025/26) of £35 million, after assuming a council tax increase of 3% in each of these years (£44 million before any decision on council tax). Applying differing assumptions to reflect optimistic to pessimistic scenarios suggest a range of £28 – 61 million before any decision on council tax, reducing to a range of £19 – 52 million after council tax. The table below attempts to summarise the main movements for the central scenario:

Table 2

	2023/24 £m	2024/25 £m	2025/26 £m	
Income				
Movement in revenue grant	0.0	0.0	0.0	
Movement in council tax base	2.5	1.0	0.8	
	2.5	1.0	0.8	
Expenditure				
Pay award %	3.0%	3.0%	2.5%	
Pay award £	11.9	8.1	7.0	
Contract and inflationary pressures	7.8	6.0	6.0	
Long term debt	0.5	0.5	0.5	
	20.2	14.6	13.5	**Total**
Gross expenditure	**17.6**	**13.5**	**12.7**	**43.8**
Council tax @ 3%	3.0	3.0	3.1	
Net pressure	**14.6**	**10.5**	**9.6**	**34.7**

5.2 The above position is based on a range of assumptions which are outlined in further detail below:

5.3 Revenue Grant

The central assumption is for a flat cash allocation over the medium term, as was outlined in the Resource Spending Review published earlier in 2022. Given the current very high rates of inflation this will obviously constrain the Council given it represents a significant real terms cut to funding. While the Scottish Government is projected to receive an additional £1.5 billion from the UK Government over the next two financial years as outlined in the UK Government Autumn Statement, given the demands on the Scottish Government and the impact of inflation, there is little to suggest any improvement in the flat cash position for local government over the medium term. This position will be clarified (for 2023/24 at least) when the Scottish Government publishes its Draft Budget on 15 December.

5.4 Council tax

Each year an assessment is made with regards movement in the council tax base ie the number and banding of domestic properties for which a council tax liability may arise. Over the period of the pandemic, a prudent approach was taken with regards the potential growth in the base from new house building; and on review it is apparent that there is some “catch-up” which can be confidently assumed in 2023/24, which will increase the total council tax collected regardless of any decision on the rate of council tax. Risk remains however with regards actual yield as the cost of living crisis continues – council tax payments may be viewed as less of a priority than heating for example.

5.5 Pay inflation

As outlined above, the pay award for 2022/23 remains to be settled for all staff groups but is currently assumed at 5%, which despite additional funding from the Scottish Government will leave an unfunded gap in 2022/23 in the order of £3 million. The pay assumptions for future years are outlined in the table above; however given the current high levels of inflation, which are forecast to endure for a large proportion of 2023, there may again be pressure on these assumed levels of increase.

5.6 Non-pay inflation

The Council has a long standing principle of no general inflationary pressures being funded, with an expectation that Directors and their management teams will seek ongoing efficiencies in order to meet general inflationary pressures. However, where a pressure is "unavoidable", and there is no scope for the manager to mitigate these costs, then provision will be made within the Council's base budget. Given the very high levels of inflation currently, the unavoidable pressure is unsurprisingly higher as we move in to 2023/24. The estimate for 2023/24 included in the table above is based on detailed returns from services which have been assessed and only the most pressing issues and costs are proposed to be funded. Pressures totalling in excess of £13 million have been outlined by services, however only a proportion of these are proposed to be funded, including an initial contribution to addressing the severe demand in children's social care.

5.7 Long term debt

Members will recall that the 2022/23 revenue budget included use of longer term capital financing flexibilities totalling £7.5 million, which it was acknowledged would result in higher costs in the longer term but were required in order to manage through the medium term; with appropriate base budget adjustments being made in future years.

5.8 The above assumptions and anticipated costs represent only those for existing services. Of course there may be other issues which arise which have not been anticipated; or the assumed levels above may prove to be inadequate. There is also no provision within the above summary for further investment in Council priorities eg climate change, social renewal and Fairer Renfrewshire etc, over that which has already been set aside.

6 Efficiencies and Financial Sustainability Workstreams

6.1 The Council's main transformation programme – branded Right for Renfrewshire (RFR) most recently – is the main route for the Council to transform services and release efficiencies, thereby supporting the delivery of recurring savings over the medium term. Members will be aware that, at the onset of the coronavirus pandemic, a decision was taken to formally pause the programme, recognising the capacity of the Council required to be fully diverted to support the emergency response. As has been outlined in previous update reports, the longer term impact of this decision is that the Council's pipeline of associated savings has now fallen behind the requirements to secure overall financial sustainability. Members agreed in June that a revised savings target of £15 million be set for the remaining phases of the existing medium term transformation programme, and that the programme be revised to clearly align with the financial sustainability portfolio.

6.2 Where management capacity has allowed, service reviews have taken place in discrete areas of the Council – corporate finance and ICT services have been reviewed utilising the RFR approach and recurring savings have been generated. In addition, reviews of the operations and infrastructure service within Environment and Infrastructure have also commenced with a view to savings being generated over the course of 22/23 to 24/25. Remaining areas of the Council where reviews will be undertaken include legal and committee services, events and communications, policy and commissioning and people and organisational development.

6.3 An area of significant spend within the Council relates to Children's Services (the service makes up nearly 50% of the Council total net revenue budget); however it is acknowledged that the current pressures being faced by elements of this service and wider obligations in terms of specific funding streams will make the delivery of recurring savings particularly challenging.

6.4 It is therefore apparent that the £15 million target is unlikely to be achieved over the medium term without impacting on service delivery. Based on work undertaken by services to date, and that for which specific plans are being developed over the next 12 – 18 months, it is estimated that £8 million of savings could be deliverable against the £15 million target.

6.5 Previous reports to Council have outlined a number of financial sustainability workstreams which are aiming to generate £20 million of savings over the medium term. Work has progressed over recent months with regards many of these; however it is becoming apparent that the ambition with regards the scale of savings is in some cases not going to be achievable within the 3 year period under consideration now that further investigation has been undertaken.

6.6 That being said, many of the workstreams have indicated potential to deliver savings in the longer term, or in some cases, while not delivering significant savings in their own right, the work is important to undertake as it is a critical enabler in the delivery of other service changes or savings. For example, development and improvement of the Council's web presence through the Digital Experience project will take some investment in the short to medium term, however this is a key enabler in increasing digital ways of working and digital customer services, which may generate efficiencies in the longer term.

6.7 In terms of savings which - at this point - can be confidently included within current financial plans, the total across all workstreams is in excess of £6 million. While this is well short of the £20 million target, as outlined above there remains a considerable amount of development of some proposals and there is scope for further achievement of savings from for example a more critical examination of the Council's property holdings. This work will continue over the coming months with update reports to be provided to Council and Policy Boards as appropriate; including consideration at Council budget setting. Development of further proposals and delivery of those which have been developed must remain a key Council priority and will be one which demands significant management capacity.

7 Medium Term Financial Position and Reserves

7.1 The culmination of the above pressures and savings can be summarised as follows:

Table 3

	2023/24 £m	2024/25 £m	2025/26 £m	
Net pressure as per Table 2	14.6	10.5	9.6	
Transformation programme	3.9	3.8	0	
Financial sustainability workstreams	5.4	0.8	0.2	**Total**
Gross pressures	5.3	5.9	9.4	**20.6**

7.2 It is apparent from the above table that there remains a considerable gap over the medium term – one which is increasing year on year – which will require to be addressed as Council considers most immediately the 2023/24 budget. As has been outlined in previous reports, there is a timing disconnect between the speed at which the financial gap is expected to emerge and the ability of the Council to generate and secure recurring savings to sustainably close it. The need for the Council to make spending and service prioritisation decisions at a greater scale and pace than over recent years in order to fully commit to the delivery of the material change and transformation required over the medium term has been consistently highlighted in every recent financial outlook report. This will require the lower level of real terms resources and spending capacity at the Council's disposal to be focused on those areas of greatest need and priority. These decisions will be challenging for the Council; and must be balanced with the requirement to continue to deliver core services.

7.3 The application of financial flexibilities agreed by the Scottish Government, in particular that relating to service concession accounting mechanisms, has been agreed by Council and is outlined earlier in this report. The revised arrangements have a two-fold benefit: an ongoing reduction in revenue costs (which are in effect deferred to the end of the relevant contract period, linked to the remaining service potential from the underlying assets); and where the revised arrangements are put in place from the commencement of the original contract, retrospective application will generate a one-off benefit representing the position that (in accounting terms, not cash terms) the Council has ‘overpaid’ for the use of assets to this point. This benefit must be utilised prudently by the Council; recognising that there is a future cost which the Council will have to fund. However, the Council may consider short to medium term use of this funding to support the current financial challenge.

7.4 The planned use of reserves as a support to the Council’s medium term financial position has been outlined in previous reports as likely to be required; and the above analysis clearly demonstrates this requirement. The application of reserves is a legitimate tool in managing shorter term financial challenges while sustainable savings are generated to match financial pressures, but it cannot ever be more than a short term measure.

7.5 While there remain uncertainties in much of the analyses above, it is prudent at this point to agree principles in terms of the planned use of specific reserve balances which could be deployed to support the Council’s medium term financial position. It is proposed that the following principles are agreed:

- No planned use of unallocated reserve balances, which are held as a risk contingency
- Unallocated balances are maintained at a minimum of £10 million (2.3% of net running costs) over the medium term
- The Council clearly sets out the planned use of ringfenced or specific reserves which have been set aside to support the medium term financial position over a maximum 3 year period, and in the interim develops and implements plans to address the underlying financial gap in a sustainable manner.
- Initially, use of the reserve balances included in Table 1 above will be considered; along with use of the service concession flexibility one-off benefit outlined in 7.3 above.

7.6 An updated financial outlook will be provided to future Council meetings including the annual budget setting meeting, incorporating the confirmed level of Scottish Government revenue support, any revised financial assumptions and any potential requirement to utilise ring-fenced reserve balances.

Implications of the Report

1. **Financial** - the report highlights the scale of the short and medium term financial challenge facing the Council. The development and implementation of the transformation programme and other financial sustainability workstreams as outlined in the report are critical to ultimately supporting the Council secure a financially sustainable position.

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; and these revised Plans will in turn require to inform the financial strategy.

4. **Legal** - none

5. **Property/Assets** - the report outlines a proposal to undertake a strategic review of property which will aim to ensure the Council's asset base remain effective and efficient

6. **Information Technology** - the report outlines the need to ensure the Council Digital strategy support ongoing financial sustainability; with any digital developments being underpinned by a robust business case

7. **Equality & Human Rights** - The recommendations contained within this report have been assessed in relation to their impact on equalities and human rights. No negative impacts on equality groups or potential

for infringement of individuals' human rights have been identified arising from the recommendations contained in the report. If required following implementation, the actual impact of the recommendations and the mitigating actions will be reviewed and monitored, and the results of the assessment will be published on the Council's website.

8. **Health & Safety** - *none*

9. **Procurement** – the report outlines a proposal for a strategic review of procurement practice in order to support the Council's ongoing financial sustainability.

10. **Risk** - as outlined in the report, the Council's financial risk exposure is increasing in the immediate term and over the medium term remains high. The report outlines increasing financial risks 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

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