

---

## NORTH AYRSHIRE COUNCIL

7 November 2018

### North Ayrshire Council

---

**Title:** Financial Outlook 2019/20 to 2021/22

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

**Recommendation:** That Council considers the Financial Outlook 2019/20 to 2021/22, 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 2019/20 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. 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 £42.5m over the next three years with £22.8m of this occurring in 2019/20. This is based on best estimates. Sensitivity analysis highlights the implications of changes to the underlying assumptions.
- 1.3. The Council has used £9.7m of reserves to support the recurring spend of the Council in the last two years. 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. The current loan charges budget and loans fund reserve underpin this programme. A high level review of the programme will be carried out to reassess phasing of projects and underlying assumptions. Any new projects, not supported by external funding, will increase the projected funding gap.

- 1.5. A clear strategy is required to ensure the Council remains financially sustainable over the medium and longer term. This will require the Council to fundamentally review the services which are delivered, how they will be delivered and who will deliver them, this approach was set out in the Long Term Financial Outlook report. The strategy requires to be developed at scale and pace informing the next phase of transformation and aligning with the refreshed Council Plan.

## **2. Background**

### **Introduction**

- 2.1. The Council's Long Term Financial Outlook was approved by Council in October 2017. 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 noted 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 financial envelope and deliver savings, the failure of which poses risk to the Council as one of the funding partners.

- 2.3. In developing its next medium term financial plan Council should consider the issues emerging from the Accounts Commission's Financial Overview of Local Government presented to Council in December 2017 and the 2017/18 External Audit report approved at Audit and Scrutiny Committee in September 2018. Some of the key messages from these are restated below;

- Recognition of the increasing financial stress within local government;
- Reducing levels of reserves;
- The need to risk assess delivery of savings;
- The need for a collaborative approach between elected members and with partners, stakeholders and communities;
- Delivery of significant transformation to ensure financially sustainable service delivery models.

2.4. Significant financial stress appears to be more evident in English local authorities. The Best Value Inspection of Northamptonshire County Council reinforces some of the messages noted above;

- requirement for sound judgement and clear decision making and accountability by members and officers;
- the need for effective collaborative 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.

### **Medium Term Financial Outlook**

2.5. The Medium Term Financial Outlook updates the assumptions set out in the Long Term Financial Outlook for the period 2019/20 to 2021/22 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.

2.6. More detail on each of these is provided within this report.

### **Economic Outlook**

2.7. 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.

2.8. Performance of the global economy is key to UK and Scottish trade. Whilst the pace of growth in the world economy has slowed slightly, particularly in emerging economies, the outlook remains robust due to the continued strength of advanced economies. Brexit and the lack of clarity on the UK's future relationship with its largest external market continues to cast a shadow over the economic outlook.

2.9. The UK GDP continues to grow. The key challenges for the Chancellor are debt which is still sitting above 80% of GDP, despite borrowing continuing to fall, the

rising pressures on health and social care and consumer and household confidence, a key driver of the economy, remaining low.

2.10. The table below summaries the anticipated levels of growth of the UK and Scottish economies with the Scottish Fiscal Commission (SFC) predicting growth of less than 1% per annum over the next five years;

	2017	2018	2019	2020	2021	2022
Scotland (SFC)	0.8%	0.7%	0.8%	0.9%	0.9%	0.9%
UK (OBR)	1.7%	1.5%	1.3%	1.3%	1.4%	1.5%

SPICE June 2018 "The Scottish Government's Five Year Financial Strategy"

2.11. The Chancellor announced his Budget on 29 October 2018. This outlined the Treasury allocations for Scotland. The final distribution of resources for Scottish public services will be set out in the Scottish Government's Draft Budget.

## **The Scottish Landscape**

### Scottish Government Medium Term Financial Strategy

2.12. The Scottish Government published its Medium term Financial Strategy (MTFS) in May 2018. The Strategy describes the Fiscal Framework and the various strategies available to meet the financial challenges, the policy environment and spending pressures that the public sector faces over the next 5 years. It does not set out new policy commitments nor any detail of proposed allocation of funding. The MTFS aligns with the Programme for Government announced in September 2018.

2.13. Key priorities within the MTFS are for increased wellbeing and sustainable and inclusive growth, built on the principle of equality for all, with access to essential public services free at the point of delivery supporting the Scottish Government's "social contract". This includes;

- Reform and investment in Health with the publication in October 2018 of the "Medium Term Health and Social Care Financial Framework", considering the health and social care landscape, looking at current expenditure, future needs, current policy initiatives and transformation of health and social care to ensure financial sustainability (£2bn);
- Police (£100m);
- Early Learning Child Care (£470m);
- Attainment Gap including PEF (£750m);
- Continuing to prioritise free tuition;
- New Scottish social security system administering new devolved benefits (£3.5bn).

- 2.14. The key SG policy commitments will result in their share of the SG budget growing from 56% to 64% by 2022/23 with health spending making up between 68% and 82% of this across the 5 year period, with all other funding requiring to be met from the remainder of the budget, including local government. This gives a clear signal of a challenging financial settlement for local government, recognised in the June 2018 SPICe report.
- 2.15. The MTFs suggests that financial constraints are aligned to the UK Government's austerity approach with significant reference to the potential impact of Brexit in terms of the EU Single Market and Customs Union, immigration, a key driver for population growth and GDP, and access to EU funding.
- 2.16. The Scottish Fiscal Commission's economic and fiscal forecasts are summarised within the Strategy with fan charts outlining various scenarios.
- 2.17. In addition to the priorities noted above further challenges and uncertainty, creating pressure on public sector budgets, include;
- Ageing population including the working population;
  - Increasing prevalence of chronic health conditions;
  - Impact of technological change on jobs of the future including economic performance, employment and tax revenue.
- 2.18. The Strategy highlighted the requirement for efficiency savings and noted that "even if the most optimistic scenario played out, if there was no reprioritisation or reform and no additional revenue generated, then efficiency savings of 5% per annum could be required". The SG's view is that efficiencies of between 3% and 6% per annum are deliverable, for NAC this equates to between £9m and £18m.

### Settlement Conditions

- 2.19. The 2018/19 Settlement was described as sanction free but included a number of assumptions by the Scottish Government. These are noted below;
- 3% ceiling on council tax increase;
  - Maintaining at a national level a pupil : teacher ratio at 13.7;
  - Continuing to prioritise financial support for social care.
- 2.20. The impact of the above alongside the historic protection of a range of services create a "gearing" effect on savings delivery, impacting more severely on unprotected service areas.

### CoSLA engagement with the Scottish Government

- 2.21. The broad strategy for engagement with the Scottish Government includes;
- Recognition of the economic impact of local government services;
  - Full discretion on local taxation;

- Protection of the core local government settlement with removal of ring fencing and sustainable funding streams;
- Effective partnership working between Scottish and Local Government.

### Publication of the Scottish Government's Budget

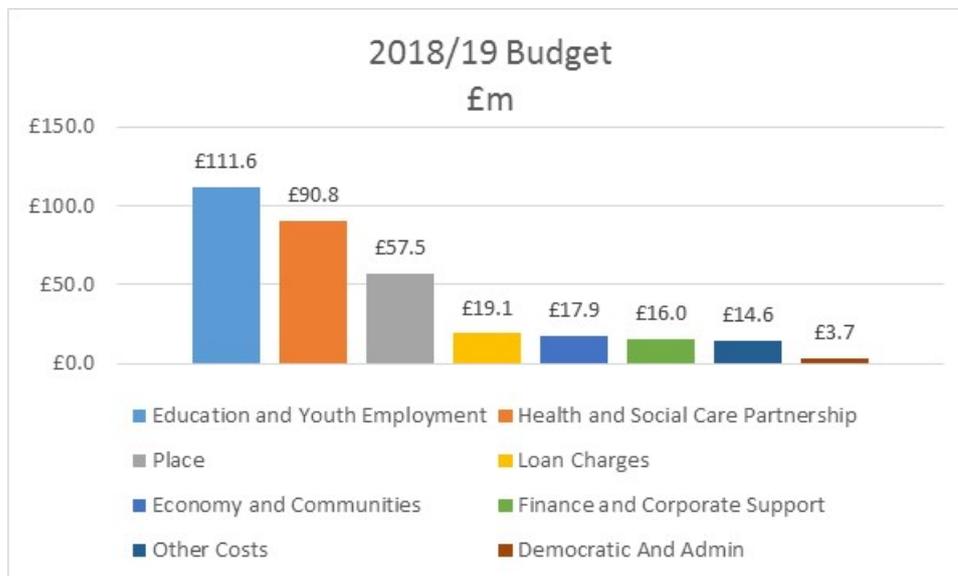
2.22. The Scottish Government continues to operate in a complex fiscal environment. The Fiscal Framework is such that the performance of the Scottish economy relative to the rest of the UK (rUK) is the determinant of whether the Scottish Budget is better or worse off under the new arrangements.

2.23. The Scottish Government has confirmed that the Draft Budget will be published on 12 December 2018 with the Financial Settlement following on 17 December. This will provide clarity on funding of policy choices and the extent to which they impact on resources for local government, with the Budget Bill being passed towards the end of February.

### **Financial Outlook for North Ayrshire Council**

#### Allocation of Resources

2.24. The Chart below summarises the allocation of resources for 2018/19 with 51% of relevant gross expenditure relating to employee costs;



## Medium term Outlook

- 2.25. 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. The model recognises the following significant pressures with an anticipated cost of almost £34m over the next 3 years:
- Workforce costs including future pay settlements, living wage, teachers' pension, pension auto enrolment;
  - 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;
  - Implementation of the Council's digital and technology strategies;
  - Reduction in loan charges support aligned to grant reduction.
- 2.26. 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.
- 2.27. Changes to core grant funding for North Ayrshire over the last 3 years have been -3.63% / -2.1% / +0.05%, with an average of just below 2%. Based on this a reduction of 2% has been built in for 2019/20, consistent with the planning assumption of a number of other Scottish local authorities and assuming that the additional £4.278m announced at the first stage debate of the Finance Bill for the 2018/19 budget is recurring.
- 2.28. A specific reduction has been included in 2020/21 and 2021/22 to reflect reducing loans fund support with the balance of funding being held at flat cash on the basis that no specific information is available to support a projection. This will be reviewed on publication of the 2019/20 Finance Circular.
- 2.29. The model assumes a 3% annual increase to Council Tax, generating £5m over the next 3 years.
- 2.30. Since 2017/18 the Council has used £9.7m 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.

2.31. A summary of the anticipated position of the Council over the next three years is provided in the table below. Further work is being undertaken to refine the underlying assumptions. Final savings proposals and the affordability of demographic pressures will be determined following the Local Government Financial Settlement.

	2019/20	2020/21	2021/22	Total
Scottish Government Grant	-£5,244	-£2,545	-£2,856	-£10,645
Council Tax	£2,012	£1,693	£1,746	£5,451
Reserves	-£3,500	£0	£0	-£3,500
				£0
Pressures (excl HSCP)	-£10,674	-£4,356	-£4,003	-£19,033
HSCP Pressures	-£5,423	-£4,944	-£4,410	-£14,777
				£0
Gross Funding Pressure	-£22,829	-£10,152	-£9,523	-£42,504
				£0
Previously approved saving	£4,874	£1,048	£333	£6,255
				£0
Net Funding Gap	-£17,955	-£9,104	-£9,190	-£36,249

#### Sensitivity Analysis

2.32. 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 £2.7m
- Council Tax Funding £0.5m
- Payroll incl. HSCP £2.1m

2.33. The table below exemplifies the potential impact on the funding gap based on a number of scenarios around the level of grant funding. The shaded box highlights the assumptions within the current summary. Core grant funding over the last 3 years has varied between a reduction of 3.63% in 2016/17 and a marginal increase of 0.05% in 2018/19.

SG Grant Assumption	2019/20	2020/21	2021/22	Total
Flat Cash	-£12,711	-£9,104	-£9,190	-£31,005
1% Reduction	-£15,333	-£11,772	-£11,832	-£38,937
2% Reduction	-£17,955	-£14,439	-£14,474	-£46,869
3% Reduction	-£20,675	-£17,107	-£17,116	-£54,899
4% Reduction	-£28,443	-£19,774	-£19,759	-£67,976

2.34. 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 investment in new initiatives will increase the projected financial gap identified within the model.

### Reserves Strategy

2.35. 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%) as noted by the Council's external auditors in their 2017/18 report. 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.

2.36. 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.

2.37. 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)**

2.38. 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.

2.39. Information on anticipated pressures and proposed savings options are shared with North Ayrshire Council to inform the allocation of resources delegated to the IJB.

2.40. 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 £5.8m as at 31 March 2018. The Council as one of the funding partners is exposed to risk unless the HSCP delivers services in a financially sustainably way.

2.41. The proposed timetable for the Integrated Joint Board setting its Budget is set out below;

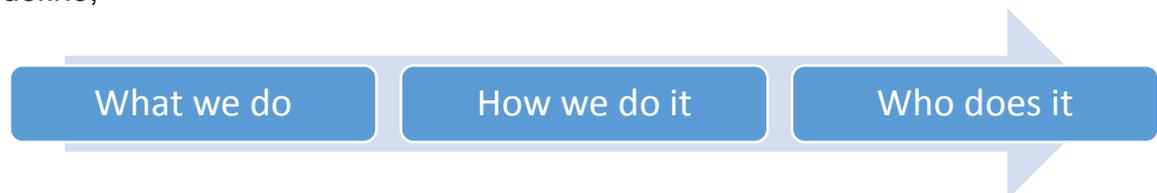
- Budget Outlook (November)
- Savings Proposals (November / December)
- Updated Budget Outlook (January 2019 following the settlement)
- Medium Term Financial Plan (March 2019)

## The Council's Approach

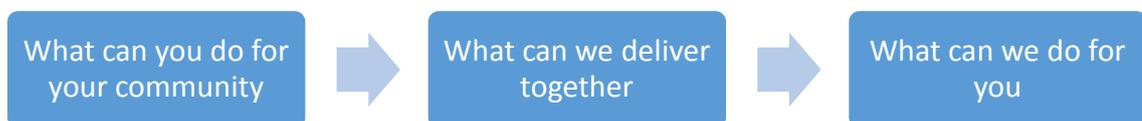
2.42. The reduction in resources noted above is happening at the same time as significant cost and demographic pressures. The scale of the financial challenge together with the change and savings which have been delivered between 2010/11 and 2018/19, £92m, equivalent to 28% of the current budget, creates a greater future challenge.

2.43. 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 the 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.

2.44. The Council's approach as set out in the Long Term Financial Outlook will inform the refresh of the Council Plan. This will transform what the Council does. It will redefine;



2.45. Sitting alongside this is the redefinition of the role of the Council and Communities;



2.46. The focus for the Council should be on priority outcomes within total available resources taking a collaborative approach to developing significant transformation at scale and pace whilst maximising income.

2.47. All of the above will have a significant impact on our workforce. Good progress is being made in developing our workforce plans, supporting the scale of change and transformation the Council requires to deliver.

## Capital Investment Programme

2.48. A full refresh of the 10 year Capital Investment Programme was undertaken for 2018/19 to 2027/28. The current loan charges budget and loans fund reserve underpin this programme.

2.49. For 2019/20 a high level review of the programme will consider the phasing of projects and availability of funding, including return of the rephased 2016/17 capital grant, to ensure the programme continues to be deliverable within the current financial model or by redirecting funding from other projects.

2.50. Any new projects, not supported by external funding, will require to be supported by a robust business case and if additional resources are required 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.

**Next Steps**

2.51. Services have made their initial budget submissions covering 2019/20 to 2021/22, these are being scrutinised as part of the officer peer review process.

2.52. Discussions require to take place with the Health Board and the Integrated Joint Board to support a partnership approach to development of the Health and Social Care Partnership’s budget.

2.53. Based on current plans community engagement and Members briefings will take place over autumn with Budget Day taking place in February 2019.

**3. Proposals**

3.1. That Council considers the Medium Term Financial Outlook 2019/20 to 2021/22, 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 2019/20 and beyond.

**4. Implications**

<b>Financial:</b>	The anticipated funding gap over the period 2019/20 to 2021/22, based on current assumptions, is £42.5m. Council will require to set a balanced budget for 2019/20 and future years.
<b>Human Resources:</b>	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.

<b>Legal:</b>	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.
<b>Equality: Children and Young People:</b>	An equality impact assessment will be carried out for all options that will assist the Council to make decisions to bridge its funding gap.
<b>Environmental &amp; Sustainability:</b>	No direct consequences.
<b>Key Priorities:</b>	In addressing the financial challenge which the Council faces it will seek to minimise the impact this has on delivering its key priorities.
<b>Community Benefits:</b>	No direct consequences.

## 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.

## 6. Conclusion

- 6.1. 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. The Medium Term Financial Outlook outlines the anticipated funding gap of £42.5m over the period 2019/20 to 2021/22, with £22.8m of this occurring in 2019/20. A change and transformation programme at scale and pace is required to address the challenge that the Council faces and to minimise the impact on the communities of North Ayrshire.



Executive Director (Finance & Corporate Support)

For further information please contact Laura Friel on 01294 324554.

## Background Papers

None