
NORTH AYRSHIRE COUNCIL

18 December 2019

North Ayrshire Council

Title: **Financial Outlook 2020/21 to 2022/23**

Purpose: To outline the likely financial position of the Council's General Fund in the medium term in order to inform the development of budget proposals.

Recommendation: That Council considers the Financial Outlook 2020/21 to 2022/23, noting the potential scale of the financial challenge which the Council faces over the next 3 years and brings forward proposals to set a balanced budget for 2020/21 and beyond.

1. Executive Summary

- 1.1. Councils continue to operate in an increasingly complex, challenging and uncertain environment with public sector funding not keeping pace with the increasing cost and demand for services. In this climate it is essential that Councils take a long term view. The Council's General Fund Long Term Financial Outlook was approved by Council in October 2017 and is due to be updated in 2020/21. This is the cornerstone of the Council's strategic financial framework and establishes a sound basis for the development of the medium term financial plan and annual budget, enabling the Council to address the challenges it faces and align resources to key priorities.
- 1.2. A review of the long term financial outlook identifies an estimated gross funding shortfall of £48.6m over the next three years with £17.1m of this occurring in 2020/21. This is based on best estimates. Sensitivity analysis highlights the implications of changes to the underlying assumptions.
- 1.3. The Council has used £13.6m of reserves and in year underspends to support the recurring spend of the Council since 2017/18. As in previous years all reserves will be reviewed as part of the budget considerations.
- 1.4. A full refresh of the 10 year Capital Investment Programme was undertaken for 2018/19 to 2027/28. For 2020/21 a high level review will be carried out. The current loan charges budget and loans fund reserve underpin this programme. New regulations were issued in 2016 which allow Councils to vary the period and / or amount of loans fund repayments, if it is considered prudent to do so.

Following a review of the current methodology it is projected that up to £9.8m can be released from the General Fund Capital Fund / Loans Fund Reserve over the period to 2025/26. This projection is based on the current Capital Programme, taking cognisance of the recent increase in PWLB borrowing rate. It should be noted however, that any subsequent changes to the capital programme could impact on the value of funds which can be released.

- 1.5. To address the financial challenges it is important the Council develops a sustainable Budget Programme which delivers change and transformation at scale and pace over the medium and long term and for this to be considered within the context of the key priorities set out in the new Council Plan 2019-2024, approved at Council on 26 June 2019.
- 1.6. In advance of the presentation of the Financial Outlook 2020/21 to 2022/23 to Council, all elected members were briefed in late October / early November 2019.

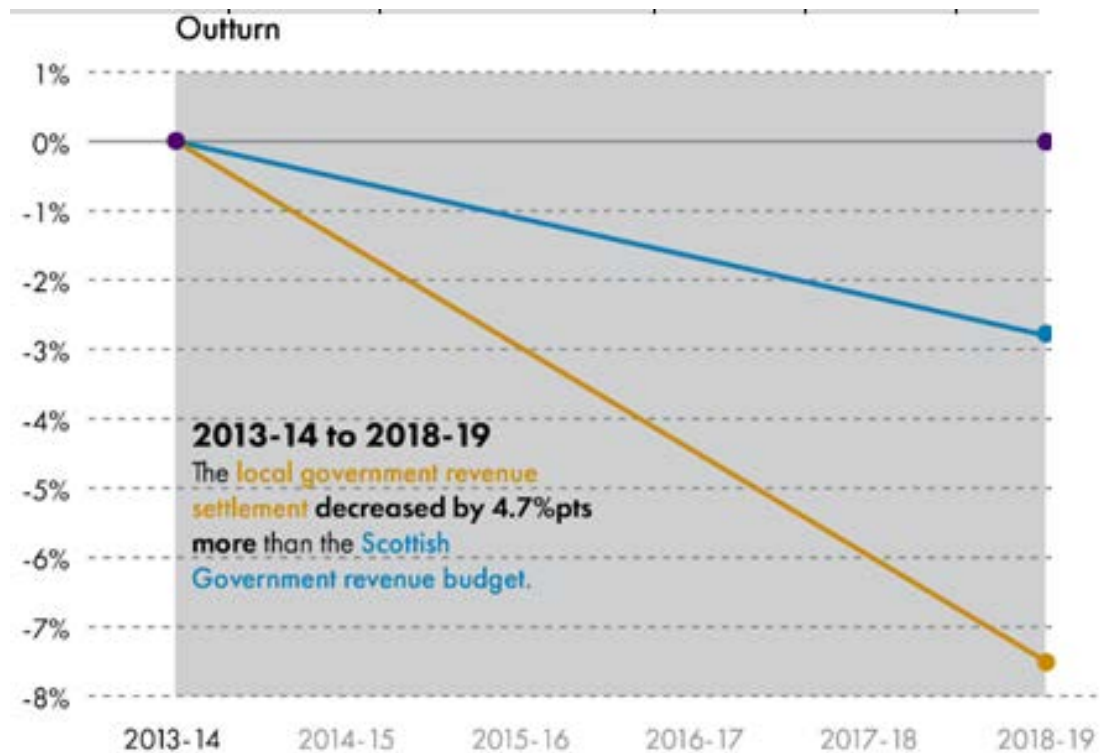
2. Background

Introduction

- 2.1. The Council's Long Term Financial Outlook was approved by Council in October 2017 and is due to be updated in 2020/21. This is the cornerstone of the Council's strategic financial framework and establishes a sound basis for the development of the medium term financial plan and annual budget. The financial framework was developed to steer the Council through the challenging economic climate and continuing real terms reduction in resources and support longer term financial sustainability of priority services.
- 2.2. The significant risks that the Council faces are set out in the Council's Strategic Risk Register. These are summarised below:
 - The financial environment including funding levels and cost pressures;
 - Inequalities; including poverty, poor health and the impact of welfare reforms; and
 - The financial sustainability of the Health and Social Care Partnership as it seeks to manage demand within its available financial resources, the failure of which continues to pose a risk to the Council as one of the funding partners.
 - The risks associated with the UK's withdrawal from the European Union across the workforce, supply chain and potential economic impact associated with the nature of the exit from the European Union.
- 2.3. In developing the medium term financial plan the Council should consider the issues and challenges noted in the Audit Scotland Report: *Local Government in Scotland: Financial Overview 2017/18* reported to Council on 13 February 2019 and the North Ayrshire Council External Audit report 2018/19, with commentary

on ensuring financial sustainability and the need to deliver the next phase of transformation. Further, the issues and challenges were included in a response by both the CIPFA Directors of Finance and COSLA in the recent Call for Evidence on the Long Term Financial Sustainability of Local Government. This response was submitted in August 2019 and provides a national context for consideration by the Scottish Parliament Local Government and Communities Committee, highlighting a number of significant challenges:-

- The scale of Scottish Government grant reductions in recent years and those forecast in future years mean it will become increasingly difficult for Scottish local authorities to remain financially sustainable under the current service delivery model.
- Local Government budgets have decreased significantly over a number of years. As the Scottish Parliament Information Centre (**SPICe**) highlighted in their most recent report on Local Government Finance, between 2013/14 and 2019/20, Local Government has been passed a disproportionate cut in comparison to budget reductions the Scottish Government has faced:



When comparing revenue settlements, real term impacts show that between 2013/14 and 2018/19, the local government revenue settlement decreased at a much faster rate (-7.5%) than the Scottish Government revenue budget (-2.8%). Although the 2019/20 settlement reported a 1% increase in local government funding, this included new funding for Scottish Government policy initiatives, principally the funding for Early Years expansion. The core grant for 2019/20 actually reduced by 1.52% in cash terms (North Ayrshire Council's reduction was 1.4%, £3.8m).

- Financial pressures through employee pay has significantly increased following recent pay settlements, with the commitments continuing into 2020/21.
- Funding non pay inflation places further pressure on Council budgets, with Councils having to fund the increases within a reduced financial envelope.
- Keeping pace with the increasing demands for social care services through demographic pressures continues to present a significant challenge to local authority budgets.
- Local authorities have responded well to the financial challenges and this is evidenced in the recent Audit Scotland report – *Local Government in Scotland - Challenges and Performance 2019*, where despite restrictions on funding and increasing demands, performance has improved in most local government performance indicators. However, it is recognised that the ability to continue to respond is increasingly limited, with decisions taken to balance budgets having an ever- increasing impact on communities.
- Current constraints continue to impact on decision making and the level of flexibility across local authorities. Financial settlements in one year cycles leave Councils with a great deal of uncertainty. Further, protection of key policy areas e.g. teacher numbers, whilst understandable, places additional strain on other Council budgets. It is recognised however, that the ability to increase Council tax (up to 4.79% in 2019/20) did provide a degree of flexibility in budget setting and the expansion of powers around discretionary taxes (e.g. Transient Visitor Tax) could offer further flexibility.
- It is a duty on all Councils to continue to consider all options around the services they deliver and for that to include opportunities for shared service delivery models, joint working, assessing which bodies are best placed to provide services, charging levels and also the discontinuation of services.

2.4 In addressing the financial stress in local government funding it is important to reinforce key lessons learned through Best Value Inspections;

- requirement for sound judgement and clear decision making and accountability by members and officers;
- the need for effective collaboration and partnership working;
- the requirement for robust and effective budget setting and scrutiny with clear corrective action where things don't go to plan;
- avoiding over reliance on the use of non-recurring funding sources to support recurring commitments;
- ensuring plans are in place to deliver savings;
- having robust business cases to support significant change.

3. Medium Term Financial Outlook

3.1. The Medium Term Financial Outlook updates the assumptions set out in the Long Term Financial Outlook for the period 2020/21 to 2022/23 considering:

- The Economic Outlook;
- The Scottish Landscape including factors affecting Scottish Government funding and funding for Local Government;
- The financial outlook for North Ayrshire including the anticipated demographic profile and the impact these will have on the Council's cost base; key costs pressures; and funding anticipated from Government Grant, Council Tax and Reserves;
- The Health and Social Care Partnership;
- The Council's approach to ensure future sustainability and alignment of resources with key priorities;
- The Capital Investment Programme.

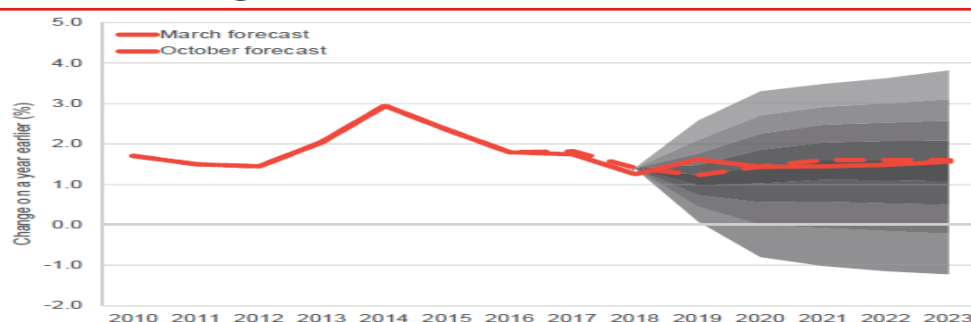
Economic Outlook

3.2 Funding for public services is inextricably linked to the performance of global and national economies. A review of financial commentators has informed the undernoted assessment.

3.3 Performance of the global economy is key to UK and Scottish trade. Following two years of robust growth a slowdown in global economic prospects is forecast. Both the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD) suggest growth will slow to around 3.3% this year before edging up to 3.4% in 2020. This is below the growth rates seen over the last three decades. Contributing factors include rising geo-political tensions in the Middle East and heightened domestic policy uncertainty (including UK withdrawal from the EU) and trade tensions between the USA and China.

3.4 The UK economy continues to grow. GDP in the three months to September 2019 grew by 0.3% (source. Office for National Statistics). Most near-term indicators continue to point to weak growth forecasts, again influenced by the uncertainties around the UK withdrawal from the European Union. The Bank of England and the Office for Budget Responsibility have attached considerably large error bands around their projections for the UK economy over the next few years which is illustrated in the chart below;

Chart 27: GDP growth, 2010 - 2023



Source: OBR

- 3.5 The Chancellor announced his Spending Round in September 2019. This outlined the budget allocations to government departments for 2020/21. The key message within a Scotland context is through the operation of the Barnett formula the UK Government will provide the Scottish Government with an additional £1.21 billion in 2020/21 (£1.12b revenue, £0.09b capital). It is important to note that this does not include any potential implications around UK tax policy. The UK Government Budget was originally planned for the 6th November 2019. Due to the General Election on 12th December, 2019 the timing of the UK Budget remains uncertain. Ultimately the final distribution of resources for Scottish public services will be set out in the Scottish Government's Draft Budget. With the dependency on the UK Budget announcement it is recognised that any settlement announcement from the Scottish Government is likely to be late January / early February, 2020.

The Scottish Landscape

- 3.6 Similar to UK economic growth forecasts, the Scottish forecasts follow a similar pattern of uncertainty. The Fraser of Allander Institute (October 2019) central forecast for GDP growth indicates increases of 1.0%, 1.2% and 1.3% through 2019 to 2021 which are not dissimilar to those of the UK as a whole, however, as is the case with UK forecasts, this is within significantly large error bands.

Scottish Government Medium Term Financial Strategy

- 3.7 The Scottish Government published its second Medium term Financial Strategy (MTFS) in May 2019. The Strategy sets out the key financial challenges and opportunities that lie ahead, including the uncertain economic backdrop through a weakened global economy and the UK's withdrawal from the European Union, and the Scottish Government's approach to inclusive growth. The Strategy provides the context for the upcoming Scottish budget. It does not set out new policy commitments nor any detail of proposed allocation of funding.
- 3.8 The funding outlook is influenced by three key determinants: -
- UK Government's fiscal stance
 - UK Government's tax performance
 - Scottish fiscal performance, with estimated income tax reconciliation shortfalls requiring to be considered in 2020/21 to 2022/23.
- 3.9 The MTFS provides the direction for the Scottish Government Spending Review and the criteria through the National Performance Framework that will be used in formulating spending plans. In terms of capital expenditure, the budget is aligned to the National Infrastructure Commission which will inform the Capital Spending Review by June 2020.

2019/20 Settlement Summary and Conditions

3.10 The 2019/20 Settlement contained the following conditions and flexibilities;

- Flexibility to increase council tax by 3% in real terms which equated to 4.79%;
- Maintaining at a national level a pupil : teacher ratio at 13.7;
- Continuing to prioritise financial support for social care with flexibility to offset their adult social care allocation by 2.2% (NAC £1.2m)

3.11 The impact of conditions against such significant spend areas creates a “gearing” effect on savings delivery, impacting more severely on unprotected service areas.

3.12 Following additional core grant, at Stage 1 of the Budget debate, of £90m (NAC £2.398m) the total level of core grant reduction moved from a 2.3% reduction to a 1.4% reduction which equated to a £3.8m reduction.

COSLA engagement with the Scottish Government

3.13 The broad strategy for engagement with the Scottish Government includes;

- Local Government’s significant contribution to delivery of the National Performance Framework;
- Full discretion on local taxation;
- Protection of the core local government settlement with removal of ring fencing and sustainable funding streams;
- Securing maximum flexibility for local government around the areas of grant settlement and investment.

Publication of the Scottish Government’s Budget

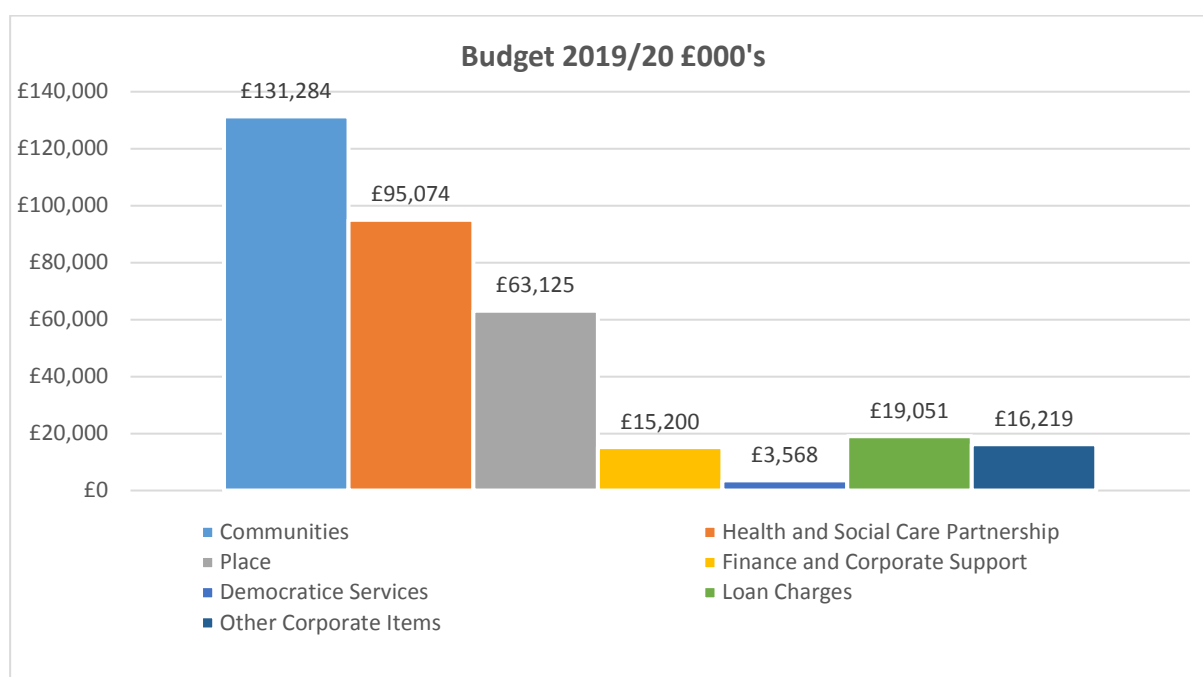
3.14 The Scottish Government continues to operate in a complex fiscal environment. The Fiscal Framework is such that the performance of the Scottish economy relative to the rest of the UK is the determinant of whether the Scottish Budget is better or worse off under the new arrangements.

3.15 The Scottish Government had originally planned to publish its Draft Budget on 12 December 2019. The new dates for the Draft Budget announcement and Stage 1 of the Budget are not known at this time. The Council is due to set its budget on 26 February 2020. It is recognised that the process from UK Budget setting through to Scottish Government Budget setting will present challenges to local authorities in setting a balanced budget within their current planned timeframe. Local authorities, through COSLA continue to monitor the current situation and engage with the Scottish Government around scenario planning and any potential contingency arrangements that may require to be put in place.

Financial Outlook for North Ayrshire Council

Allocation of Resources

- 3.16 The Chart below summarises the allocation of resources for 2019/20 approved at Council in February 2019, with 47% of relevant gross expenditure relating to employee costs;



Medium term Outlook

- 3.17 A review of the assumptions set out in the longer term financial outlook has been carried out to reassess the significant pressures and income levels anticipated over the next 3 years based on the best available information. In terms of workforce costs, recent pay settlements have addressed years of pay restraint, however this has placed further pressure on Council budgets. The model recognises the following significant pressures with an anticipated cost of up to £35m over the next 3 years:

- Workforce costs including future pay settlements (see table), teachers' pension and adjustments for pension auto enrolment;

Staff Group	20/21 Agreed	21/22 Planning Assumption	22/23 Planning Assumption
Teachers	3%	3%	3%
Other Staff	3%	3%	3%

- Inflationary uplift for major commodities and contractual commitments only, with no provision for general inflation;
- Significant socio economic and demographic pressures including:

- A growing older population;
- Increased demand for adult services;
- Increased demand for support of vulnerable children and young people;

- 3.18 Single year settlements have been a feature of Scottish Government budget setting since 2015/16 creating a high level of uncertainty about funding levels. This, alongside, the complex interaction of block allocations from the UK Treasury, Scottish Government fiscal policy, priorities and commitments and the complexities of the distribution formulae make it difficult to forecast future grant funding levels.
- 3.19 Changes to core grant funding for North Ayrshire over the last 4 years have been -3.63% / -2.1% / +0.05% / -1.4%, with an average of 1.8%. Based on this a reduction of 2% has been built in for 2020/21. This is consistent with the planning assumption of a number of other Scottish local authorities and assumes the additional £2.398m (NAC share of £90m) announced at the first stage debate of the Finance Bill for the 2019/20 budget is recurring.
- 3.20 Specific adjustments have been included in 2020/21 and 2021/22 to reflect reducing loans fund support with an anticipated increase in 2022/23.
- 3.21 The model assumes a 3% annual increase to Council Tax, generating £6m over the next 3 years. This assumes the flexibility issued to local authorities as part of the 2019/20 to increase to 4.79% is not available in 2020/21.
- 3.22 Since 2017/18 the Council has used £13.6m of reserves and in year underspends to support recurring expenditure. As in previous years all reserves will be reviewed as part of the budget considerations.
- 3.23 The General Fund Capital Fund / Loans Fund Reserve underpin the funding of the Capital Programme. New regulations were issued in 2016 which allow Councils to vary the period and / or amount of loans fund repayments, if it is considered prudent to do so. Following a review of the current methodology it is projected that up to £9.8m can be released from this Fund over the period to 2025/26. This projection is based on the current Capital Programme, taking cognisance of the recent increase in PWLB borrowing rate. It should be noted however, that any subsequent changes to the Capital programme could impact on the value of funds which can be released.
- 3.24 A summary of the anticipated position of the Council over the next three years is provided in the table below. Further work continues to refine the underlying assumptions. Final savings proposals and the affordability of demographic pressures will be determined following the Local Government Financial Settlement.

	2020/21	2021/22	2022/23	Total
	£000's	£000's	£000's	£000's
Scottish Government Grant	-5,575	-5,413	-5,247	-16,235
Teachers Funding	687	0	0	687
Council Tax	2,256	1,876	1,934	6,066
Use of Reserves*	-3,460	-302	-118	-3,880
Pressures (Excluding HSCP)	-6,473	-7,528	-7,885	-21,886
HSCP Pressures	-4,590	-4,420	-4,389	-13,399
Gross Funding Pressure	-17,155	-15,787	-15,705	-48,647

Sensitivity Analysis

3.25 Given the uncertainty that underpins the assumptions, sensitivity analysis has been carried out on the key components. A 1% movement on these is noted below;

- Scottish Government Grant £2.8m
- Council Tax Funding £0.6m
- Payroll incl. HSCP £2.2m (**note.** Settlement agreed until 2020/21)

3.26 The table below exemplifies the potential impact on the gross funding gap based on a number of scenarios around the level of grant funding. The shaded box highlights the assumptions within the current summary.

Gross Funding Gap Scenarios Based on Scottish Govt Grant	2020/21	2021/22	2022/23	Total
	£000's	£000's	£000's	£000's
Flat Cash	-11,580	-10,374	-10,458	-32,412
1% Reduction	-14,368	-13,081	-13,082	-40,530
2% Reduction	-17,155	-15,787	-15,705	-48,647
3% Reduction	-19,943	-18,494	-18,329	-56,765
4% Reduction	-22,730	-21,200	-20,952	-64,882

3.27 The medium term financial outlook assumes any new legislative requirements will be funded fully by the Scottish Government and makes no provision for new investment. Future local investment in new initiatives will increase the projected financial gap identified within the model.

Reserves Strategy

3.28 The Council's reserves are classified as either earmarked or unearmarked. The Council's unearmarked reserves, i.e. those set aside to allow the Council to manage any unanticipated events, are in line with current policy of a minimum of

2% as set by Council on 1 March 2017. This level is the minimum of best practice between 2% and 4%. Earmarked reserves have been established to meet a range of known commitments. It is anticipated that these will reduce significantly over the next few years.

- 3.29 The level of Council reserves requires to be maintained at the right level to ensure the Council's future financial stability. These are kept under review and considered bi-annually on the setting of the Council's budget and on closure of the Council's Account.
- 3.30 To support the scale and pace of the next phase of transformation the level of resources available in the Change and Service Redesign Fund will require to be considered when the Council sets its budget.

Health and Social Care Partnership (HSCP)

- 3.31 The Integration Scheme sets out the Integrated Joint Board's (IJB) responsibility for financial planning and management of the HSCP's resources. The IJB has an implicit statutory obligation to set a balanced budget.
- 3.32 Information on anticipated pressures and proposed savings options are shared with North Ayrshire Council to inform the allocation of resources delegated to the IJB. As part of the 2019/20 budget the Council made a net contribution to the HSCP of £2.145m which consisted of £1.389m net funding to meet demand and inflationary pressures (£5.618m gross pressures and £4.229m savings) and £1.730m to meet new expenditure requirements.
- 3.33 Despite significant investment by the Council in HSCP services over a number of years, including Challenge Fund resources to support transformation, consistent year end overspends, including non-delivery of savings have been returned. This has resulted in a cumulative deficit and debt to the Council of £5.1m as at 31 March 2019. The Council as one of the funding partners is exposed to financial risk unless the HSCP delivers services in a financially sustainable way.
- 3.34 The proposed timetable for the Integrated Joint Board setting its Budget is set out below;
- Budget Outlook (November)
 - Savings Proposals (November / December)
 - Updated Budget Outlook (January / February 2020 following the settlement)
 - Medium Term Financial Plan (March 2020)

The Council's Approach

- 3.35 The reduction in resources noted above is happening at the same time as significant cost and demographic pressures. The scale of the financial challenge within the context of the savings which have already been delivered between

2010/11 and 2019/20, £102m, equivalent to almost 30% of the current budget, creates a greater future challenge.

- 3.36 The above together with the anticipation of continued pressure on public sector funds and in particular core local government funding and longer lead in times to deliver significant change and transformation requires the Council to take a longer-term approach to financial planning. The requirement for such an approach is recognised by a number of bodies including CIPFA and Audit Scotland.
- 3.37 The Council's approach as set out in the Long Term Financial Outlook will be considered within the context of the new Council Plan 2019-24, approved at Council on 26 June 2019. The Council priorities are defined across Aspiring Communities and Inspiring Place and a Council for the Future;

Our Priorities:-

Aspiring Communities

Priorities:

- ▶ Active and strong communities.
- ▶ Children and young people experience the best start in life.
- ▶ Inclusive, growing and enterprising local economy.
- ▶ People enjoy good life-long health and well-being.
- ▶ People and communities are safe.

Inspiring Place

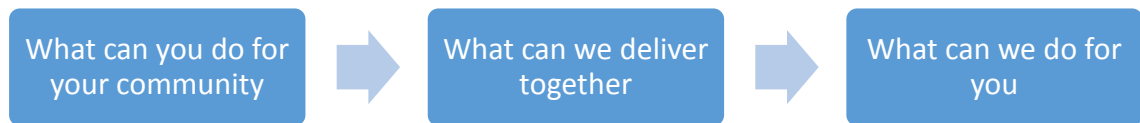
Priorities:

- ▶ Effective infrastructure and digital connectivity.
- ▶ Affordable, modern and well-designed homes that meet residents' needs.
- ▶ Vibrant, welcoming and attractive places.
- ▶ A sustainable environment.

A Council for the Future

- An accessible Council that puts residents and communities at the heart of what we do.
- A valued workforce that delivers high quality services.
- An efficient Council that maximises resources and provides value for money.
- A powerful and respected voice.

- 3.38 A key component of the Council's approach will be defined by the relationship between the Council and communities within the context of service delivery and available financial resources and how a collaborative approach can generate positive outcomes for the citizens of North Ayrshire.



- 3.39 It is important to carefully plan and manage the impact of any change on the workforce. The Council continues to develop Workforce Plans that will support the pace and scale of change and transformation the Council requires to deliver.

Capital Investment Programme

- 3.40 A full refresh of the 10 year Capital Investment Programme was undertaken for 2018/19 to 2027/28. For 2020/21 a high level review will be carried out. The Review will consider the phasing of projects and further refinement of current programme commitments.
- 3.41 Any new projects, not supported by external funding, will require to be supported by a robust business case and if additional resources are required this may increase the projected funding gap. Consideration will also require to be given to the impact on the loans fund, operational and maintenance costs alongside life cycle investment.

Progress and Next Steps

- 3.42 In advance of the presentation of the Financial Outlook 2020/21 to 2022/23 to Council, all elected members were briefed in late October / early November 2019.
- 3.43 Directorates have made their initial budget submissions covering 2020/21 to 2022/23. These are being scrutinised as part of the officer peer review process, with progress to date shared with all members through the Policy Advisory Panel.
- 3.44 Discussions continue with the Integrated Joint Board to support a partnership approach to development of the Health and Social Care Partnership's budget.
- 3.45 Community engagement sessions were held across each locality during November. All feedback has been captured and will be considered through the Budget process.

4. Proposals

- 4.1. That Council considers the Medium Term Financial Outlook 2020/21 to 2022/23, noting the scale of the potential financial challenge which the Council faces over the next 3 years and brings forward proposals to set a balanced budget for 2020/21 and beyond.

5. Implications/Socio-economic Duty

Financial

- 5.1 The anticipated funding gap over the period 2020/21 to 2022/23, based on current assumptions, is £48.6m. Council will require to set a balanced budget for 2020/21 and future years. The gross funding gap in 2020/21 is £17.1m.

Human Resources

- 5.2 It is anticipated that delivery of savings will impact on the Council's future workforce. The Council has established corporate and Service workforce plans which include; active management of the size of its permanent work force; vacancy management; review of temporary contracts; together with selective use of voluntary severance and early retirement. Communication and regular consultation will continue to take place with the work force and Trade Unions.

Legal

- 5.3 It is a statutory requirement for the Council to set a balanced budget and appropriate level of Council Tax to support this. Development of a balance budget is contingent on identification and subsequent delivery of significant transformation and robust savings alongside management of risk and pressures, particularly those of a demand led nature. Directors will require to provide assurance that plans are in place to secure delivery of proposed savings and deliver services within the final financial envelope.

Equality/Socio-economic

- 5.4 An equalities and Children's Rights Integrated Assessment will be carried out for all options that will assist the Council to make decisions to bridge its funding gap.

Environmental and Sustainability

- 5.5 None.

Key Priorities

- 5.6 In addressing the financial challenge which the Council faces it will seek to minimise the impact this has on delivering its key priorities within the context of the new Council Plan 2019-24.

Community Wealth Building

- 5.7 None.

6. Consultation

- 6.1 Development of the Council's medium term financial plan is carried out collaboratively across the Executive Leadership Team and with key Partners and stakeholders.

7. Conclusion

- 7.1 The Council is starting from a strong position in terms of financial planning with a clear understanding of its key strategic risks. Longer and medium term financial planning is critical to ensure sustainability of key Council priorities within the context of the new Council Plan 2019-24. The Medium Term Financial Outlook outlines the anticipated funding gap of £48.6m over the period 2020/21 to 2022/23, with £17.1m of this occurring in 2020/21. Recent year trends in core funding reduction and rising inflationary and demographic pressures increases the challenge of delivering a balanced budget. A change and transformation programme at scale and pace is required alongside the prioritisation of services to address the challenges that the Council faces and to minimise the impact on the communities of North Ayrshire.

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Background Papers

None