Renfrewshire Council

To: Council

On: 16th December 2021

Report by: Director of Finance and Resources

Heading: General Fund Financial Update

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1. **Overview and Key Messages**

1.1 The Council's financial outlook remains subject to increased risk over the medium term as the Council continues to support both community and organisational recovery from the COVID19 pandemic; however the financial position in the current financial year remains stable and consistent with previous reports.

1.2 The UK Budget and Comprehensive Spending Review (CSR) outlines that the inflationary risks which previously were anticipated to be transitory now appear to be longer lasting at higher levels, with consequential impact for the Council in terms of supplies costs and potential pay costs. The prospects for economic recovery though have improved from previous forecasts, with the vaccine roll out being a key enabler in allowing quicker improvement.

1.3 UK Government borrowing, while still high in historic terms, is forecast to be lower than previous forecasts which provides the UK Government with some additional capacity for public spending. This capacity is further supplemented by increased tax receipts from the measures outlined by the Chancellor over 2021 ie the introduction of a health and social care levy on both employers and employees; increased corporation tax and the freezing of income tax thresholds. These improved forecasts may however be shortlived, with economic prospects in terms of lower growth forecasts in the later years of the spending review period and stubbornly high inflation also highlighted.

1.4 The CSR has confirmed that the Scottish Government block grant will increase substantially in 2022/23, with only very moderate increases over the remainder of the spending review period. 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 2022/23 and ultimately the local government settlement. The Scottish Budget will be published on 9 December, however it is anticipated that the detailed breakdown of the local government settlement by Council will not be published until 20 December.

1.5 The Scottish budget is subject to a number of pressures and there is no guarantee that the levels of increase for the block grant as a whole will be reflected in the local government settlement. In addition, the Scottish Government has committed to a number of policy priorities which will require to be funded and which may subsume much of any increase in the settlement. For context, growth in the block grant settlement of 3.5% 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.

1.6 Based broadly on the central planning scenario over 2022/23 – 2024/25 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.

1.7 The Right for Renfrewshire transformation 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 over the course of 2022. The current financial planning assumption is that the transformation programme will provide little further delivery of savings in 2022/23. Further, it is anticipated that the delivery of the transformation programme is now likely to require to be refreshed and extended into a longer term programme.

1.8 Consequently, it is anticipated that the Council's financial strategy over the next two years will require to draw heavily on changes approved locally by the Council to establish financial flexibilities arising from changes to capital financial planning arrangements. It is important 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 transformation programme. Re-establishing the programme at scale will be crucial to the financial sustainability of the Council over the medium to longer term.

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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 on the 9th December and the local government financial settlement in the days thereafter, and

- note that if it is apparent from the Scottish Budget announcement on 9 December that any of the information within this report requires to be fundamentally revised, that a further update will be provided to members at the Council meeting.

3. Revenue Summary Update

Current Financial Position including COVID19 related impact

3.1 The financial outlook report to Council in September outlined an expectation that - excluding education recovery costs – the net additional costs expected to be incurred in 2021/22 in relation to COVID19 were in the region of £9 million. This position has not changed markedly, with the range of costs now estimated at £9 – 10m. Some areas of cost have increased as prevention measures remain in place and the societal impact of the pandemic endures e.g. continuing high levels of household waste collection cost as working from home remains recommended. Increased costs are also being experienced in childcare. These estimates are based broadly on the current environment of moderate restrictions remaining in place until the end of the financial year. Should this change materially, for example with increasing levels of restrictions coming into place over the winter period, there is likely to be a consequential impact on council services and associated costs.

3.2 This forecast includes an anticipated impact on net council tax income of around £0.5m and an estimated loss of £1.3m for Renfrewshire Leisure (RL). Both of these forecast outturns appear likely to reduce however there is still some risk as the full impact of the ending of furlough support continues to be felt across households; and the potential for increased restrictions may again impact on footfall within leisure facilities.

3.3 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 through the use of COVID19 reserve balances and by the Scottish Government should these reserves be exhausted.

3.4 Costs related to the pandemic which are being incurred in schools and ELC are estimated to be £3.3 million. It remains the expectation that this cost will be self contained within the additional funding provided by the Scottish Government specifically for education recovery. As mentioned above, additional children's social care costs are estimated to be £1.3m which will require to be funded from Covid specific reserves.

3.5 In terms of the Council's core financial position, current forecasts outline an expected slight underspend of £2m which is compiled of a range of smaller underspends across all council services which will continue to be closely monitored. It should be noted however that this position excludes the anticipated impact of the now agreed 2021/22 pay award which is expected to cost the Council £2-3m more than what was budgeted for 2021/22, more than negating the core underspend anticipated. In addition, members will recall that the 2021/22 budget was set based on an unaddressed deficit of £1.7m to be supported temporarily from non-recurring COVID19 resources. This figure will also increase due to the additional pay pressures.

3.6 In summary in relation to the current year financial outlook, the position has not changed markedly from that previously reported to Council, with a substantial reliance on COVID19 non-recurring resource being required to meet the exceptional costs still being incurred. The estimates above do not take into account any costs which are likely to be incurred in relation to COVID19 organisational recovery measures which will be required; nor additional costs being experienced in terms of the capital programme which are likely again to have to be addressed through the use of COVID19 resources. Cost pressures are now being evidenced through increased tender price submissions and this pressure may be sustained for some time as inflationary concerns endure. This issue is explored further later in this report.

3.7 As approved by Council, unallocated reserves have been replenished to £10 million moving into 2021/22 - approximately 2.3% of the Council's net revenue expenditure. This prudent step has increased the 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, 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.

4 Medium Term Economic Outlook

4.1 The UK Budget and Comprehensive Spending Review was published on 27 October. At the same time, the Office for Budget Responsibility (OBR) published updated economic and fiscal forecasts.

<u>Economic outlook</u>

4.2 According to the OBR, the successful vaccine rollout has allowed the economy to reopen largely on schedule, despite continuing high numbers of coronavirus cases. The vaccines' high degree of effectiveness, combined with consumers' and businesses' adaptability to public health restrictions, has meant that output this year has recovered faster than expected in March, boosting tax revenues in the process. The stronger economic recovery has also helped to reduce the fiscal cost of pandemic-related support to below their March 2021 forecast. The economy is now expected to grow by 6.5 per cent in 2021 (2.4 percentage points faster than predicted in March).

4.3 Over the medium term, the OBR has revised up real GDP as they now expect post-pandemic scarring of potential output to be 2 per cent – rather than the 3 per cent assumed in March. They forecast that the UK economy will return to pre-pandemic levels at the start of 2022, earlier than previously anticipated. The forecast growth of 6.5% this year is expected to be followed by growth of 6% in 2022, 2.1% in 2023, 1.3% in 2024 and 1.6% in 2025. Unemployment is now expected to peak across the UK at 5.2% this year, lower than previously forecast. In the longer term, they also now forecast that the pandemic will have a less damaging 'scarring' effect on the size of the UK economy.

4.4 The strength of the rebound in demand in the UK and internationally has led it to bump up against supply constraints in several markets, causing supply bottlenecks which have been exacerbated by changes in the migration and trading regimes following Brexit. Energy prices have soared, labour shortages have emerged in some occupations, and there have been blockages in some supply chains. These can be expected to hold back output growth in the coming quarters, while raising prices and putting pressure on wages. The OBR expects CPI inflation to reach 4.4 per cent next year, with the risks around that tilted to the upside ie inflation could peak at close to 5 per cent in 2022.

4.5 Overall, the OBR forecast a more optimistic economic outlook than the previous one presented at the UK Budget of just seven months ago, but there are still significant downside risks – chief amongst these being higher inflation over a longer period. Rising inflation also means that an interest rate rise cannot be ruled out. If this were to happen, it could feed into public spending via the resulting increase to the costs to the UK government of their extensive borrowing. Higher interest on borrowing means that less is available for public spending by the UK government, with potential knock on effects for Scotland.

Borrowing

4.6 UK Government borrowing, while still high in historic terms, is forecast to be lower than previous forecasts, with total borrowing of £320bn in 2020/21 being £35bn lower than expected, with the OBR expecting borrowing of £183.0 billion in 2021-22. Public Sector Net Debt has reached the highest level since the early 1960s, with public sector net debt excluding the Bank of England expected to rise by nearly 10 percentage points of GDP from 75.9% of GDP in 2019-20 to a peak of 85.7% of GDP by the end of 2023-24.

Tax

4.7 According to the OBR, stronger and more tax-rich growth, coupled with the tax rises announced over the last two Budgets, raise the tax burden from 33.5% of GDP recorded before the pandemic in 2019-20 to 36.2% of GDP by 2026-27 – its highest level since the post-war peripod in the early 1950s. Alongside a modest increase reflected in the plans the Chancellor inherited in March 2020, this 2.7 percentage point increase in the tax take is largely thanks to the combined effects of three tax rises announced by this Chancellor:

- Increases in the main rate of **corporation tax** to 25 per cent from April 2023 onwards, as a result of the cancelling of the cut from 19 to 17 per cent at the March 2020 Budget and then raising the rate from 19 to 25 per cent at the March 2021 Budget. These together raise £25.7 billion (0.9 per cent of GDP) a year by 2026-27.

- The five-year income tax **personal allowance and higher rate threshold freeze** from the March 2021 Budget, which raises £13.9 billion (0.5 per cent of GDP) by 2026-27.

- September’s announcement of a **new health and social care levy** of 1.25 per cent on employees, employers and the self-employed directly raises £18.2 billion (0.6 per cent of GDP) by 2026-27 (although net of its effect on wages it raises £15.0 billion).

Fiscal outlook

4.8 Despite the high levels of borrowing and debt, public spending is still set to grow in real terms (ie after adjusting for inflation) in the coming years, with the Chancellor announcing that each UK department is projected to receive a real-terms increase over the spending review period as a whole.

4.9 The stronger underlying fiscal position this year, coupled with higher nominal GDP over the medium term, provided the Chancellor with significantly more fiscal room for manoeuvre going into his first three-year Spending Review – which he increased further through the tax rises outlined above. The Chancellor has therefore increased spending by around £30 billion a year – with about half going directly from the new levy into the NHS and social care budgets and half undoing the £18 billion of cuts to pre-pandemic departmental spending totals pencilled in at the March 2021 Budget. According to the Budget publication:

"Total departmental spending is set to grow in real terms at 3.8% a year on average over this Parliament – a cash increase of £150 billion a year by 2024-25 (£90 billion in real terms). This is the largest real-terms increase in overall departmental spending for any Parliament this century."

4.10 It should be noted however, increases are not spread evenly over the CSR period – much of the increase is front loaded into 2022/23 with only marginal real terms increases in the final two years of the period.

Scottish Block Grant

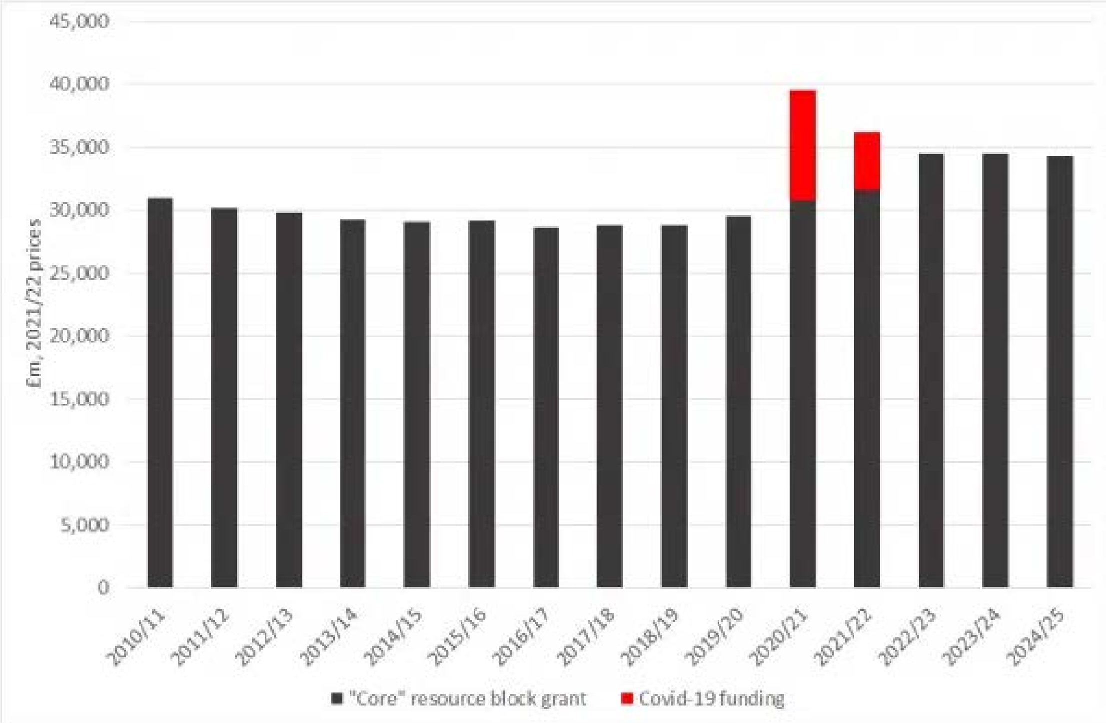
4.11 As mentioned above, the increases in departmental spending are frontloaded – a large increase next year, and relatively flat in real terms in the subsequent two years of the Spending Review period (the position of the resource block grant in 2024/25 is only £300m improved than what was projected based on the UK government's projected spending envelope announced in September).

4.12 The Budget included an average increase in the total Departmental Expenditure Limit for Scotland of £4.6bn per year, being £4.1bn revenue and £0.5bn capital. These figures may be affected by the current review of the Fiscal Framework which operates between the UK and Scottish Governments, and any change in particular to the reconciliation and block grant adjustment process..

Budgets in Cash Terms for Scotland

DEL = Departmental Expenditure Limits

	Baseline 2021-22 (£b)	**Plans 2022-23 (£b)**	**Plans 2023-24 (£b)**	**Plans 2024-25 (£b)**
Resource DEL	31.6	35.0	35.7	36.3
Capital DEL	5.2	5.6	5.6	5.5
Total DEL	36.7	40.6	41.2	41.8
% increase		10.7%	1.48%	1.46%



Source – Fraser of Allander Inst

4.13 While the Scottish Government now has some visibility over the SR period, it is likely that the Scottish Budget for 22/23 will again be for one year only. However, the Scottish Government has also committed to publishing its Medium Term Financial Strategy on 9 December which may give some indication at a portfolio level as to the potential direction of travel for public spending. A further commitment has been provided with regards consulting on a resource spending review which will be published by May 2022. It should be noted however that the publication on 9 December will detail departmental level aggregate spending only – it is anticipated the local government finance circular which provides detail on the settlement for each Scottish Council will not be published until 20 December. It is only at this point that the Council will get the full detail required to establish understanding of the local government settlement; and indeed it could takes some weeks into the New Year to clarify the local government settlement through the mechanisms COSLA will put in place before the Council will have the complete picture in terms of grant for 2022/23.

4.14 Should sufficient detail emerge in the Scottish Government budget which would alter any of the information within this report, or necessitate a revision to the broad financial plans outlined, officers will provide an update to Members either in advance of, or at, the Council meeting.

5 Updated Financial Outlook

5.1 As outlined in the report to Council in September and reiterated above, the Council is expected to be running a recurring deficit position of approximately £4-5m as we move into 2022/23. This position requires to be addressed in the budget setting for next financial year prior to any further budget considerations.

There are a number of key risks to the medium term financial position which are further detailed below.

Government Grant

5.2 The section above outlines the position for the Scottish Block Grant increasing in 2022/23, however this does not necessarily translate into an equal uplift being programmed for the local government settlement. The Council's financial outlook is currently based on the assumption that revenue grant will increase by 1% year on year over the medium term. This was based on the most recent medium term financial plan published by the Scottish Government which suggested improved prospects for the local government settlement which would broadly mirror the movement anticipated in the overall Scottish budget. The CSR has confirmed further improvement in the 2022/23 Scottish Budget with a considerable uplift expected, however this is followed by two years of marginal real terms growth which is a concern in terms of the Council's financial outlook.

5.3 Assuming this pattern is reflected in the local government settlement then it may be that grant prospects for 2022/23 are improved; however this does not account of any new burdens or commitments which local government may be asked to deliver. Experience suggests that where there have been significant uplifts in resource for local government, this has been accompanied by equally significant new responsibilities which reduce the like-for-like uplift to near flat cash levels. A live example of this is the expansion of free school meals to all primary pupils over the course of the next financial year. The recently announced increase in the Scottish Child Payment in 2022/23 will also impact on the resource available for other portfolios within the Scottish Budget – necessitating “hard choices” for elsewhere in the Budget.

5.4 On this basis the medium term outlook continues to be based on an assumed 1% year on year growth which is viewed as a prudent level given the risks outlined above; and the known commitments made by the Scottish Government in relation to for example the expansion of free school meals; and ongoing risks around COVID19 recovery which may require the Scottish Government to disproportionately support for example the NHS or the provision of support to businesses directly affected by the pandemic and the protection measures required.

5.5 COSLA has recently commenced its Budget Lobbying Campaign which outlines the need to invest in local government in order to ease pressures on the NHS and ensure the joint aim that everyone can “Live Well Locally”. The campaign highlights that since 2013/14 there has been an estimated 20% real terms reduction in the local government grant settlement; and that simply to stand still in terms of current levels of service and known Scottish Government policy commitments, the local government settlement will need to increase by £0.7bn or 6.5%. From these figures it can be viewed that even should the local government settlement receive a substantial increase in 2022/21, this will simply address existing pressures and will unlikely trigger the conditions for increased investment potential.

Pay

5.6 A revised pay offer has now been agreed which will exceed the budget provision made in setting the 2021/22 by an estimated £2-3m. This position will require to be addressed in setting the provision for the pay settlement in 2022/23. In addition, the 2022/23 pay provision will need to reflect the additional employer costs from the new Health & Social Care levy estimated at £1.7m for the Council, unless specific funding is included within the financial settlement to cover this additional cost burden. The UK Budget included a commitment that the pause in pay rises for public sector workers would be lifted for the CSR period from 2022/23, with recommendations being sought from pay review bodies which ensure fairness and sustainability of the public finances and which broadly reflect parity with the private sector. The Scottish Government will develop their own view on public sector pay which may reflect the UK view or potentially diverge from this

5.7 As outlined above, there are increasing fears that the relatively high levels of inflation currently being experienced may linger for longer than had been previously anticipated; potentially increasing pressure for higher pay settlements. It has been hoped that the publication of the CSR would provide the Scottish Government with increased certainty around the block grant it will receive, thereby allowing a multi-year settlement to be announced in Scotland, however it appears that publication of more detailed information in relation to years beyond 2022/23 will be delayed until May 2022 once the consultation on the Resource Sending Review proposed by the Scottish Government is complete.

5.8 Given the current backdrop, pay negotiations for 2022/23 are likely again to be challenging. There is therefore a very strong possibility that the Council will need to set a budget for 2022/23 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.

COVID19 longer term impact

5.9 It is expected that there will be longer term costs incurred in relation to the pandemic or from decisions the Council has taken in order to respond and to support communities and the organisation recover. These costs continue to evolve but it is expected that there will be permanent behavioural and societal changes which will demand a service response and which may manifest themselves in terms of both increased cost and/or reduced income. Examples of this include increased levels of household waste, longer term hybrid or remote working, increased cleaning requirements and ongoing support to communities. The longer term impact on council tax collection levels will also require to be closely monitored with there being some uncertainty as to how (or if) collection levels will recover. The medium term financial strategy will require to reflect these potential additional costs.

Other medium term financial issues

5.10 There are a range of other considerations for the financial strategy which are likely to impact over the medium term and which are summarised below:

- HSCP – the National Care Service proposals which are being considered for implementation over the course of the current Parliament will potentially impact on the Council's financial arrangements, but more significantly on the HSCP. The practice of requiring ring-fenced elements of the local government revenue grant to be passed through to the HSCP is anticipated to continue, with the Council's budget assumption being that no further contribution from Council resources will be made.
- Education recovery – the Council has received in both 2020/21 and in 2021/22 additional resource from the Scottish Government to support education recovery, with costs being incurred on additional teaching

staff and pupil support; and also on devices which enable remote learning. It is expected that this funding will continue to be utilised over a number of academic years to ensure ongoing recovery and additionality of teaching resource; however there may be recurring costs which arise and endure after the current funding has been utilised which the Council will require to fund.

- Council Commitments – as previously reported to Council, the financial plan includes provision for the recurring impact of existing commitments including City Deal investments and schools investment; and will require to reflect longer term impacts which may emerge from service changes required to support current initiatives in regard to Tackling Poverty, Social Renewal, Alcohol and Drugs and the Climate Emergency.

5.11 The Council's medium term financial plan is continually updated in light of new information as outlined above and in response to evolving views on uncertainties linked to particularly to grant and pay. The updated outlook continues to consider a range of scenarios which suggest that over the next three year period, the Council will continue to require to deliver significant budget savings to achieve a balanced budget. Since the previous update in September however, the scale of these has remained broadly consistent 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 3% per annum increase in Council Tax levels each year.

5.12 This three year forecast continues to represent a wide variation in potential lower and upper planning scenarios and it is probable that over the three 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 this juncture, this continues to be a broadly valid financial outlook. Over the course of the coming months, the budget announcement by the Scottish Government will provide greater certainty for 2022/23, however there may be limited insight as to how this may inform what 2023/24 and beyond holds for the Council's financial outlook.

6 Financial Strategy Response

6.1 The Council's three year financial strategy 2020 – 2023 was 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. 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.

6.2 The approved 2021/22 budget included £1.7m of recurring savings linked to the full year effect of savings agreed in 2020/21 from the Tranche 1 service redesigns, bringing the total saving from the initial service redesigns to approximately £6m. In line with the original savings objective, there would remain approximately £19 million of associated savings yet to be delivered through the Council's transformation programme. In the context of the above financial outlook, this financial target remains at this stage broadly appropriate in scale.

6.3 The financial update report to Council in September outlined a requirement to revise the financial strategy to reflect the pausing of the Right for Renfrewshire programme and the consequent impact on the phasing of savings delivery over the medium term. It remains the case that the Council's organisational capacity remains focussed on COVID19 response and increasingly, recovery. It is therefore unlikely that the Council's financial planning for the forthcoming year will be able to place reliance on the transformation programme delivering significant savings over those relatively minor measures outlined in the June update to the Leadership Board. However, the financial risks outlined above reinforce the need for the Council to be decisive and make substantial and potentially more challenging decisions than it has previously in order to fully commit to the delivery of the significant change and transformation which will be required over the medium term.

6.4 As agreed by Council in September, a number of measures will require to be taken in order to position the 2022/23 budget for the medium term:

- A minimal target of £2m of transformation savings from the full year effect of the initial RFR reviews and those non-frontline areas agreed to be included in Phase 2
- The use of longer term corporate financing flexibilities to bridge the savings gap over the short term; recognising that these savings will entail increased borrowing to support the capital programme and will result in higher borrowing costs over the long term, to be met through appropriate base budget adjustments and the release of long term flexibility resources.
- Plans to develop a refreshed transformation programme will be progressed, recognising the emerging environment post-COVID19, however there remains a significant risk that even once fully remobilised and restarted, the pace at which transformation work can progress may continue to be hampered and constrained by the capacity of the organisation.

6.5 The financial outlook will continue to be updated in light of the Scottish Budget for 2022/23 and any subsequent announcements which may affect the position outlined above over the short and medium term. The UK CSR publication has created the potential for a multi-year settlement to be developed by the Scottish Government once they have fully considered the CSR, consulted on the Scottish Resource Spending Review, and progressed discussions on the Fiscal Framework which is currently being reviewed by both UK and Scottish Governments. Reports will be provided to future cycles as the financial outlook and strategy is updated and adapted as appropriate.

Revenue Investment Capacity

6.6 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.

6.7 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 therefore anticipated that the Council is likely to have limited 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.

7 **Capital Investment Programme**

7.1 Previous reports to Council have outlined the impact that COVID19 has been having on the capital programme, with initial lockdown measures severely delaying progress over the course of 2020 and ongoing social distancing and supply constraints continuing to impact progress on live projects over 2021.

7.2 Further, an arguably more significant second phase of risk has emerged and continues to increase in significance over the course of 2021 in relation to construction inflation. Both supplies and labour shortages are being experienced which is driving inflation in the sector higher, along with increased demand as backlog maintenance is tackled and new projects are beginning. Key materials such as timber, roof tiles and copper are experiencing both increased costs and supply shortages. Estimates of inflation across the construction and infrastructure sector range from 4 to 8% for 2022.

7.3 The impact of this is now being increasingly experienced in both live Council projects and as Council projects are coming to the market. The Council will need to keep under careful and detailed review the cumulative impact on both individual projects and the overall approved capital plan as set against available resources and contingencies; and remain alert to the prospect of capital projects requiring additional funding to maintain the deliverability of the overall programme. In this context and as agreed by Council in September, £5 million of COVID19 resources are earmarked for this purpose in the first instance. The adequacy of this provision will be assessed over the coming months however it should be noted that in the context of the general fund capital programme this represents a relatively limited level of additional financial cover for the Council and further actions may require to be considered. The capital programme will continue to be reviewed for any opportunities 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.

7.4 Moving beyond the existing capital programme, the level of Scottish Government capital grant the Council can expect in future years will continue to be pressured as demands for capital investment across the public sector increases. Within local government significant capital costs are anticipated in relation to the expansion of free school meals which may impact on the residual amount of general capital grant available to be distributed. Scottish Government capital grant was reduced by around 20% in 2020/21, maintained at this level in 2021/22 and there is therefore little prospect of any recovery in this source of grant funding moving forward. Members will recall that at this level of funding, capital grant resource is able only to support a limited rolling lifecycle maintenance programme across all asset classes. The Council will therefore be required to continue to seek out and pursue alternative capital grant opportunities from government funds and other grant providing bodies as well as recognising that prudential borrowing represents the major lever at the Council's disposal to support major investment. However, prudential borrowing requires to be financially sustainable and underpinned by recurring revenue resources to ensure this is the case. As the Council moves forward and major financial challenges persist for the revenue budget, the capacity to sustainably support prudential borrowing will become an increasing challenge.

7.5 The Council agreed in March capital investment plans for housing and general services for the period 2021/22 to 2025/26 which included investment totalling £443 million. In the current financial year, it was planned that spend of £115 million of investment would take place. Owing to the delays being experienced as outlined above, it is now anticipated that spend in 2021/22 will be approximately £90m with budget pushed further into the future to match anticipated spend profiles. This rephasing of spend will have a consequential impact on potential borrowing costs which may provide some short term headroom in revenue budgets which will be incorporated into the medium term financial plans as outlined above.

Implications of the Report

1. **Financial** – the report highlights the scale and shape of the medium term financial challenge facing the Council. The recommencement and delivery of the transformation programme and associated savings are critical to ultimately supporting the Council secure a financially sustainable position. 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 transformation 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 remains high. 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

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