

REPORT TO: East Lothian Council

MEETING DATE: 28 June 2022

BY: Executive Director for Council Resources

SUBJECT: Financial Outlook and Budget Development
Framework 2023/24 Onwards

1 PURPOSE

- 1.1 To provide an indicative overview of the financial outlook for 2023/24 onwards and seek approval for the proposed cross-party working arrangements to support the development of future budget strategy.

2 RECOMMENDATIONS

- 2.1 To note the emerging findings from the recently published Resource Spending Review and the potential implications;
- 2.2 To agree that the Council Leader writes to the Cabinet Secretary expressing his concern at the independent review of Capital Accounting, particularly given a recent review has only just concluded, and outlining the significance of risks that may arise from this review;
- 2.3 To note the updated scenario planning and the potential scale of funding gap facing the Council by 2027/28 as set out in paragraph 3.16 and **Appendix 1**;
- 2.4 To agree that budget planning will be undertaken on a 5-year basis from 2023/24 onwards;
- 2.5 To agree the draft terms of reference for the cross-party budget working group detailed within **Appendix 2**;
- 2.6 To agree to the proposed principles for the deployment of earmarked reserves to support the delivery of efficiencies and ongoing financial sustainability;
- 2.7 To note the proposed next steps to inform the development of the budget and financial strategy for 2023/24 onwards.

3 BACKGROUND

- 3.1 The Council is operating in an increasingly challenging financial environment. The range of risks detailed within this report and current uncertainty surrounding future funding levels pose a significant threat to the Council's ability to meet its statutory duty to set a balanced budget over the coming years. As the gap between available resources and demand for services continues to widen, the need for the Council to refresh the budget development framework and approach to developing budget proposals remains essential.
- 3.2 On 29 March 2022, Council agreed to the following high-level principles to steer the future budget development process and support the development of a sustainable financial strategy which appropriately reflects the Council's priorities:
1. Establishment of a cross-party budget working group to oversee the development of detailed budget proposals and the different work streams supporting this.
 2. Commitment to developing an approach aligned to the financial strategy which combines a range of options to close the gap between available funding and anticipated expenditure including an enhanced programme of transformation, asset review, income generation, cost reduction and efficiency.
 3. A holistic approach to budget development, which recognises the relationship between capital and revenue planning and the role of investment in cost-reduction strategies.
 4. Commitment to minimising the use of one-off resources to balance the budget and ensuring that use of reserves is limited to investment that will deliver ongoing cost reductions.
 5. Ensuring alignment of financial planning and resources with wider strategic priorities, the Council Plan and consultation results.
 6. Consideration of a 5-year budget plan aligned to the financial and capital strategies.
- 3.3 The primary focus of this report is to progress the establishment of the cross-party working group, to enable members from all political groups to contribute to the development of budget strategy for 2023/24 onwards. In preparation for the commencement of work to develop more detailed budget proposals, Council is also asked to commit to working towards a 5-year budget covering the period 2023/24–2027/28, and to consider a principles-based approach to investing earmarked balances to support the delivery of sustainable budget plans.
- 3.4 This report provides an overview of the key messages arising from Scottish Government's resource spending review announcement on 31 May 2022, and some initial strategic revenue projections based on favourable, neutral and adverse scenarios.

Spending Review Update

- 3.5 On 31 May 2022, Scottish Government published its Resource Spending Review which set out high-level plans for resource spending from the period 2023/24 to 2026/27 across all elements of the public sector. The review indicates an intention to 'flat-line' revenue (resource) funding for local government at current levels between 2023/24 and 2025/26, which includes the baselining of £120 million added during the 2022/23 Budget Bill and commits to an further additional £100 million by 2026/27.
- 3.6 Whilst the exact funding settlement for local government and individual councils will not become clearer until the Scottish budget is announced (expected in December), independent commentators (including SPICE and Fraser of Allander) have indicated that this essentially represents a 7% real terms decrease in funding for local government, by contrast against a 4.7% real terms increase in Scottish Government available resource funding. Whilst the publication of the Resource Spending Review will provide some context to support medium term financial planning, the projected level of funding being made available, will leave local government with some very significant challenges in the years ahead to ensure it can continue to deliver local and national policy priorities and essential local services. The national funding settlement must be set within the context of a growing range of very significant external cost pressures including; inflation, interest rate rises, the cost of living crisis and the ongoing impacts of the COVID-19 pandemic, Russia's invasion of Ukraine and EU Exit.
- 3.7 The announcement reiterated Scottish Government's commitment to reducing child poverty, addressing the climate crisis, building a strong and resilient economy and helping public services recover from the pandemic. The following priorities for local government were also announced:
- The development of a 'new deal' for local government through the development of a Partnership Agreement and Fiscal Framework. This will build on the Review of Local Democracy and develop a deeper dialogue and debate on how Scottish and local government will work together to achieve better outcomes for people and communities.
 - Seeking to balance greater flexibility over financial arrangements for local government with increased accountability for the delivery of national priorities so that both partners can have certainty over inputs and outcomes alongside scope to innovate and improve the delivery of services to local communities.
 - Exploring greater scope for discretionary revenue-raising, such as the Visitor Levy and the newly created Workplace Parking Levy.
 - Exploring further with COSLA, Digital Office and Revenue Scotland how best to transform the digital administration of the Non-Domestic Rates system.
 - Confirming that further flexibilities requested by COSLA will be made available to councils for existing service concession arrangements (PPP/PFI); and

- Ensuring these decisions are supported by a phased approach towards alignment with the CIPFA Code of Practice for Local Authority Accounting through a comprehensive Capital Accounting Review in partnership with COSLA, Audit Scotland and CIPFA.
- 3.8 The Resource Spending Review also highlighted areas in relation to public sector pay, including a commitment to fair work, but to returning the public workforce to pre-pandemic levels, targeting workforce growth in priority areas but holding the overall pay bill (as opposed to pay levels) at 22/23 levels. Whilst local government is responsible for making decisions about pay for its workforce through national negotiations, and is not specifically directed by the public sector pay policy, this does set the tone through national negotiations, and the potential implications of managing future pay settlements, within the context a flat cash settlement, and the scale of wider risks, may be very difficult to manage.
- 3.9 Confirmation that councils will be able to consider the application of service concession as part of ongoing consideration of national fiscal flexibilities is welcomed, but it currently remains unclear whether this flexibility will provide any further benefit to the Council in support future of recovery activity. Officers will consider the potential implications once updated guidance has been provided.
- 3.10 This potential flexibility is set within the context of a very significant and enhanced risk arising from an independent review of Capital Accounting which has been outlined by the Cabinet Secretary as part of the Resource Spending Review. This very technical area of accounting and has already been subject to a very recent and full review nationally lead by Directors of Finance section and approved by COSLA Leaders in March 2022 prior to submission to the Minister. The findings from this review re-iterated: that local authorities already prepare accounts in accordance with International Accounting Standards which are fully aligned to the CIPFA Code of Practice for Local Authority Accounting and subject to external audit review on an annual basis, and the need for statutory mitigation has been in place for a significant number of years and remains appropriate. Despite these findings, the Cabinet Secretary has indicated the recent review does not deliver proposals for greater alignment with accounting standards. The potential implications arising from this further review places a very significant and enhanced financial risk to councils at a time when future financial sustainability remains a critical area of focus, and could have the potential to result in very increases to wider taxpayers (Council Tax and rent payers) and an increasing pressure on the on-going ability to support essential capital infrastructure investment. Given this has only recently been subject of a full review and detailed review, it is recommended that the Council Leader writes to the Cabinet Secretary expressing his concern and significance of risks that this review could bring at a time when financial sustainability of councils remains a key concern.
- 3.11 Whilst it is too early at this stage to precisely determine the impact of the spending review announcement on the Council in monetary terms, it remains clear that the potential impact may be very difficult to manage alongside the increasing range of significant and concurrent risks.

- 3.12 Clarity regarding the Council's allocation of funding through the local government finance settlement is not anticipated until December, with confirmation provided through the final stage of Scottish Government's budget in early 2023. However, given the scale and complexity of the challenge ahead, the details included within the Resource Spending Review will provide a useful platform to inform medium term financial planning, including the opportunity to review and update previous budget assumptions.
- 3.13 Alongside the publication of the Resource Spending Review, a targeted review of the Scottish Government's Capital Spending Review has also been published, setting out revised spending plans for financial years 2023/24 to 2025/26. Previous medium-term capital spending plans were announced in February 2021, with no reported change to previous local government capital funding levels.

Budget Assumptions & Scenario Planning

- 3.14 As a reminder, the approved budget for 2022/23–2024/25 incorporates the need to identify recurring annual savings totalling £15.5m over this three-year period, when added to the recurring requirement to deliver £2m from enhanced staffing management amounts to £17.5m. These approved savings were based on a range of assumptions that were made as part of the budget setting process for 2022/23, including a 5% increase in Council Tax charges during 2023/24 and 2024/25, and a flat-lined national funding.
- 3.15 The existing budget setting approach covers a three-year timeframe. However, in accordance with principle 6 set out at paragraph 3.2 to the report, it is recommended at this stage that Council agrees to extend the timeframe for future budget planning (i.e. for this budget setting cycle, to cover the period 2023/24 to 2027/28). The rationale for this change is as follows:
- The Council currently develops its financial and capital strategies on a 5-year rolling basis. Therefore, extension of the budget to this timeframe will bring consistency to these different aspects of financial planning.
 - It is currently anticipated that local government will receive a multi-year finance settlement for 2023/24 onwards, which will enable planning over a longer time frame to be undertaken with a greater degree of certainty over future funding streams.
 - The widening of the gap between available resources and demand for Council services, and the scale of the challenge in addressing this to deliver a balanced budget will require planning over a longer timeframe to identify areas for investment in transformation initiatives to unlock budget savings in the future.
- 3.16 Officers have revisited and updated some of the key assumptions used in the budget projections, based on conclusions drawn from the resource spending review announcement, and other potential factors which may impact on available resources and demands on expenditure. The current economic outlook means that the Council is continuing to operate in an extremely challenging and uncertain environment. Projections have been developed to incorporate three potential scenarios: the neutral position which will be used for planning purposes, alongside favourable and adverse scenarios. A summary

of these scenarios is set out in the Table below, with further information provided in **Appendix 1** of this report. It should be reminded that these assumptions remain subject to change and will be kept under close review.

Scenario	22/23	23/24	24/25	25/26	26/27	27/28	TOTAL
	£'000	£'000	£'000	£'000	£'000	£'000	
		Year 1	Year 2	Year 3	Year 4	Year 5	
Existing Planned Efficiency Savings	393	8,766	6,412	-	-	-	15,571
Potential Funding Gap (Inclusive of approved savings)							
1	0	8,808	8,631	8,373	6,666	8,579	41,057
2	0	10,553	8,779	10,057	8,406	10,378	48,173
3	0	12,233	11,114	11,720	16,156	12,219	63,442

- 3.17 Whilst these scenarios should not be confused with any funding gap and associated saving plans developed during budget development, they are relevant to support and enhance future spending discussions and medium term financial planning. In reality there are many variables which feed into budget development and financial plans, nevertheless it remains clear there is a very significant financial challenge facing the Council in the years ahead. The scenarios highlighted above do not take account of the totality of risks facing the Council, and the funding gap may increase further. Addressing options to mitigate this funding gap will be a key area of focus as part of the ongoing budget development review.

Cross-Party Working

- 3.18 Preparation of the annual budget and development of robust and sustainable financial plans are central to ensuring that the council is able to deliver its strategic objectives set out within the Council Plan and to meet statutory obligations in relation to setting a competent and balanced budget.
- 3.19 Council has demonstrated a commitment to developing cross party working arrangements for the budget through the creation of a working group and the proposed terms of reference for this group are attached at **Appendix 2** for consideration and approval. If agreed, the establishment of this group as an informal working party can be progressed in order to fulfil the commitment made to commencing the budget development process at an early stage during the year.
- 3.20 It is recognised that a review of the budget development arrangements for submitting budget amendments is also needed. This will be an area for officers to explore with the cross-party working group over the coming months, with a view to bringing a proposed protocol back to Council for consideration and approval.

Earmarked Reserves

- 3.21 The principles agreed by Council on 29 March 2022 incorporate the development of a strategy which combines a range of options to close the gap between available funding and anticipated expenditure including an enhanced programme of transformation, asset review, income generation, cost reduction and efficiency. The principles also recognise the important role that reserves and one off resources have to play in unlocking transformation initiatives.
- 3.22 The Council currently holds earmarked reserves which are designated to supporting specific objectives and priorities. The 2021/22 is the subject of a separate report on the agenda for this meeting, and as part of the year end closedown, officers have undertaken a review of earmarked reserves to ensure that they continue to support the Council's strategic priorities and financial sustainability.
- 3.23 As a result of this review, the following recommendations have arisen:
- That the scope of the COVID Action Fund be expanded to allow this funding to be used to support the broader range of risks which the Council is currently facing, including short term inflationary pressures.
 - That the existing Cost Reduction Fund be repurposed as a Transformation Fund, and further deployed to unlock transformation initiatives (including the asset review) and digitalisation projects that will lead to the delivery of wider efficiencies.
- 3.24 Members are asked to consider the proposed deployment of these reserves as part of this report, in recognition of the fact that investment can have an important role to play in developing robust and sustainable budget proposals to close the budget gap.

Budget Development – Next Steps

- 3.25 In order to inform the process for budget development for 2023/24 onwards, there are a number of critical next steps to take forward. These include:
- Subject to Council approval, the establishment of the Cross-Party Budget working group;
 - Updated and refreshed charging policy;
 - Develop a public budget consultation, with the expectation that this will be developed and taken forward end of summer/early autumn;
 - Development of an updated Capital Investment Strategy;
 - Development of a refreshed Financial Strategy including reserves strategy;
 - Update Treasury Management and Investment Strategy;
 - Update budget development arrangements for submitting formal budget amendments;
 - Development of draft General Services & HRA;

- Approve setting of Council Tax and Rent levels within the context of setting a balanced budget.

3.26 All of these elements will be taken forward within the context of the medium-term financial planning, and will be subject to ongoing approval and review.

4 POLICY IMPLICATIONS

4.1 The Council's budget and financial strategies should be a representation of the Council Plan and strategic priorities in financial terms. The proposals within this report are intended to enhance the Council's budget development framework to ensure that this process supports the effective delivery of policy objectives.

5 INTEGRATED IMPACT ASSESSMENT

5.1 Equalities – impact assessments may be required for budget proposals which involve a significant change to delivery of services by East Lothian Council. Political groups will be provided with all relevant information relating to the potential impact of budget saving proposals as part of the budget development process.

6 RESOURCE IMPLICATIONS

6.1 Financial – the focus of this report is financial planning, and details of potential financial implications are set out at paragraph 3.16.

6.2 Personnel - none at this stage

6.3 Other – none at this stage

7 BACKGROUND PAPERS

7.1 Council 14 December 2021 - Financial Strategy 2022-27

7.2 Council 1 March 2022 - Budget Development including setting of Council Tax and Council Housing Rent for 2022-23 and Budget Proposals

7.3 Council 29 March 2022 – Review of Budget Development Process

7.4 Scottish Government – 31 May 2022 - Investing in Scotland's Future: Resource Spending Review

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Appendix 1

Financial Modelling 2023/24 to 2027/28 and potential savings gap

	<u>Current</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>	
	<u>2022/23</u>	<u>2023/24</u>	<u>2024/25</u>	<u>2025/26</u>	<u>2026/27</u>	<u>2027/28</u>	<u>TOTAL</u>
Current Planned Efficiencies	393	8,766	6,412	n/a	n/a	n/a	<u>15,571</u>

<u>Scenario 1 *</u>	<u>2022/23</u>	<u>2023/24</u>	<u>2024/25</u>	<u>2025/26</u>	<u>2026/27</u>	<u>2027/28</u>	
Pay	0	3,293	3,359	3,426	3,495	3,564	
RSG	0	-2,160	0	0	-1,800	0	
Other (1)	0	11,195	8,897	8,681	8,817	8,977	
Council Tax	0	-2,160	0	0	-1,800	0	
TOTAL	0	8,808	8,631	8,373	6,666	8,579	41,057

<u>Scenario 2 *</u>	<u>2022/23</u>	<u>2023/24</u>	<u>2024/25</u>	<u>2025/26</u>	<u>2026/27</u>	<u>2027/28</u>	
Pay	0	5,038	5,189	5,345	5,505	5,671	
RSG	0	-2,160	0	0	-1,800	0	
Other (1)	0	11,195	8,424	9,739	9,929	10,144	
Council Tax	0	-3,520	-4,834	-5,027	-5,228	-5,437	
TOTAL	0	10,553	8,779	10,057	8,406	10,378	48,173

<u>Scenario 3 *</u>	<u>2022/23</u>	<u>2023/24</u>	<u>2024/25</u>	<u>2025/26</u>	<u>2026/27</u>	<u>2027/28</u>	
Pay	0	6,718	6,986	7,266	7,557	7,859	
RSG	0	-2,160	0	0	-1,800	0	
Other (1)	0	11,195	10,170	10,798	11,061	11,355	
Council Tax	0	-3,520	-6,042	-6,344	-662	-6,995	
TOTAL	0	12,233	11,114	11,720	16,156	12,219	63,442

* Inclusive of delivery of existing approved savings

(1) Includes a range of cost pressures including: Inflation & indexation; increased demand; increased revenue consequences of capital

Scenario Assumptions

Variable	Scenario 1
Pay	- 2%
RSG	- Flat cash years 2/3 and 5 - share of £120m year 1 and £100m year 4
Other	- Range of factors including 2% inflationary assumption
Council Tax	- 2%

Variable	Scenario 2
Pay	- 3%
RSG	- Flat cash years 2/3 and 5 - share of £120m year 1 and £100m year 4
Other	- Range of factors including 3% inflationary assumption.
Council Tax	- 3%

Variable	Scenario 3
Pay	- 4%
RSG	- Flat cash years 2/3 and 5 - share of £120m year 1 and £100m year 4
Other	- Range of factors including 4% inflationary assumption
Council Tax	- 5%

Appendix 2

Terms of Reference – Cross-Party Budget Working Group

Purpose & Overview

The purpose of the group will be to steer the development of the budget, and oversee the different work streams which contribute to this process. The creation of the group should enhance the budget development process by facilitating opportunities for cross-party working and ensuring that the inputs which contribute throughout this process are politically balanced and represent the wider priorities of East Lothian Council.

The group will be an informal working group and meetings will not be held in public or formally minuted. The group will act as a sounding board and will not hold any decision making powers; however, the content of discussions may be used to steer and inform the recommendations which are put forward through formal governance arrangements.

Remit

It is intended that the role and objectives of the group will be:

- ▶ Supporting the development of a balanced budget through consideration of budget proposals intended to close the gap.
- ▶ Receiving updates on the development of the Council's capital strategy and wider asset review, and considering the overall impact of the proposed programme on revenue budgets.
- ▶ Providing political oversight for transformation work streams.
- ▶ Providing political oversight to steer strategic financial planning to ensure alignment between resource allocation and the priorities identified within the Council Plan.
- ▶ Promoting greater awareness and understanding of the stakeholder engagement plan and using consultation results to inform the development of political priorities.
- ▶ Communicating financial challenges and opportunities to respective political groups and acting as a conduit to represent the priorities of wider political groups in relation to budget planning.
- ▶ Developing effective cross-party working on the development of the annual budget and financial strategies.
- ▶ Providing political oversight on the planned deployment of the council's usable reserves and balances.
- ▶ Offering feedback and learning opportunities for continually improving this process, through debrief following the Council budget meeting.

Appendix 2

This will be kept under regular review and modified as appropriate.

The working group will not:

- ▶ Replace formal governance arrangements for setting the budget or agreeing Council Tax and Rent Levels.
- ▶ Act as a barrier to transparency in the development of budget proposals and decision making.
- ▶ Supersede arrangements for delegated decision making on operational matters.
- ▶ Replace current arrangements through which officers work to support political groups on an individual basis.

Membership

Political representation: All political group leaders, Depute Council Leader and Provost. Members are asked to send a substitute representative where they are unable to attend.

Officers: Executive Management Team, Head of Finance. Members of the Corporate Management Team and other officers will attend meetings as required.

Chair / Vice Chair: Council Leader / Depute Council Leader

Transparency and Accountability

To aid transparency, relevant updates on the work of the group will be reported to Cabinet or Council through regular financial update reports.

Frequency of Meetings

The group will meet at regular monthly intervals, as and when appropriate.

At certain times of the year it may be necessary to arrange additional meetings for specific areas of focus relating to the budget.