Renfrewshire Council

To: Council

On: 22 June 2023

Report by: Director of Finance and Resources

Heading: General Fund Financial Outlook

1. **Overview and Key Messages**

1.1 The Council's financial outlook is subject to increasing risk over the short and medium term as the Council continues to support both community and organisational recovery from the COVID19 pandemic.

1.2 The Scottish Government Medium Term Financial Strategy (MTFS) outlines the potential spending and funding position for the Scottish Government over the next 5 years. While the MTFS is not a budget, it does provide useful context for the potential outlook for the local government settlement.

1.3 The MTFS outlines a growing financial gap for the Scottish Government, with limited economic growth, high (but easing) inflation and increasing spend in demand-led areas of the budget eg health and social security; leaving unprotected budgets being squeezed. On this basis, there is little prospect of an improved grant settlement for local government over the medium term.

1.4 The Cabinet Secretary has stated that given the financial constraints being faced by the Scottish Government, there is a need to prioritise spending, and to reset growth in the public sector, with a focus on efficiency and innovation. The Cabinet Secretary also outlines a need for a sharp focus on structural change and collaboration – a message echoed by the Accounts Commission in their recent local government overview report. The Resource Spending Review (RSR)outlines a range of efficiency measures which will be taken by the Scottish Government including efforts to contain pay growth, public sector reform, income maximisation and improved public sector procurement.

1.5 Despite there being now relatively greater certainty in terms of future grant settlements, the prospects for pay and supplies spend remain volatile, linked to current exceptional levels of inflation. The Council's financial outlook remains broadly consistent with that previously reported to members, however the ability of the Council to continue to develop and implement savings at the scale and pace required in order to remain financial sustainable is now exceptionally difficult. This is particularly evident when viewed in the context of the high level of savings delivered by the Council over the past 13 years, and in considering from which services these savings have been secured. The Council must consider the full range of services being provided when making future savings decisions.

1.6 It is recommended the Council agree to continue to develop savings and cost reduction measures aimed at ensuring future financial sustainability (and shorter-term financial stability) is prioritised; and that savings of £35m are targeted over the next three years in order to close the forecast financial gap. It is not going to be possible to deliver savings at this scale without the Council reprioritising spend and reducing the scope, level, and quality of some services.

1.7 The shift in the scale and nature of the financial risks outlined above reinforce the need for the Council to be decisive in order to fully commit to the delivery of the significant change, transformation and service reduction which will be required over the short to medium term. The 2023/24 budget set by the Council is not recurringly in balance and is heavily dependent on the use of non-recurring reserves which have an increasingly limited lifespan. Without decisive action in the short term that drives out a substantial and sustainable reduction in the Council's net costs, the Council risks rapidly becoming financially unsustainable with reserves exhausted. This would require immediate and unstructured spend controls and reductions to be introduced, which would impact on overall service stability and delivery. The current financial circumstances and medium term financial outlook present a financial challenge in nature and scale that has never been faced by the Council in its history.

1.8 In relation to the capital programme, significantly higher risk in relation to construction inflation has been emerging. Supplies and labour shortages are being experienced which is driving inflation in the construction sector higher, along with increased demand as backlog maintenance is tackled and new projects commence as the public sector emerges from the worst of the pandemic. The Scottish Government is taking the opportunity to revise their capital spending in light of these pressures, and the Council will also require to consider some revision to existing capital investment plans in order to manage within overall available resource.

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2. Recommendations

2.1 It is recommended that members:

- Note the update provided in the report with regards the Scottish Government's Medium Term Financial Strategy

- Note the update to the Council's medium term financial strategy, the estimated financial gap the Council is facing over the medium term and the heightened financial risks the Council is facing in the short term

- Agree that officers continue to progress financial sustainability and transformation workstreams; with further savings options being developed for member consideration

- Note the capital programme update; and agree the revision to the capital plan as outlined in section 7.

3. **Revenue Update**

Current Financial Position

3.1 The outturn position for the 2022/23 financial year is reported within the annual accounts report elsewhere on the agenda for this meeting. A net £6 million overspend position is reported.

3.2 As approved by Council, unallocated reserves have been maintained at a minimum of £10 million moving into 2023/24 – approximately 2.3% of the Council's net revenue expenditure. This position maintains a degree of immediate financial resilience for the Council and is reflective of the heightened financial risks the Council will continue to face – the result of increasing costs while income remains constrained.

3.3 Council agreed the 2023/24 budget on 2 March, including the utilisation of non-recurring reserve funding of up to £12 million to generate an in year breakeven budget position. Key risks will be in relation to the 2023/24 pay award which remains to be agreed. National pay negotiations are ongoing and are anticipated to again be challenging given the affordability constraints facing local government. As was the case in 2021/22 and 2022/23, the level of pay provision which has been incorporated into the 2023/24 base budget may require to be adjusted depending on the concluded outcome of the negotiations.

3.4 In summary in relation to the current year financial outlook, there is significant reliance on non-recurring resource to underpin the revenue position while measures are taken to develop a more sustainable spend level. However, given the significant level of savings already generated by the Council over the past decade, it is increasingly difficult to implement savings which do not impact on service delivery. As the Council continues to implement new ways of working there is also the potential for some cost to be incurred in relation to the transitioning of both workplace accommodation and ICT provision to a hybrid working environment that is suitable and appropriate to facilitate safe and efficient working practice. In addition, and as outlined in previous reports to members, increasing pressure is being experienced in the council's capital investment programme owing to high levels of construction inflation. Further detail on this issue is provided later in this report.

4 Scottish Government Medium Term Financial Strategy

4.1 The Scottish Government Medium Term Financial Strategy (MTFS) was published on 25 May, outlining its projected financial position for the next five years. At the same time, the Scottish Fiscal Commission published updated economic and fiscal forecasts.

4.2 The MTFS covers the period from 2023/24 to 2027/28, and while it is not a Budget (the annual budget process will remain) it does provide an indication of the prioritisation of spend by the Scottish Government within an increasingly constrained financial envelop. In this regard, the MTFS provides welcome financial planning context over an extended period.

Scottish Government Resource and Spending

4.3 The total Scottish Government revenue budget is anticipated to increase from £45.2bn in 23/24 to £52.5bn in 27/28, based on both known and assumed levels of block grant increase from the UK government. The UK government block grant is anticipated to increase marginally in real terms over the MTFS outlook period. However, spending pressures are expected to outstrip the resources available from 2024/25, with an estimated funding gap of approaching £2 billion by 2027/28.

4.4 The pressures facing the Scottish Government budget over the current Parliament are detailed in the publication, with significant spending pressures outlined in relation to pay growth (both workforce numbers and pay progression). Previous modelling assumptions in relation to spending on health and social care of annual increases on 3.5% are now modelled on annual growth of 4% - thereby implicitly squeezing the remainder of public spending further. The commitment to create a new National Care Service is reaffirmed.

4.5 The significantly increased level of spend on social security is also outlined, with spend anticipated to increase from £5.2bn in 23/24 to £7.0bn in 26/27, reflecting increased spend in relation to the Scottish Child Payment and adult disability payments. The level of funding from the UK government in relation social security increases over the RSR period, but not to the same extent as anticipated spend due to more generous allowances and eligibility in Scotland as opposed to the rest of the UK.

4.6 Due to tax reconciliation adjustments, there is also a significant impact in 2024/25 expected due to a £0.7 billion block grant adjustment which may present an issue for the Scottish Government in the short term. The scenarios for spending and funding are outlined in the table below:

	2023-24	2024-25	2025-26	2026-27	2027-28
Central spending outlook	45,260	47,575	49,304	51,013	52,846
Central funding outlook	45,260	46,535	47,917	49,415	50,971
Surplus/(Shortfall)	*0*	*-1,040*	*-1,387*	*-1,598*	*-1,875*
Upside funding scenario	45,466	47,166	49,363	51,973	54,805
Surplus/(Shortfall)	*206*	*-409*	*59*	*960*	*1,959*
Downside funding scenario	44,951	45,965	46,882	47,945	48,933
Surplus/(Shortfall)	*-309*	*-1,610*	*-2,422*	*-3,068*	*-3,913*

Source: Scottish Government, SFC, OBR

Capital

4.7 The outlook for the capital settlement is even more constrained than for revenue, with both increased costs of borrowing and higher construction costs impacting on SG investment plans at the same time as there are both cash and real terms declines in funding. The MTFS is clear that reprioritisation of investment plans will be required in advance of setting the 24/25 Budget with spend being prioritised to those areas which support employment and the economy

Local Government Settlement

4.8 There is little detail in the MTFS which would allow any certain assumptions to be drawn in relation to the local government revenue settlement, other than an estimate of spending need as is outlined in the table below. This table however also outlines the funding gap facing the Scottish Government, which must be addressed each year when setting the Budget. In order to achieve this, the estimates of spend will require to be adjusted barring any further increase in funding. The outlook therefore for the local government settlement is likely to remain very constrained and in line with that previously outlined in the Resource Spending Review ie effectively real terms cuts.

Annex A: Central Resource Spending Outlook

Table A. 1: Central Resource Spending Outlook

	2023-24	2024-25	2025-26	2026-27	2027-28
Social Security	5,290	6,192	6,638	7,000	7,389
Health and Social Care	18,176	18,903	19,660	20,446	21,264
Local Government	10,958	11,403	11,720	12,054	12,417
Other	10,836	11,076	11,286	11,513	11,777
Total	45,260	47,575	49,304	51,013	52,846
Central funding outlook	45,260	46,535	47,917	49,415	50,971
Modelled shortfall	0	-1,040	-1,387	-1,598	-1,875
		-2%	-3%	-3%	-4%

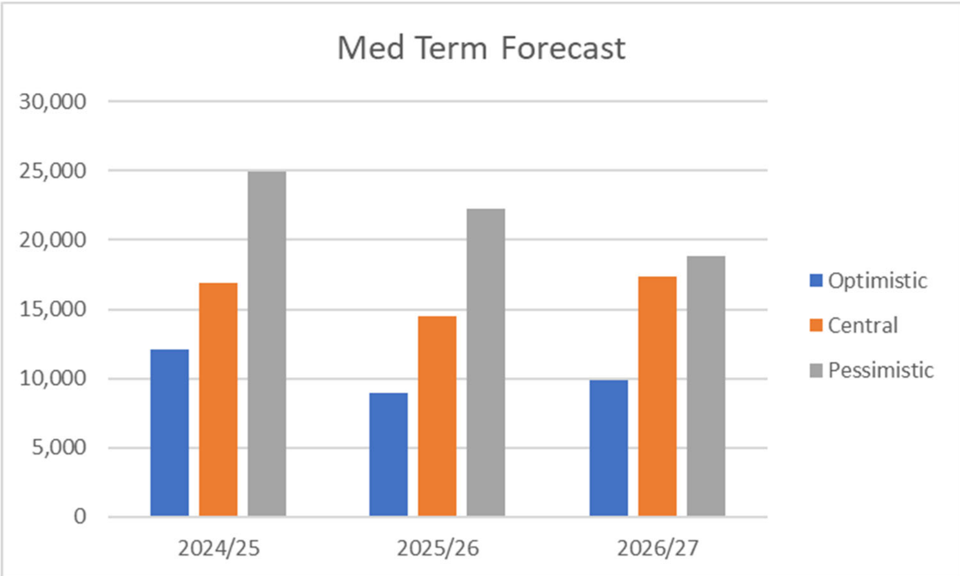
Source – Scottish Government MTFS

4.9 The MTFS also reaffirms the Scottish Government commitment to a new deal for local government, with finalisation of work on the fiscal framework (which has been ongoing in discussion with COSLA for some time) and a new Partnership Agreement. While this is encouraging in terms of improved working between local and national governments, it is not a solution to the financial difficulties both are facing. The MTFS suggests better collaboration to jointly deliver shared priorities, to tackle the collective challenges faced and to improve outcomes for people. The Scottish Government has also previously outlined a commitment to explore local revenue raising, and in this regard draft legislation has been laid before Parliament in relation to the Visitor Levy. It is clear however that owing to the legislative timetable and also the requirement for councils to undertake consultation and an 18 month notification period, the earliest any additional income from the introduction of a visitor levy could be assumed would be 2026/27.

4.10 In summary, the MTFS outlines a forecast position of increasing financial constraint for the Scottish Government, with low economic growth, higher (but easing) inflation and increasing spend in demand-led areas of the budget eg health and social security; leaving a continued squeeze on unprotected budgets such as local government over the medium term. In short, irrespective of any changes in the relationship and working between local and central government that emerges from a new deal and fiscal framework, there appears to be little to no prospect of increased revenue grant being made available to address the Council's own financial challenge.

5 Council Financial Outlook

5.1 As outlined in previous reports to Council, the central planning assumption over the medium term is a financial gap in the range of £40m-£45m over the three year period 2024/25 to 2026/27. This forecast is prior to any decision on council tax. Assuming a 5% uplift in council tax in each year, the cumulative gap would reduce to a range of £25m-£30m. This forecast is continually updated to reflect any new information in relation prospective grant settlements and spend pressures. The most recent update now suggests a central scenario of £45-50 million before any decision on council tax:



<u>Key assumptions</u>

5.2 The forecast position outlined above reflects a range of assumptions which determine the overall financial gap – key amongst these being the level of grant settlement and the level of pay award. Previous financial outlook reports have assumed a broadly flat cash settlement over the medium term, and there is nothing with the MTFS outlined above which would suggest that this assumption does not remain valid. Members should be aware there will also remain risks in terms of the distribution process and factors within that - Council is already aware of future pressure on the early learning funding as the agreed distribution is embedded within the overall settlement.

5.3 The pay settlement for 2022/23 was agreed at a level which was significantly above that budgeted, linked to the very high levels of inflation and the associated cost of living crisis which is facing households. The 2023/24 council budget was agreed incorporating a provision for pay pressures which was affordable, however this is potentially again going to come under pressure as pay negotiations remain unsettled. The forecast position – in light of expected easing levels of inflation – incorporates provision for pay awards which reduce back to historic norms in the 2-3% range.

5.4 It is expected that there will remain some impact on the services the Council requires to provide from the pandemic, and these continue to evolve eg the hybrid working environment and demand for children's residential care.

Support to households and communities in relation to costs of living continue to be experienced, and the council has made non-recurring provision in this regard through the Fairer Renfrewshire programme. The longer term impact on council tax collection levels will also require to be closely monitored with there still being some uncertainty as to how collection levels will be affected. Collection rates have encouragingly held up well over the course of 2022/23 although the impact of the cost of living crisis in 2023 may have a negative impact on future collection rates.

5.5 The financial outlook also assumes inflation will reduce to a level more in line with Bank of England targets over the period up to 2024/25, which would hopefully see the very high increases in some contract costs (notably the schools PPP contract) begin to ease. The outlook also includes provision for the recurring impact of existing commitments including City Deal investments and schools investment. However there is no provision within the outlook for ongoing investment in areas currently supported through the use of ringfenced reserves eg Tackling Poverty, Social Renewal, Alcohol and Drugs and Climate Change. Should the Council wish to continue to invest in these areas then decisions around the reprioritisation of spend will be required. The financial outlook also includes (from 2026/27 onwards) the increased borrowing costs related to the new primary school at Dargavel and extension of Park Mains High School. The annual increase in cost related to these projects – while significant in absolute terms – is a relatively small proportion of the financial challenge the Council is facing.

5.6 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 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 without doubt require to deliver significant budget savings to achieve a balanced budget. As is outlined below however, the challenge around delivering savings at the scale and pace required is dramatically increasing.

5.7 This updated position, while not significantly differing from previous forecasts, does have a different context in that the main drivers for the gap relate to spend issues – grant income being relatively more certain. The profile of the gap is also now more immediate – predominantly being related to near term spend pressures as have been outlined above. The Council will therefore need to act decisively and quickly to secure its future financial stability and sustainability moving forward. In this context it is recommended the Council agree to develop a further portfolio of work aimed at ensuring financial sustainability (and short term financial stability) is prioritised; and that savings of £35m are targeted over the next three years in order to close the projected financial gap outlined above and allow for a degree of flexibility to manage the risks associated with the challenge to deliver this scale of savings over a relatively short period.

5.8 The next 12 month period will be crucial for the Council in terms of key decisions on service reform, scope and design which ensure service costs are in line with available resource over the medium term, with reserve balances being used prudently to provide some time and space for service change to be embedded. Without this decisive action, and delivery of substantial savings in the near term, the Council will quickly find itself in a position where reserves are exhausted and no longer capable of supporting the recurring revenue budget deficit.

In such circumstances the Council would move to a position of being financially unsustainable – necessitating immediate, unstructured spend controls and cost reductions which would undoubtedly impact services and communities more severely than any planned change.

6 Financial Strategy Response

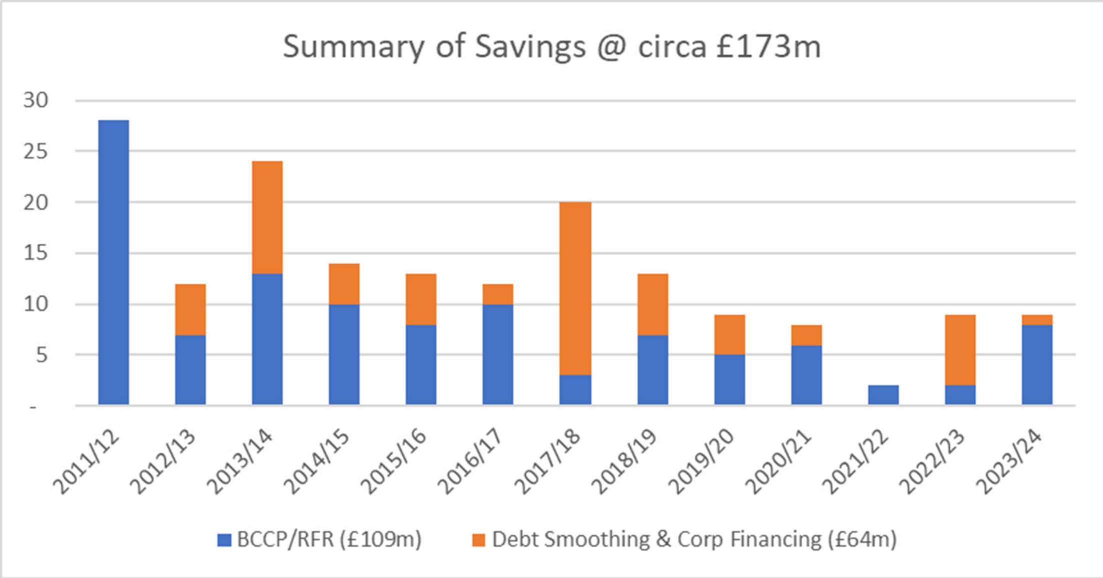
6.1 The Council has a history of sound financial management and of generating savings generally in advance of when they would be required – allowing the Council to make non-recurring investment s in priority services such as Tackling Poverty and Alcohol & Drugs services. This position has in the past been underpinned by the Council prioritising key financial decision making, whereby the financial sustainability of the Council was protected by adopting a medium term perspective and taking savings decisions early and in good time relative to the forecast requirements outlined in the medium financial plan.

6.2 The Council's main route to delivering recurring savings has been through its long term transformation programmes and also the longer term and prudent management of debt. Previous reports to Council have outlined how over the period of the pandemic, the Council's transformation programme was largely paused while management capacity was focussed on responding to the immediate demands of the situation. This resulted in a position whereby the development and delivery of transformation and savings options were "behind the curve" in terms of supporting the Council's medium term financial sustainability.

6.3 Council therefore agreed a range of financial sustainability workstreams be developed with a focus on early delivery of savings at the scale required. Many of these workstreams remain ongoing and have the potential to deliver significant savings from for example improved and more effective use of council buildings, investment in digital services and improved procurement practice.

6.4 However, it is evident from the financial sustainability work undertaken to date that the delivery of savings at scale is becoming more and more difficult without impacting on service delivery. Audit Scotland recognise this position and in their recent local government overview state service cuts and reductions are likely, with councils needing to make difficult choices about spending priorities. Audit Scotland recognise that "the scale of the challenge that lies ahead is greater than anything local government leaders will have ever experienced".

6.5 This challenge is clear when viewed in the context of the scale of savings delivery over recent years. In total, the Council has delivered savings of £173 million since 2011/12 as outlined in the exhibit below:



While a significant proportion of saving has been delivered through the effective management of borrowing and corporate financing, the majority has been delivered through service redesign and transformation (ie the Better Council Change programme and the Right for Renfrewshire programme).

6.6 However, the level of savings delivered through transformation has not been equally felt across all council services. It is estimated that of the total £109m savings delivered as outlined above, approximately half of these have been delivered by Finance & Resources, and Environment & Infrastructure (or predecessor) services. These services however only make up around 20% of total council budgets. In effect, these services have delivered savings equivalent to 60% of their 23/24 base budget over the past decade. It is not tenable for these services to continue to deliver savings at this level without services being withdrawn or impacting on front line service delivery.

6.7 Inevitably if the Council is to remain financial sustainable an increased level of savings will be required from all services. In addition, it is expected that savings will require to be sought from partner organisations such as OneRen along with specific options to generate further income.

6.8 Experience over 2022/23 suggests that further options for savings delivery and spend prioritisation over those already considered will require to be developed and agreed in the coming months. In addition, the Council will need to consider how it can flexibly utilise reserves to assist managing the financial risks associated with the challenge of delivering savings at this scale over a relatively short period of time, or from spending pressures which manifest themselves at a level above that anticipated; always considering the overall levels of financial risk and longer term financial sustainability.

6.9 Members will be aware that securing £35m of financial savings represents a very significant challenge for the organisation, not just reflecting the scale of savings but in the context of the Council being required to do so after such a long period of similar financial challenge having been in existence. It is highly unlikely that savings at this scale can be delivered without the Council reprioritising spend and reducing the scope and quality of some services.

6.10 As reflected in the recent Audit Scotland local government overview, the council must challenge existing service design and take urgent action to reform. The report also outlines there are likely to be fundamental reforms for the workforce across local government; and that we are entering an environment of potential job losses at a scale not experienced for some time. It will be crucial for the Council to actively engage with staff and trade unions on these implications as we continue to reshape and inevitably downsize services.

7 Capital Investment Programme

7.1 Previous reports to Council have outlined the impact that the pandemic has been having on the capital programme, with initial lockdown measures severely delaying progress with investment projects since 2019; and subsequent supply constraints continuing to impact progress with projects since then resulting in very high levels of construction inflation. Supplies and labour shortages are being experienced which is driving inflation in the construction sector higher, along with increased demand as backlog maintenance is tackled and new projects commence as we emerge from the worst of the pandemic. The war in Ukraine is exacerbating these constraints.

7.2 As outlined above, these issues are being experienced across the whole of the public sector, with the Scottish Government also being forced to reprioritise investment spend.

7.3 Members will recall that the current level of capital grant funding 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 now represents the most significant tool 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.

7.4 The culmination of increasing prices and the impact of the above factors (which has led to delays on some council projects) has previously been recognised and the Council has made provision in prior years for additional cost. Given the potential requirement to continue to support the council's revenue position however, it is viewed that the construction contingency funding will require to be reallocated within the wider financial sustainability resource. Given this, and similarly to the Scottish Government, it is proposed that within the wider programme of resource agreed by Council in September 2017 to invest in cultural venues and town centre infrastructure, that those elements of the programme not currently in progress (predominantly the town centre public realm improvements) are paused in order to release resource within this programme to those projects which are currently experiencing cost pressures which may exceed the levels of contingency funding available.

Implications of the Report

1. **Financial** – the report highlights the scale and shape of the short and medium term financial challenge facing the Council. The early delivery 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** – improved purchasing practice will be important in continuing to support the delivery of savings.

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 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** – COSLA are undertaking active engagement with the Scottish Government in relation to the fiscal framework in order to protect as far as possible the interests of local government.

13. **Climate Risk** – the financial challenges the Council is facing will potentially impact on its ability to implement actions and investments which would be key to achieving net zero aspirations.

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