East Lothian Council

REPORT TO: East Lothian Council

MEETING DATE: 31 October 2017

BY: Depute Chief Executive (Resources & People Services)

SUBJECT: Financial Prospects – 2018/19 and Beyond

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1 PURPOSE

1.1 To provide the Council with an update on the financial outlook for 2018/19 and beyond, setting out forecasts of the Council's anticipated cost pressures and changes to funding over the medium term, and to set out proposed changes to the budget planning framework for 2018 to 2023.

2 RECOMMENDATIONS

2.1 Members are recommended to:

- note the content of the report including the financial prospects for 2018/19 through until 2022/23;
- agree that advance work on budget development for 2018/19 onwards commences in accordance with the potential scenarios outlined within this report; and
- approve the new budget development process set out in paragraph 3.11 of this report.

3 BACKGROUND

2017-2020 Current Budget

3.1 At its meeting of 21 February 2017, the Council approved a General Services budget for 2017/18 and an outline budget for two subsequent years. In addition, the Council meeting on 27 June 2017 approved a number of additional budget adjustments for 2017/18.

3.2 The budget approved from 2017/18 to 2019/20 was balanced in each year, however included a number of key assumptions as to income and expenditure commitments, as well as the delivery of a range of efficiencies. The ability for the Council to deliver its commitments and associated outcomes within available resources is predicated on ensuring that these assumptions remain accurate and should any of these assumptions change then appropriate remedial action is put in place. A summary of key variables that were reflected within the approved budget over the next 3 years is set out below;

- **Revenue Support Grant**
  - Assumed 'flat cash' across the 3 year horizon with the exception of one adjustment relating to potential reduction in historic Loan Charge Support. This includes the assumption that the additional £130 million funding which was reflected within the overall 2017/18 Local Government Settlement to secure the Parliamentary Budget process is baselined. At the moment, we currently have a one year confirmed LG Finance Settlement for 2017/18, with the assumed level of Scottish Government general Revenue Support Grant (RSG) £166.108 million.
  - The general RSG funding provided from the Scottish Government currently makes up over 71% of the Council's overall funding. Given the significance of the grant funding, any variance to the current assumptions can have a significant financial implication to overall resources and forward plans.
- **Other Scottish Government Funding**
  - The Council also receives Scottish Government funding for a growing number of specific purposes including: Social Care Fund, Pupil Equity Fund, Criminal Justice Funding as well as additional funding provided to support the delivery of Early Learning and Childcare – 1140 hours expansion.
  - Over the past few years, there has been an increasing trend for an increased level of national policy commitments being funded by grant which can only be used for these specific purposes at the same time as we are facing reductions in the core grant for the provision of other services. The earmarking of these resources, reduces the scope for flexibility in how the Council allocates resources in a way which best meets shared outcomes. The current budget assumes that the current levels of specific grant funding will continue across the 3 year budget.
- **Council Tax Income / Yield**
  - Following years of relative stability as a result of the nationally imposed Council Tax Freeze, the Council Tax income within the 3 year approved budget includes: anticipated income relating to the change in Council Tax multipliers introduced in 2017/18,

increased yield from additional properties anticipated to be built in the next 3 years, and an assumed annual Council Tax increase of 3%.

- **Use of Reserves**
    - The Council plans to make use of reserves amounting to £4.670m across the next 2 years, with no reserves applied in year 3 in line with the requirements of the Financial Strategy to deliver a sustainable budget.
    - The 2016/17 audited accounts reports a total General Fund Reserves balance of just over £20.5 million. Most of these reserves have already been earmarked to support a wide range of future commitments. As a consequence, there is minimal flexibility to manage financial pressures through reliance on reserves. The importance of the financial strategy to steer an appropriate course of actions and ensure the deliverability of a recurring and stable cost base has never been higher.

- **Pay / Pensions**
    - The approved budget assumed a pay award of 1% for all staff which is largely in line with public sector pay policy. From April 2017, the annual pay award has now been agreed for most staff groups (excluding Teachers). The actual award is overall higher than the budgeted 1%, with the average anticipated to be just under 1.3%. Whilst the pay award has been approved for 2017/18 only, the additional costs will create a recurring pressure throughout the current budget model.
    - As highlighted above, we are already facing additional pressure on the approved budget arising from the approved pay award from April 2017. The teachers' pay negotiations remain on-going; however, assuming that teachers pay settles in line with other staff groups, it is likely that there will be an additional £0.4 million recurring pressure on the baseline budget across the next 3 years.
    - In addition, the Scottish Government has set out within its Programme for Government the removal of the public sector pay cap, which is currently sitting at 1%. This will inevitably place increased pressure on wider public sector pay claims. Even if pay awards are contained within 2017/18 levels for 2018/19 and 2019/20, this will place an increased recurring pressure on the wider Council budget.
    - Any increase in pay will also increase the totality of employers pension & NI contributions. We currently have in place a stability mechanism agreement with Lothian Pension Fund which provides a degree of certainty around current employers pension contribution rates. This stability mechanism will be updated in

line with the next triennial valuation, the outcome of which will be effective from April 2018. An expected 0.5% increase in contribution rates from April 2018 and April 2019 has already been reflected within the annual budget, however there is a risk that this may increase. Latest indications also suggest that there may be an increase to employers contributions rates required to support the Teachers' Pension Scheme, resulting from the outcome of recent actuarial valuations. It is likely that any new rates would be effective from April 2019. No increase to teachers' pension contribution rates are reflected within the existing budget.

- **Inflation**
    - Following an extended period of low inflation, no inflationary adjustment has been made to individual service budgets, however some limited adjustments are made to reflect inflationary increases relating to certain exceptional contractual commitments including PPP. Already we are starting to see some inflationary pressures affecting the procurement of supplies & services.
    - UK inflation rate is currently at its highest rate in recent years, and is currently standing at 3%. Experts are currently forecasting that inflation will range between 2% and 3% in 2018/19 reducing marginally over the following few years.
- **Demand Growth**
    - There are relatively few areas where demand growth has been built into service budgets although the current budget includes an anticipated increased in pupil school roll over the next 3 years in line with significant planning projections.
    - The Council is currently experiencing a rapidly expanding population with the delivery of an additional 10,000 new homes by 2024 (equating to around a 20% growth) and with this is forecast a significant growth in particular in the number of school-age children and the number of pensioners. This will create both opportunities for the Council but also will provide significant financial challenges in terms of the provision of services to meet these growing demographic changes such as; the number of school children, care packages, waste collection etc. and ensure that the Council has the appropriate infrastructure to support these growing demands.
- **Capital commitments including future LDP / City Deal**
    - The Council already has an increased General Services Capital Programme which has been designed to support the infrastructure requirements across the Council area.

- Whilst the majority of these costs are likely to fall outwith the current 3-year approved budget, the financial implications of supporting both any future adopted LDP and emerging City Deal commitments are significant and the Council budgets will need to be updated to reflect the related capital and revenue implications.

- **Transformational Change / Efficiency Programme**

  - A key requirement to of the current budget is the delivery of the planned programme of efficiencies. The Council has already made significant progress in delivering previous year's recurring efficiencies, and an enhanced transformational change programme is now underway that will support the delivery of new efficiencies. This will not only secure the financial efficiencies which are needed within the approved budget, but will also ensure that the Council is better equipped to deliver further savings and including ensure that our IT platforms remain flexible and fit for purpose

  - The current 3-year budget assumes the delivery of an additional £9 million of efficiencies from 2017 to 2020.

    - £4.8 million service efficiencies;

    - £2.4 million enhanced programme of transformational change;

    - £1.85 million staffing / enhanced vacancy management.

  - Whilst substantial progress has been made, the delivery of an additional £9 million of new savings over the next few years does not come without significant challenges. Any delays regarding the implementation of these recurring savings will create further problems, and ensuring that the Council has resilient plans in place to minimise any potential delays, or accelerate any new efficiency programmes remains critical.

General Services Budget – Prospects/Potential Implications

3.3 Whilst many of these assumptions still remain appropriate, the implications of any movement in any of these key variables poses a very significant risk to balancing our budgets and therefore to maintaining service provision at existing levels.

3.4 The overall economic position for the public sector and local government is likely to remain challenging for the foreseeable future with independent commentators from a wide range of sources including: Fraser of Allander Institute, Government Expenditure and Revenue Scotland (GERS), Office of Budget Responsibility (OBR) and the Improvement Service (IS); suggesting that the current period of austerity is likely to remain in the medium term. Further uncertainty has been created relating to the potential impacts upon the economy and public spending of the UK's departure from the EU. Furthermore, we know that as part of the Government's programme of priorities, that continued investment in health and other public service portfolios means that enhanced investment in local government services remains unlikely.

3.5 The Scotland Act (2016) adds another layer of complexity and uncertainty to future public sector funding projections, where a number of taxes including Income Tax have been devolved to Scotland. The devolution of these taxes will impact on the Barnett Formula and Block Grant which Scotland receives from the UK Government. As a consequence, the future sustainability of public sector funding and Scottish Government expenditure will be increasingly dependent upon the performance of the Scottish economy.

3.6 Given the challenging economic situation, it remains highly likely that the Council will expect further reductions in funding over the next few years, and there will be a requirement to deliver significant budget reductions going forward to ensure that services can be delivered within available resources. It is therefore essential that the Council's Financial Strategy provides a practical framework within which policy choices can be identified, debated and approved. This will require some difficult choices to be made around how resources are prioritised to best deliver local services.

Funding Gap

3.7 Despite the many uncertainties facing Scottish local authorities, in particular those arising from reduction in Government funding, the need for medium to longer term financial planning is becoming increasingly important. Councils must ensure that they have robust financial plans in place to mitigate any potential impact arising from a wide range of variables highlighted earlier in this report. This need for medium to longer term financial planning is promoted by Audit Scotland both nationally and locally to help ensure longer term financial sustainability in the delivery of public services.

3.8 Scenario based financial modelling has been carried out across a 5-year planning horizon. Further details are provided within **Appendix 1** but in summary the modelling work has been carried using a relatively limited set of key variables (RSG, Pay and Non-pay Inflation) on three levels of optimism. In reality the budget model includes a wide range of different variables all of which may ultimately impact on any future funding gap.

3.9 These scenarios have currently been modelled against the existing approved 3-year approved budget, and therefore any funding is over and above existing planned efficiencies as illustrated in the summary table set out in paragraph 3.10. A summary of these scenarios are set out in Section 3.10 with the basis behind each scenario set out below.

- Scenario 1

  - RSG remains in line with current 3-year approved budget, and remains static in cash terms from 2019/20 onwards
  - Pay assumes recurring impact of 2017/18 pay award, and a 1% claim in 2018/19 to 2022/23
  - Non Pay / Inflation – assumes an increase of 2% in 2018/19 and a 0.1% reduction each year until 2022/23 to 1.6%

- Scenario 2

  - RSG decrease by 1% each year until 2022/23
  - Pay assumes recurring impact of 2017/18 pay award, and a 1.5% increase in 2018/19 and each year until 2022/23
  - Non Pay / Inflation – assumes an increase of 2.5% in 2018/19, 2.4% in 2019/20 and 2.2% from 2020/21 until 2022/23 in line with current UK Government forecast for inflation from 2020.

- Scenario 3

  - RSG decrease by 3% in 2018/19 and 2019/20 and an annual 2% reduction from 2020/21 until 2022/23.
  - Pay assumes recurring impact of 2017/18 pay award, and a 2.25% increase in 2018/19, a 2.05% increase in 2019/20 and a 1.45% increase from 2020/21 until 2022/23, all of which equates to 0.75% below the inflation rate projections.
  - Non Pay / Inflation – assumes an increase of 3% in 2018/19 in line with current UK inflation rate, a 2.8% increase in 2019/20 and a 2.2% increase from 2020/21 until 2022/23 in line with current UK Government forecast for inflation from 2020

3.10 The estimated total level of savings which will be required to be delivered over the next 5 years are summarised in the following table and set out in more detail in **Appendix 1** of this report.

Scenario	**18/19 £'000**	**19/20 £'000**	**20/21 £'000**	**21/22 £'000**	**22/23 £'000**	**TOTAL**
Existing Planned Efficiencies	3,447	3,492	-	-	-	**6,939**
1	2,200	1,710	2,920	2,830	2,740	**12,400**
2	4,961	4,439	5,530	5,514	5,498	**25,942**
3	9,708	8,671	6,936	6,875	6,814	**39,004**

3.11 All of the scenarios indicate a clear requirement that the Council will require to make large cost savings unless there is a significant improvement in the level of funding provided to Local Government through the next financial settlement and beyond. While the level of savings identified will undoubtedly change as work progresses on developing the Revenue Budget, this provides an indication of the scale of financial challenge potentially facing the Council over the next five years. Reductions on this scale would have a potentially significant adverse impact upon service delivery and it is imperative that early consideration is given to how best this might be minimised. What remains clear however is that if these reductions materialise, the Council will be required to make some difficult choices in order to balance the budget.

Budget Development Process

3.12 Officers have been reviewing the current budget development process and are recommending that the following arrangements should apply to the 2018/21 budget. This will set the framework for the budget discussions and set out the financial platform for the development of an updated set of financial plans.

- A 3-year General Services revenue budget is prepared covering 2018/19 to 2020/21, based on a roll forward of existing budget plans.

- A longer term General Services capital budget is prepared covering the 5 year period 2018/19 to 2022/23.

- The Council's Financial Strategy setting out a clear direction on how the Council will manage its financial resources in the medium to long will now be considered at an earlier date in advance of the budget meeting.

- An initial set of DRAFT budget proposals (covering both General Services and HRA) is developed by the Administration and considered by Cabinet on 16 January 2018 covering both revenue and capital budgets.

- Other Political Groups will have the option to develop any amendments to the Administration budget, with formal proposals to be considered by Council on 13 February 2018, where the Council budget for both General Services, HRA and Council Tax setting will be approved.

3.13 Given the high likelihood that further savings will be required to be delivered across the next few years, it is recommended that advance work on budget development for 2018/19 and beyond commences to consider the potential options outlined within this report.

4 POLICY IMPLICATIONS

4.1 There are no direct policy implications associated with this report although on-going monitoring and reporting of the Council's financial performance is a key part of the approved Financial Strategy.

5 INTEGRATED IMPACT ASSESSMENT

5.1 The subject of this report has been considered and given there is no change in policy direction, there is no requirement to undertake any further impact assessment.

6 RESOURCE IMPLICATIONS

6.1 Financial – as described above

6.2 Personnel - none

6.3 Other – none

7 BACKGROUND PAPERS

7.1 Council 21 February 2017 – Item 1 – Council Financial Strategy 2017/18 – 2019/20

7.2 Council 21 February 2017 – Item 4a – Budget Proposals – Administration

7.2.1 Council 27 June 2017 – Item 4 – 2016/17 End of Year Financial Review

7.2.2 Members Library Report 102/17 – Financial Review 2017/18 – Quarter 1

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Appendix 1 – Financial Modelling 2018/19 to 2022/23 and potential savings gap

Scenario 1 - A	2018/19 £'000	2019/20 £'000	2020/21 £'000	2021/22 £'000	2022/23 £'000	TOTAL
RSG – Flat Cash	0	0	0	0	0	0
Pay	400	0	1,300	1,300	1,300	4,300
Non Pay / Inflation	1,800	1,710	1,620	1,530	1,440	8,100
TOTAL SAVINGS GAP	**2,200**	**1,710**	**2,920**	**2,830**	**2,740**	**12,400**

Scenario 2 - B	2018/19 £'000	2019/20 £'000	2020/21 £'000	2021/22 £'000	2022/23 £'000	TOTAL
RSG – decrease	1,661	1,629	1,600	1,584	1,568	8,042
Pay	1,050	650	1,950	1,950	1,950	7,550
Non Pay / Inflation	2,250	2,160	1,980	1,980	1,980	10,350
TOTAL SAVINGS GAP	**4,961**	**4,439**	**5,530**	**5,514**	**5,498**	**25,942**

Scenario 3 - C	2018/19 £'000	2019/20 £'000	2020/21 £'000	2021/22 £'000	2022/23 £'000	TOTAL
RSG - decrease	4,983	4,786	3,071	3,010	2,949	18,799
Pay	2,025	1,365	1,885	1,885	1,885	9,045
Non Pay / Inflation	2,700	2,520	1,980	1,980	1,980	11,160
TOTAL SAVINGS GAP	**9,708**	**8,671**	**6,936**	**6,875**	**6,814**	**39,004**