NORTH AYRSHIRE COUNCIL

02 November 2022

North Ayrshire Council

Title:	**Medium Term Financial Outlook 2023/24 to 2025/26**
Purpose:	To outline the financial challenges facing the Council over the medium-term in order to help inform the development of budget proposals.
Recommendation:	That Council considers the financial position identified in the Medium-Term Financial Outlook 2023/24 to 2025/26, notes the scale of the financial challenges which the Council faces over the medium term and brings forward proposals to set a balanced budget for 2023/24.

1. Executive Summary

1.1 Local authorities continue to operate in an increasingly complex, challenging, and uncertain environment with public sector funding not keeping pace with the increasing costs and demand for services, with challenges continuing through the legacy impact of the pandemic and more recently through the significant cost impact of inflation. In this climate it is important that Councils continue to take both a medium-term and long-term view, however it is recognised the current level of volatility will require immediate focus on the short-term impacts. The Council's Long-Term Financial Outlook was updated and presented to Council on 16 December 2020. This is the cornerstone of the Council's strategic financial framework and establishes a sound basis for the development of the Medium-Term Financial Outlook and subsequent annual budgets, enabling the Council to address the challenges it faces and best align resources to key priorities.

1.2 The Long-Term Financial Outlook 2021/22 to 2030/31 identified an estimated funding shortfall of £120m over the next ten years which the Council requires to address. This is based on best estimates at the time with sensitivity analysis highlighting the implications of changes to the underlying assumptions. It is recognised that further recent cost impacts will change this position over the long term, with an update planned during 2023/24.

1.3. The Medium-Term Financial Outlook for the period 2023/24 to 2024/25 draws on the same data and projections as the Long-Term Financial Outlook, however, incorporates several more recent updates including the impact of inflation, output from the Scottish Government Spending Review and assumptions related to both Scottish Government and UK Government policy. Importantly, the Scottish Government Spending Review, published in May 2022, has indicated a broadly flat cash funding position for Local Government over the medium-term. When this funding landscape is set within the context of significant rising cost pressures, based on current planning assumptions around financial pressures, Scottish Government funding levels and Council tax funding this has identified a funding gap of £53.314m (including the HSCP), £35.016m (excluding the HSCP) over the next 3 years which must be addressed as part of the Council's Medium-Term Financial Plan.

1.4 To address the financial challenge the Council must examine its cost base and carefully consider the allocation of available resources across Council priorities. Due to the scale of the challenge faced, minimising impacts on communities and services will be extremely challenging.

1.5. Elected members have previously received briefings on the contents of the Medium-Term Financial Outlook and officers are currently developing proposals to support the Medium-Term Financial Plan for 2023/24 to 2025/26, which will be presented to Council for consideration on 1 March 2023.

2. Background

Long-Term Financial Outlook (LTFO)

2.1 The Long-Term Financial Outlook 2021/22 to 2030/31 was approved at Council on 16 December 2020 and outlined the potential impact of:

- The strategic financial framework.
- Local issues for North Ayrshire including current and anticipated demographic and health profiles, employment and levels of deprivation and the impact these will have on the Council's income and cost base.
- Global and national economic performance.
- Factors affecting Scottish Government funding and funding for Local Government.
- The financial outlook for North Ayrshire including funding and expenditure requirements.
- A review of the Council's balance sheet including assets, debt, future liabilities and reserves; and
- The strategic response required by the Council to ensure future financial sustainability.

Key Messages

2.2 The LTFO highlighted several key messages in relation to the anticipated financial environment and the potential impact on funding and expenditure requirements of the Council over the next 10 years, including:

- Demographic Changes – North Ayrshire's overall population is forecast to reduce by 3.9% over the period, with reductions in the numbers of children and working age adults being offset by a projected 18.1% increase in Older People. At the same time the percentage of North Ayrshire residents living with disabilities or long-term health and mental health issues is projected to be higher than the Scottish average. This will result in significant changes to demand for services, particularly in Communities and Health and Social Care.

- Economic Impacts – North Ayrshire's economy has taken longer to recover from previous challenges than other areas, with pre-Covid economic activity still below pre-2008 levels. The percentage of adults claiming out of work benefits is 40% higher than the Scottish average and 26.8% of North Ayrshire's SIMD datazones are within the 15% most deprived in Scotland.

- Other Expenditure Requirements – In addition to the demographic and economic impacts on service demands, the expenditure requirements of the Council will be subject to further pressures in relation to pay and price inflation and the revenue implications of the Council's ambitious General Services Capital investment Programme, more recently through increased costs of borrowing, which will result in increased budget pressures across the full timeframe of the LTFO.

- External Funding – The economic impact of the pandemic on the UK and Scottish economies is expected to result in real terms reductions in public expenditure budgets. Combining the anticipated reduction in the Scottish block grants with the potential impact of any shortfall in the recovery of devolved revenues and the continued direction of funding to support Scottish Government funding priorities within Health, Social care and Education sectors, the LTFO is projecting ongoing challenges to the overall local government funding position, resulting in anticipated reductions in Aggregate External Finance allocations to North Ayrshire Council of 1% per annum in the medium term.

- Council Tax Income and the Use of Reserves – As funding from the Scottish Government in relation to core local government services reduces, North Ayrshire Council will become increasing reliant on income from Council Tax and internal reserves to fund service delivery. The LTFO assumes a 3% per annum Council Tax increase over the period. However, it is anticipated that the Council's Useable Reserves will be reduced to the minimum recommended levels by 2024; and

- The Financial Challenge - The LTFO identifies an estimated funding shortfall of £120m over the next ten years. This is based on best estimates with sensitivity analysis highlighting that a 1% change in the underlying assumptions could result in this increasing to as much as £228m over the same period. It is recognised that further recent cost impacts will change this position over the long term, with an update planned during 2023/24.

The Medium-Term Financial Outlook

2.3 The Medium-Term Financial Outlook for the period 2023/24 to 2025/26 draws on the same data and projections as the Long-Term Financial Outlook, however, brings into sharp focus the short and medium-term impacts from recent key global, UK and national events, all of which have contributed to an extremely challenging financial landscape for citizens, communities, and local government finance. The report examines the medium-term impact arising from:

- 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

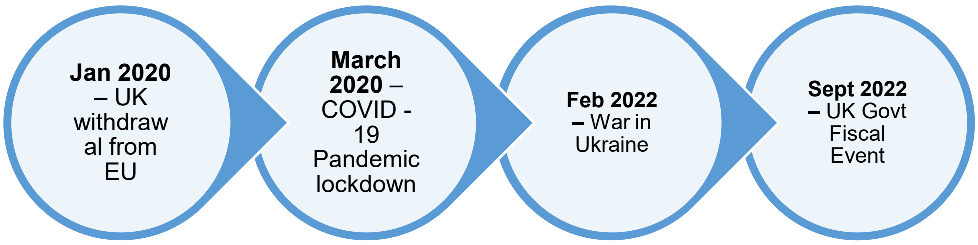
- The Health and Social Care Partnership

- The Council's approach to ensure future sustainability and alignment of resources with key priorities; and

- The Capital Investment Programme.

Economic Outlook

2.4 Funding for public services is inextricably linked to the performance of global and national economies and more recently through the volatility in financial markets. Several key events have contributed to what has been and will likely continue to be a very turbulent period for the economy. These events include;



2.5 In 2022 and through to 2023 households will continue to experience reduced disposable income as the result of a variety of factors, a number of which also contribute to additional cost pressures for local government.

Inflation

2.6 Inflation to September 2022 sits at 10.1% based on the CPI measure. The forecast is for inflation to rise to 11.7% by January 2023. Forecasters advise this would have been higher, however, the recent UK Government intervention to Introduce an Energy Price Guarantee Scheme for households (typical cap at £2,500) and Energy bill relief scheme for businesses, has dampened the forecast. Current indications are for inflation to remain high through the early part of 2023, then falling towards the end of 2023. The biggest price rises have been connected to basic goods, like food and energy and costs of materials through the construction sector. In summary;

- Energy costs – over 54% increase in 2022.
- Food costs – 9.8% increase in 2022 when compared to previous year
- Fuel costs – up to 80% increase in fuel costs
- Cost of materials – Building Cost Information Service (BCIS) report 20% + annual increase in costs for construction sector

2.7 It is important to also note the impact rising inflation has on many contracts that are linked to inflation indices. This again will have a material effect on the financial pressures facing local government.

Public Sector Pay

2.8 Trade unions have pushed for public sector pay to rise more in line with current inflation levels. From a local government perspective, a general 5% increase in 2022/23, with greater levels of increase applied at the lower grades equating to an overall increase of around 6.5% to the pay bill, has been accepted by 3 of the bargaining groups. At the time of writing, negotiations continue with the teacher unions, with strike action a real risk. Although the Scottish Government has provided a level of funding to support the pay negotiations, the level of increase requires local authorities to fund around 3.60% of the 6.50% increase in the pay bill.

2.9 Within the context of the local government funding landscape, this level of pay increase presents significant affordability challenges to local government finances in 2022/23 and will increase the base budget requirements in 2023/24, however, it should also be stressed, with inflation forecasts remaining high through the 1st 2 quarters of 2023, there remains a significant risk that pay negotiations for 2023/24 will again centre around similar levels of increase. Without further Scottish Government funding support, absorbing this level of increase will prove extremely challenging.

Interest Rates and Taxation

2.10 Recent Interest rate rises have included 1.25% to 1.75% and more recently to the current Bank of England base rate position of 2.25%. The Bank of England Monetary Policy Committee next meets on 3 November 2022. Economic forecasters predict that interest rates could rise to around 4% by the end of 2022, with further increases predicted to around 5.0% by the 2nd quarter of 2023 to tackle inflation.

2.11 The UK Government mini-budget announcement on 23 September 2022 included several economic measures from cuts to the basic rate of tax, removal of top rate of tax, energy support measures, removal of the 1.25% national insurance increase and removal of the planned increase in corporation tax. The intention behind the policy was to stimulate economic growth, however, the reaction from the financial markets impacted negatively on the value of sterling and led to an increase in the rates associated with government bonds (Gilts). At the time of writing most of the tax cutting measures have already been reversed or deferred. From a household perspective the position has impacted on available mortgage rates and in terms of local government borrowing through the Public Works Loan Board (PWLB), the increase in Gilt yields has increased interest on borrowing by over 200 basis points (2%). Current forecasts indicate that rates will remain high over the next 3 years, however, there remains a high level of volatility in the financial markets. What also remains unclear at this time is whether the reversal of measures will also be accompanied with public spending cuts. This looks likely and could further impact the level of block grant passported through to Scotland.

The Scottish Landscape

2.12 The Scottish Government (SG) Spending Review published in May 2022 reinforced SG priorities of reducing child poverty, addressing the climate crisis, building a strong and resilient economy, and helping public services recover from the pandemic. The current cost of living crisis and war in Ukraine has further influenced priorities and placed additional pressure on government finances. As things currently stand, portfolios including Health and Social Care and Social Justice and Housing will see planned annual growth in cash terms over the years to 2026-27. Importantly, however, from a local government funding perspective, the SG has indicated a broadly "flat cash" position up to 2025-26, with growth expected in 2026-27.

	2022-23	2023-24	2024-25	2025-26	2026-27
Local Government	10,616	10,616	10,616	10,616	10,716

2.13 Although not a budget, the SG Spending Review is an indication of the level of overall resource allocated to the local government portfolio. When compared against the current planning assumption of a 1% grant reduction for North Ayrshire Council, this is considered a prudent assumption as the reducing population demographic relative to other local authority areas will continue to reduce the proportionate share of funding to North Ayrshire Council. It is also unclear if the funding of new SG policy areas will be met from this portfolio or transferred from another portfolio. An example of which is the expansion of universal free school meals to primary 6 and primary 7 pupils. If this is the case, then this will place further pressure on available funding. The SG Spending Review presents a very challenging funding landscape for local government.

2.14 On 7 September 2022 the Deputy First Minister (DFM) announced some details of an Emergency Budget, with a commitment to release full details later in October 2022. The headline announcement was set against the backdrop of the cost-of-living challenges (including energy), rising inflation, rising interest rates, public sector pay negotiations and new commitments linked to support for Ukrainian citizens. The DFM made clear the SG Programme for Government commitments for increasing the Child payment in November and universal free school meal expansion for P6 and P7 pupils, however, the areas of saving identified included;

- £53m reduction in employability funding
- £56m generated by the Scotwind clearing process, to be utilised and re-instated at later date
- £33m use of ring-fenced agricultural funds
- £37m reduction in concessionary fares

The SG state that they have identified areas with least impact on public services and individuals. Details of further savings will follow as well as any impact to local authorities.

2.15 From the information available to date, the short and medium-term economic outlook for local government finance presents a very challenging picture. The SG continue to engage with local authorities via COSLA across a range of potential areas of "financial flexibility". The extremely pressing desire from local authorities is to have more autonomy over the use of resources and to deploy those resources based on local priorities and needs, without restrictions or conditions from Scottish Government across particular policy areas. Although not a funding solution this would at least provide local authorities with more flexibility around significant areas of the budget. Some of the key areas of discussion include;

- Resources passported to Integration Joint Boards
- Teacher numbers and pupil: teacher ratios / national standards
- Early learning and childcare resources,
- Council tax levels
- Visitor levy

2.16 The SG have recently confirmed details of accounting based financial flexibilities. The specific areas available to local authorities were initially developed during the pandemic as a mechanism to help address additional cost pressures and lost income. They include;

- Loans fund principal repayment holiday
- Flexible use of capital receipts

2.17 Use of such flexibilities is in effect the re-direction of resources in place to fund the capital programme, for use to help address revenue pressures. However, in view of the significant cost pressures faced by the capital programme, it would be prudent at this time to retain the resources in supporting delivery of the capital programme.

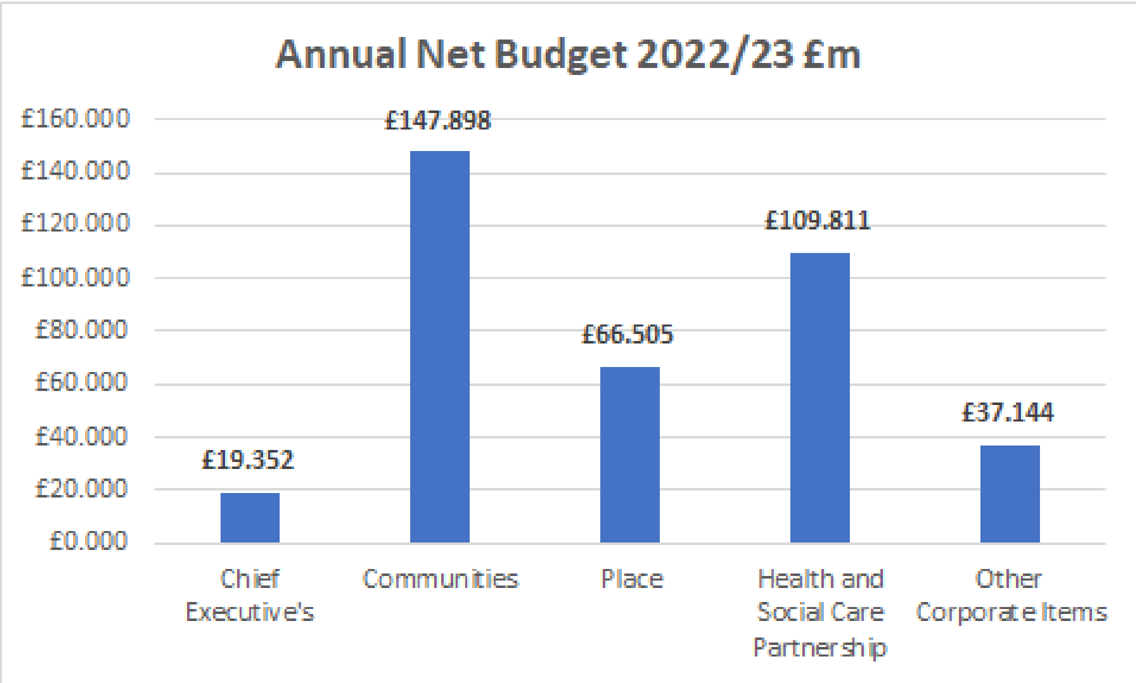
2.18 In September 2022, the SG issued an updated Finance Circular to all local authorities titled "Accounting for Service Concession Arrangements, Leases and Similar Arrangements." This guidance includes the method of accounting for PPP/PFI contracts and introduces a change in accounting to reflect such contracts in a manner consistent with accounting for other local authority fixed assets and to base this accounting over the useful economic life of the asset, rather than the term of the contract. It is recognised that the retrospective implementation of this guidance could generate a potentially significant level of "one-off" saving to the Council and a far reduced level of recurring saving. Due to the significance of this change a report will be brought to Council on 14 December 2022 to consider the implications of this change and to seek approval for its implementation.

2.19 Although the use of "financial flexibilities" is important in helping to manage the financial resources of the Council, the case for financial sustainability and fair funding for local authorities must continue to be recognised, especially when the level of SG general grant allocation is set within the context of significant inflationary pressures, legacy pandemic pressures and demographic pressures. It is vital that productive dialogue around local government funding continues. The SG commitment to a National Care Service by 2026 will further impact this position, with Council HSCP budgets representing almost one third of total Council expenditure.

Financial Outlook for North Ayrshire Council

Allocation of Resources

2.20 The Chart below summarises the allocation of resources for 2022/23 approved at Council in March 2022, with around 60% of gross expenditure relating to employee costs;



2.21 As noted in section 2.15 of the report it is recognised that in the last number of years, the level of influenceable budget which is not linked to Scottish Government requirements or statutory contractual commitments, be it through the Health and Social Care Partnership or large elements of the Communities budget, has greatly reduced. This continues to place a disproportionate level of pressure on the other Council budgets and reinforces the desire for local authorities to have more flexibility around resource allocation.

Medium-Term Financial Pressures and Planning Assumptions

2.22 Following an assessment of cost pressures and income levels anticipated over the next 3 years further work has been completed in respect of the short and medium-term impact of anticipated pressures, although it should be stressed that cost forecasts are subject to a high degree of volatility at this time. In addition, ongoing work to review the General Services Capital Programme has identified significant additional cost risks, mainly through the legacy impact of the pandemic and a very high level of construction inflation. When set within the context of the current planning assumptions around funding, this has resulted in a projected medium-term funding gap of £53.334m (including the HSCP) and £35.016m (excluding the HSCP) over the next 3 years. Areas of significant pressures identified within the Medium-Term financial Outlook include:

Workforce costs

2.23 Estimated pay settlement includes a general 5% increase in 2022/23, with greater levels of increase applied at the lower grades equating to an overall increase of around 6.5% to the pay bill. This has been accepted by 3 of the main bargaining groups and is summarised across pay bandings as follows;

- A minimum of £1,925 increase for those on up to £39,000 per year;
- 5% increase for those between £39,000 and £60,000 per year; and
- A maximum increase of £3,000 for those earning more than £60,000 per year.

2.24 At the time of writing, negotiations continue with the teacher unions. The SG has provided a total of £260.6m on a recurring basis to support the pay negotiations. The level of anticipated increase still requires local authorities to fund around 3.60% of the 6.50% increase in the pay bill. This is 0.60% more than what was provided for in the 2022/23 Budget and will require to be met from existing Council resources.

2.25 Within the context of the local government funding landscape, this level of pay increase not only presents a significant affordability challenge to local government finances in 2022/23, but it also increases the base budget requirements in 2023/24. Further, with inflation forecasts remaining high through the 1st 2 quarters of 2023, there remains a significant risk that pay negotiations for 2023/24 will centre around similar levels of increase. Currently the planning assumption for pay increases over the next 3 years is 3% per annum. This planning assumption is on the basis that the SG would provide additional support to fund any further increase. Without this support, absorbing additional increases would prove extremely challenging and could amount to an additional £8m on a recurring annual basis.

Staff Group	2023/24 Planning Assumption	2024/25 Planning Assumption	2025/26 Planning Assumption
Teachers	3%	3%	3%
Other Staff	3%	3%	3%

Other Inflationary Costs

2.26 As noted in section 2.6 of the report, significant Inflationary cost increases have been included in forecasts for major utilities (electricity and gas), fuel, food and those contractual commitments with increases linked to inflation indices. In respect of utilities, cost forecasts are based on rates already secured via Procurement Scotland from the advance purchases and from available price indices applied to the balance of expected energy need across each of the years. What is uncertain at this time is the extent to which the recent UK Government “Energy Bill Relief Scheme” announcement will benefit those public sector organisations who purchase energy via national frameworks. Procurement Scotland is currently working with the Council’s energy providers to ascertain the position. A prudent position is reflected at this time.

2.27 Major contracts linked to inflation indices include PPP contracts and waste contracts. Cost impacts based on inflation forecasts over the next 3 years have been included in the budget model. In addition to this an allowance has been made to cover other major contractual increases e.g., Strathclyde Passenger for Transport and to meet legislative requirements.

2.28 The Council makes no provision for general inflation. It is recognised that due to the high levels of inflation this will place further significant strain on operational budgets across the Council. The implications of this will include a reduced level of purchasing power for a range of materials and commodities and possible re-phasing of programmes / activities to operate within existing resources on an annual basis. It is important that elected members are kept fully informed of any impacts.

2.29 The UK Government decision to reverse the 1.25% national insurance increase has created an in-year saving and a recurring saving to the Council. On the basis that this position does not change, a recurring saving of around £1.2m per annum has been included in the Budget model. However, as noted in section 2.11 of the report, the cost of borrowing to the Council to support delivery of the capital programme has increased significantly over the last month. This, along with high levels of construction inflation places a significant burden on the affordability of the 10-year capital programme. It is therefore prudent at this time to re-direct this saving into the Council's Loans Fund to help support the additional funding required to deliver the capital programme.

Other Pressures and Risks

2.30 The legacy impact of pressures from the pandemic will continue to trail through into 2023/24 and possibly beyond, whilst additional Scottish Government funding ceased in 2021/22. They include waste services costs, facilities management costs and commercial and general income and financial pressures faced by North Ayrshire Leisure Ltd. No additional financial provision will be incorporated into the 2023/24 Budget; however, a balance of legacy resources remains to help mitigate the ongoing risks.

2.31 There remains a risk of additional cost pressures from Scottish Government policy commitments. Although the SG Spending Review indicates a broadly "flat cash" funding landscape for local government, what is unclear is if this overall funding envelope is also intended to fund policy commitments or if resources will be transferred from another portfolio e.g. we would expect around £1m revenue funding to support the expansion of primary 6 and primary 7 universal free school meals. This is therefore a risk within the context of the local government grant settlement. From a capital funding perspective, it is also clear that available SG capital funding is insufficient to deliver this policy intent. To address this risk the sum of £10m has already been included in the capital plan from the 2022/23 Budget.

2.32 The Scottish Government policy intent in delivering a National Care Service by 2026 will also have potentially wide ranging financial and operational implications for the Council including the impact on funding, assets and staffing. This is set within the context of the current socio economic and demographic pressures, including:

- A growing older population;
- Increased demand for adult services; and

- Increased demand for support of vulnerable children and young people.

Local Government Funding and Anticipated Budget Gap

2.33 Single year settlements have been a feature of Scottish Government budget setting since 2015/16. This approach continues to create a high level of uncertainty around future funding levels and impedes progress in delivering sustainable change. 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, makes it difficult to forecast future grant funding levels. The publication of the SG Spending Review in May 2022 provides an indication of the level of overall financial resource. As noted in section 2.12 of the report this indicates a broadly “flat cash” funding position.

2.34 With a predicted decline in overall population for North Ayrshire it is both reasonable and prudent to assume that the level of future budget settlements will remain challenging. Based on this, a reduction of -1.0% has been incorporated in the 3 years of the Medium-Term Financial Plan. This remains consistent with the planning assumption of several other Scottish local authorities. The 2022/23 settlement included a late allocation of £120m additional funding to local authorities announced on 27 January 2022. This was originally stated as non-recurring with North Ayrshire Council receiving an allocation of £3.208m. The SG have subsequently confirmed this funding will now be baselined in the settlement and therefore recurring, with the Medium-Term Financial Plan updated accordingly.

2.35 The Medium-Term Financial Plan includes a planning assumption of an annual 3% increase to Council Tax. Council tax income is a vital source of funding and represents around 17% of council funding i.e., £64m per annum. With current inflation sitting at 10.1%, this level of anticipated increase sits well below current inflation, however, it is recognised that any level of increase will add a further burden to citizens during the current cost-of-living crisis. An important point to note when considering the level of council tax to be set is the future year impact of any decision e.g., a decision to maintain council tax at 2022/23 levels equates to around £2m less income. Due to the recurring impact on the base budget for 2024/25 this would require an increase in council tax in 2024/25 of more than 6% to simply recover the base income position. This is before the measures to address the budget gap for the year are even put in place. When considered within the context of the scale of the budget gap facing the Council over the next 3 years, not only would this present a significant challenge in delivering balanced budgets, but it is also more likely that members may have to consider increases beyond 3% to deliver a balanced budget in 2023/24.

2.36 Since 2017/18 the Council has used over £17m of reserves to support recurring expenditure. A full review of all revenue reserves will be carried out as part of the Medium-Term Financial Plan. Due to the scale of the budget gap forecast in 2023/24, it is highly probable that use of Council reserves will be a requirement in delivering a balanced budget, however, this approach does not offer a sustainable solution and simply increases the budget gap further in subsequent years.

2.37 A summary of the anticipated funding gap position of the Council (including the HSCP) over the next three years is provided in the table below. Further work continues to refine the underlying assumptions. Final savings proposals are being progressed and will be presented to Council on 1 March 2023.

	2023/24 £m	2024/25 £m	2025/26 £m	Total £m
General Fund Gross Funding Gap	£14.500	£10.661	£9.855	**£35.016**
HSCP Pressures	£7.591	£5.412	£5.295	**£18.298**
Total	**£22.091**	**£16.073**	**£15.150**	**£53.314**

Sensitivity Analysis

2.38 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 £3.0m;
- Council Tax Funding £0.65m;
- Payroll incl. HSCP £2.5m

2.39 The anticipated General Fund budget gap for 2023/24 based on current planning assumptions is £14.500m, with gaps of £10.661m and £9.855m for 2024/25 and 2025/26 respectively. As noted in section 2.36 of the report, addressing the 2023/24 Budget gap will likely require the use of Council reserves. It is important to note that this is not a sustainable solution and will have the effect of increasing the gap further in 2024/25. To understand the potential impact of using reserves, the undernoted table provides an example of delivering a balanced budget in 2023/24 with £7m recurring savings and £7.5m non-recurring savings (including use of reserves). The effect in 2024/25 is an increase in Budget gap from £10.661m to £18.161m.

	2023/24 £m	2024/25 £m	2025/26 £m
General Fund Gross Funding Gap	£14.500	£10.661	£9.855
Revised Gap with 23-24 Budget gap met from £7m recurring savings and £7.5m non-recurring savings	£-	**£18.161**	£9.855

Reserves Strategy

2.40 The Council's reserves are classified as either earmarked or unearmarked. The Council's current unearmarked reserves, i.e., those set aside to allow the Council to manage any unanticipated events, were reported in the 2021/22 Annual accounts as £11.315m, equivalent to 2.9% of General Fund net budgeted expenditure.

This compares to the recommended best practice of between 2% and 4% and the Council's approved Reserves Policy that unearmarked reserves are held at a minimum of 2% of General Fund net budgeted expenditure. In addition to the unearmarked reserves, earmarked reserves have been established to meet a range of known commitments, including the Council's Investment fund and Recovery and Renewal Investment programme, and it is anticipated that these will reduce significantly over the next few years.

2.41 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.

2.42 The Council also maintains statutory reserves in the form of an Insurance fund and Capital Fund. The Insurance Fund is maintained to meet the cost of future insurance liabilities, while the current Capital Fund is earmarked to support the Council's capital investment programme and any capital financing requirements, as noted above.

Health and Social Care Partnership (HSCP)

2.43 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.

2.44 Information on anticipated pressures and proposed savings options are shared with North Ayrshire Council to inform the allocation of resources delegated to the IJB. The level of contribution to the HSCP is based on an anticipated "flat cash" planning assumption where the HSCP address budget pressures through the delivery of equivalent savings and with the use of reserves. The allocation of resources will also continue to be influenced by any requirements set out in the local government finance settlement. The HSCP have identified financial pressures of £7.591m in 2023/24 and £18.298m over the next 3 years. The position for 2023/24 currently assumes the passporting of Scottish Government funding to support the 2022/23 pay negotiations on a recurring basis. The share of SG funding amounts to £1.866m.

2.45 The HSCP currently hold earmarked reserves of £24.305m, which includes COVID related reserves, and unearmarked reserves of £7.248m, which represents around 2.5% of the HSCP Budget.

2.46 The cumulative debt position to the Council at 31 March 2022 totals £2.320m. The Council has set aside the recurring sum of £1.486m to fund the repayment of this debt and based on the current repayment profile, the debt to the Council will be fully repaid during 2023/24. In view of the scale of the financial challenges faced by the Council in 2023/24 a mechanism to facilitate the early repayment of this debt in 2022/23 will be explored. This would release the recurring sum of £1.486m to support the Budget programme.

The Council's Approach

2.47 With a forecast reduction in resources occurring at the same time as increased cost through extreme inflationary impacts and demographic pressures, the scale of the financial challenge remains significant. This is also set within the context of the savings which have already been delivered between 2010/11 and 2022/23 which totals over £118m, equivalent to around 25% of the gross revenue budget.

2.48 Prudent financial planning requires a medium- and long-term view to be taken on the level of financial resources likely to be available to North Ayrshire Council in the years ahead. Due to the significant Budget gap anticipated in 2023/24, immediate focus requires to be given to deliver a balanced budget in March 2023. This will require the identification of a significant level of savings and a review of current earmarked and unearmarked reserves. Resources to support the repayment of HSCP debt will also be considered as part of the Budget Programme.

2.49 The Council's approach to addressing the financial challenges is influenced by the Council's key priorities. It is important to allocate available financial resources, and deliver positive outcomes aligned to these priorities, however, recognising resources are becoming increasingly limited. This will require potentially reduced levels of investment in areas that don't closely align to these priorities. This will be considered when developing options as part of the Budget programme. Work to develop the new Council Plan is currently being progressed, with some initial key priorities identified which include;

- Addressing poverty and cost of living
- Communities
- Sustainability

2.50 With over 60% of the Council's financial resources represented by workforce related budgets, it will be difficult for the Council to sustain the current level of workforce within available financial resources over the medium-term. When developing options to address the Budget gap and aligned to the work undertaken to develop the Council's key priorities, workforce planning will be a key consideration through this process.

2.51 The Council's sustainable change programme continues to be progressed across a range of themes. It is vital that the programme is delivered at scale and pace to address the Budget gap over the short, medium, and long term and to try and help reduce the impact on communities from Council services provided. In progressing the Budget programme, the areas of renewable energy development, supported with financial resources in the Council's Investment Fund, and the utilisation of the Council's land and property assets are recognised as areas where material financial savings / returns on investment could be delivered. However, in terms of timescale, the opportunities for financial benefit are more likely to feature from 2024/25 onwards.

Sustainable Change Programme			
Sustainability / Renewable Energy	Land and Property Assets	Accessing the Council	Transport and Travel

2.52 It is important for local authorities to have more autonomy and financial flexibility over the use of resources and to deploy those resources based on local priorities and needs, without restrictions or conditions from Scottish Government across specific policy areas. As noted in section 2.15 of the report, local authorities through COSLA will continue to progress a dialogue with Scottish Government across a range of areas which include;

- Resources passported to Integration Joint Boards
- Teacher numbers and pupil: teacher ratios / national standards
- Early learning and childcare resources,
- Council tax levels
- Visitor levy

2.53 In September 2022, the SG issued an updated Finance Circular to all local authorities titled "Accounting for Service Concession Arrangements, Leases and Similar Arrangements." This guidance includes the method of accounting for PPP/PFI contracts and introduces a change in accounting treatment to reflect such contracts in a manner consistent with accounting for other local authority fixed assets and base the depreciation over the useful economic life of the asset, rather than the term of the contract. It is anticipated that the retrospective implementation of this guidance could generate a potentially significant level of "one-off" saving to the Council and a far reduced level of recurring saving. Due to the significance of this change a report will be brought to Council on 14 December 2022 to consider the implications of this change and to seek approval for its implementation. From a Budget planning perspective, it is strongly recommended that any savings arising from this change are used to address the pressures in the capital programme and the medium-term financial position.

Capital Investment Programme

2.54 The General Services Capital Investment Programme 2022/23 to 2030/31 was approved at Council on 2 March 2022. The review currently being undertaken as part of the 2023/24 Budget will focus on the affordability of the programme when considering the additional cost pressures, mainly through high levels of construction inflation and contractor claims following the pandemic. The current assessment indicates additional costs of more than £25m, however, this position remains volatile and will require to be monitored. The financing of the capital programme has been recently affected by the significant increase in borrowing costs following an increase of over 200 basis points (+2%) in Gilt yields which links directly to the rates available through the Public Works Loans Board (PWLB). Based on current and projected borrowing rates the anticipated additional cost of borrowing to 2030/31 is estimated at over £30m. It is therefore prudent at this time to help address the financial risks, that further financial provision is incorporated in the medium-term financial plan to supplement the existing loans fund resources. As noted in section 2.11 of the report, the recent UK Government reversal of the 1.25% national insurance increase, will provide around £1.2m per annum to help address the pressures.

2.55 As well as the additional costs being incurred in the capital programme, it is also recognised that, from the impact of inflation, the purchasing power of lifecycle investments is greatly reduced. This affects capital investments in roads, property, vehicles, and other infrastructure. To operate within available financial resources, even by sustaining the level of budgeted investment this will result in a real term reduction in the level of investments across these areas and will lead to the requirement to re-profile programme activity over a longer period.

2.56 In terms of funding the capital programme, further prudent assessments will be undertaken around the level and timing of capital receipts, the anticipated level of Scottish Government capital grant, the anticipated funding profiles associated with the Ayrshire Growth Deal and how the use of the Council's loans fund reserve and capital fund will support the programme across the 10 years.

2.57 The anticipated revenue implications of the Capital Investment Programme have been reflected in both the Medium- and Long-Term Financial Outlook. However, any further operating or staffing costs resulting from changes or additions to the Capital Investment programme will result in an increased funding gap from the year of completion.

Progress and Next Steps

2.58 In advance of the presentation of the Medium-Term Financial Outlook report, briefings for Elected Members have been carried out.

2.59 Officers continue to progress the Budget programme and develop options to address the budget gap covering the period 2023/24 to 2025/26. Progress to date will be shared in further elected member sessions during November 2022.

2.60 Discussions continue with the Integrated Joint Board to support a partnership approach to development of the Health and Social Care Partnership's budget.

2.61 Community engagement sessions are planned during January 2023 across each locality. This process will also be supported by access to an on-line tool to capture feedback on priorities from our citizens and communities. In view of the current financial challenges, it is important that citizens both understand the scale of the challenge and provide feedback on their views to help inform the prioritisation of resources as part of the Budget setting process. Elected Members will be provided with the details of this feedback in advance of the Council Budget setting meeting.

2.62 It is planned that proposals for the Medium-Term Financial Plan 2023/24 to 2025/26 will be presented to Council for consideration on 1 March 2023.

3. Proposals

3.1 That Council considers the financial position identified in the Medium-Term Financial Outlook 2023/24 to 2025/26, notes the scale of the financial challenges which the Council faces over the medium term and brings forward proposals to set a balanced budget for 2023/24.

4. Implications/Socio-economic Duty

Financial

4.1 The anticipated funding gap over the period 2023/24 to 2025/26, based on current planning assumptions, is £53.314m (including the HSCP) and £35.016m (excluding the HSCP). Council will require to set a balanced budget for 2023/24 and future years. The projected funding gap for 2023/24 is £14.500m.

Human Resources

4.2 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 workforce; 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 workforce and Trade Unions.

Legal

4.3 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 savings alongside management of risk and pressures. Chief Officers will require to provide assurance that plans are in place to secure delivery of proposed savings and deliver services within available financial resources.

Equality/Socio-economic

4.4 An Equality Impact Assessment will be carried out for all options presented to Council to assist Council's in making decisions on the bridging of the funding gap.

Environmental and Sustainability

4.5 Significant elements of Council investment have been targeted towards sustainability projects and this is reflected in the Council's sustainable change programme. This will play a key role in supporting the Council's journey towards net zero.

Key Priorities

4.6 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 Council Plan 2019-24. Recognising also that early work has been undertaken in developing the new Council Plan with initial areas of key priority across Poverty and cost of living, communities and sustainability.

Community Wealth Building

4.7 All capital and revenue investment will continue be considered within the context of the Council's Community Wealth Building Strategy, with maximising opportunities for local suppliers through procurement a key priority and pillar of the strategy. Further, this strategy is a vital reference for the Council's sustainable change programme, most notably through the Land and Property Assets theme.

5. Consultation

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

Mark Boyd
Head of Service (Finance)

For further information please contact **Mark Boyd, Head of Finance,** on **01294 324560** .

Background Papers
None