REPORT TO: **MORAY COUNCIL 10 AUGUST 2022**

SUBJECT: **SHORT TO MEDIUM TERM FINANCIAL PLANNING**

BY: **DEPUTE CHIEF EXECUTIVE (ECONOMY, ENVIRONMENT AND FINANCE)**

1. REASON FOR REPORT

1.1 To consider an update to the Council's Financial Plan for 2022 to 2025 and agree a hierarchical approach to the financial planning process for 2023/24 and 2024/25.

1.2 This report is submitted to the Council in terms of the Council's Administrative Scheme section (III) (A) (2) relating to considering Capital and Revenue budgets and long term financial plans.

2. RECOMMENDATION

2.1 It is recommended that the Council:-

(i) considers and notes the updated budget for 2022/23 and forecast positions for 2023/24 and 2024/25;

(ii) notes the likely implications of the Scottish Government Spending Review;

(iii) notes the current position regarding inflation;

(iv) notes that there are still significant uncertainties relating to the Council's budgetary position for 2022/23 and future years; and

(v) approves the approach to financial planning for 2023/24 and 2024/25 set out in paragraphs 5.7 and 5.8.

3. BACKGROUND

3.1 The Council's revenue and capital budgets for 2022/23 were approved at a special meeting of Moray Council on 22 February 2022 (paragraph 4 of the Minute refers). At that time there was an environment of considerable uncertainty about the state of the economy, due to the impact of the Covid-19 pandemic and Brexit and geo-political pressures, with rising inflation and bank rates increasing. The pay award for local government staff for 2022/23 was unknown and the teacher's pay award for 2021/22 still not agreed.

3.2 There is still considerable uncertainty regarding key variables in the budget. This report updates the position reported in February 2022 for the following areas where there have been developments: the unaudited out-turn for 2021/22; Scottish Government Spending Review in May 2022; communications from Scottish Government about financial flexibilities for local government in 2022/23, and the latest inflation forecasts.

3.3 The report also recommends adhering to the hierarchical methodology for approaching financial planning for 2023/24 and 2024/25 alluded to in the budget setting report to Council on 22 February 2022, with the addition of income generation.

4. REVENUE BUDGET 2022/23

4.1 An updated budget for 2022/23 is included in **APPENDIX 1** to this report. When the budget for 2022/23 was approved, expenditure of £242,309,000 was included, to be funded from Scottish Government grant £180,723,000, Council Tax receipts £46,555,000, financial flexibility (use of capital receipts to fund Covid-related revenue expenditure) £3,120,000 and use of reserves £10,335,000. Savings of £1,576,000 were approved. An underspend of £2,132,000 was anticipated for 2021/22.

4.2 The unaudited out-turn for 2021/22 is an underspend on General Funds of £3,364,000 (£3,748,000 after adjusting for Education ear-marked reserves which are spent on an academic year basis). The variations from actual out-turn to that projected when the budget was set were the subject of a report to Moray Council on 29 June 2022 (paragraph 24 of the minute refers). This increased the level of usable general reserves and has enabled the budgeted financial flexibility to be swapped out against use of reserves. There were expected to be two types of financial flexibility available to the Council in 2022/23 when the budget was set: use of capital receipts to fund Covid-related expenditure and expenditure on transformation expected to generate financial savings and a loans principal holiday. Confirmation of both was expected. Confirmation of the ability to take a loans principal holiday has been received but the Treasury has advised Scottish Government that the use of capital receipts to fund Covid-related revenue costs would score against the Scottish Government capital allocation and so this financial flexibility has been withdrawn. The impact of a loans principal holiday is being investigated. As an illustration of the likely impact in 2022/23, the loans principal repayment in 2021/22 was £10,033,000. If taken the loan principal repayment would increase in future years and the impact of this needs to be fully understood. Part of the increased underspend related to project slippage and funding for reserves in 2022/23 of £1,449,000 in relation to project slippage has been included as approved by Moray Council on 29 June 2022 (paragraph 24 of the Minute refers).

4.3 There have been a number of funding streams announced since the budget was set. £4,490,000 is for the Cost of Living reduction in Council Tax payments for dwellings in Bands A – D and for people in receipt of Council Tax Reduction.

Budgeted Council Tax receipts has been reduced by that amount. A further £3,032,000 relates to Scottish Government initiatives: £1,280,000 for economic recovery; £472,000 for benefits bridging payments; £409,000 social work capacity in Adult Services; £272,000 full year effect of removing charges for core curriculum subjects and music instruction; £287,000 more than estimated for Discretionary Housing Payments, Free School Meals expansion, free period products; £173,000 additional summer activities funding; £50,000 National Trauma Training programme; £44,000 Easter study provision and £45,000 support for people claiming Adult Disability Payments. These have been included as new burdens, with the assumption that all funding streams will be required in full to deliver the policy intent but the funding is unrestricted and all streams will be reviewed on a case-by-case basis.

4.4 As a result of these amendments budgeted expenditure for 2022/23 now stands at £249,655,000 with anticipated grant from Scottish Government of £188,245,000, budgeted Council Tax receipts of £42,065,000 and use of reserves of £17,769,000. £2,960,000 are planned use for transformation or Council priorities and £1,449,000 relates to project slippage, as noted in paragraph 4.2 above. The balance of £13,360,000 represents the underlying structural deficit in the budget. The underlying position has changed little since the budget was set, with savings totalling £19.5 million still requiring to be found across 2023/24 and 2024/25.

4.5 A modest spend to save project was added to the approved Capital Plan for 2022/23 – salt store at the Keith depot and the anticipated annual recurring savings of £35,000 have been added to approved savings.

5. <u>FINANCIAL PLANNING 2023/24 AND 2024/25</u>

Scottish Government Spending Review

5.1 The Scottish Government published its Medium Term Financial Strategy and Resource Spending Review in May 2022. The Medium Term Financial Strategy looks at likely funding available to Scottish Government in the period 2022 to 2027, using the Office for Budgetary Responsibility March 2022 forecasts and Scottish Fiscal Commission tax forecasts. Three scenarios are used to give a range of forecasts, from highest to lowest level. Looking at the central case, real (i.e. after inflation) growth of 5% is forecast across the period. However, over half of that relates to devolution of social security benefits, and increased spend in that demand-led area can be expected to match the additional income so for the rest of the budget 2% real growth is forecast in the central case. The Resource Spending Review indicates real growth in social security benefits and also in health and social care. All other portfolios are projected at real term reductions. Funding for Local Government is projected as flat cash. This is the projection used in **APPENDIX 1** for Scottish Government funding. There are a number of caveats which should be applied to this.

5.2 The Medium Term Financial Strategy uses 1%, 2% and 3% as its public sector pay award assumptions – these may be unrealistically low. Scottish Government have made an assumption that local authority and other public sector pay awards will be funded within budget by reducing staff numbers – it is unclear how feasible that will be. Not all manifesto commitments have been funded – for example the roll-out of expansion of Free School Meals to primary 6 and 7 has been delayed – and funding for those commitments (on the assumption they go ahead) will most likely be top-sliced from the overall local government settlement, adding pressure to core funding. The last two settlements in particular have seen significant restrictions placed on local authorities' ability to direct funding to areas of local priority. Previous assumptions of growth of the Scottish economy have been overly optimistic. The Scottish Fiscal Commission assumes a rapid decrease in inflation to 2.4% in 2023/24. Although the general view of commentators is that inflation will decrease, the Bank of England are no longer referring to a "transitory" level of inflation but are referring to it as "embedded". The Bank of England Monetary Policy report published in May 2022 refers to significant uncertainties in forecasting inflation.

Inflation

5.3 The Consumer Price Index (CPI) stood at 9.1% when results were reported for May 2022. Food prices were the largest contributor to the increase but a quarter of the items measured by the Office of National Statistics were 10% higher than a year ago.

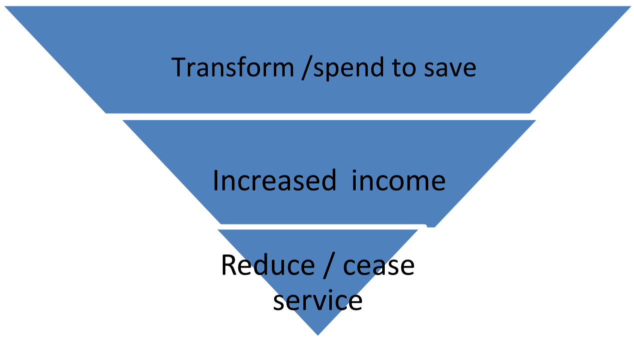
5.4 As a general rule these increase will be felt by local authorities. There is a measure of protection within contracts for pay increases. When contracts are re-tendered the impact of inflation will be felt, and some contractors will be unable to absorb additional costs and will either have to pass them on or resile the contract.

5.5 Significant increases in the cost of fuel and utilities has been widely reported. Scottish local authorities purchase utilities through a Scotland Excel contract. Electricity is mainly bought on the futures market and therefore there has been a measure of protection in terms of cost inflation in 2022/23. Despite that, in-year costs have risen at a higher rate than forecast when estimates of energy prices became available towards the end of 2021, and have continued to increase and are anticipated to increase further. The cost of electricity is estimated to have risen by 30% since April 2021 and the cost of gas by 153% (these are the fuel components of the total cost and do not include cost of supply or taxation.) The Council spent £3 million on energy costs in 2012/22 and recognised a budget pressure of £411,000 for 2022/23 when the budget was set. The latest indications are that the budget pressure will cover the increased costs of electricity only.

5.6 Some contracts include provision for an inflation uplift linked to CPI or – in the case of some older contracts – to RPI. Most notably the schools PPP contract has provision for an annual uplift for RPI and the school transport contract has provision for an annual uplift of CPI. These two contracts total £12 million.

Financial Planning approach and risks

5.7 When the budget for 2022/23 was set, the Council noted the following hierarchical approach to savings: transformation of services; small scale spend to save; reducing service; stopping services. Income generation requires to be added to that hierarchy, significant opportunities for which have recently arisen including development at Buckie Harbour and surplus landfill capacity. Transformation of services is preferable to reducing or stopping services and the Council has set aside ear-marked reserves to facilitate transformation of services and Council priorities. Given the current financial situation it is clear that the Council's top priority must again be to create financially sustainable services. However, it has proven difficult to develop a programme of transformation on the scale required to make the level of savings anticipated to be required. It should be noted that that the Council has been making savings since 2010/11 and in that time has delivered savings of £56 million. There are no easy options for making further savings. The following hierarchy is proposed:



5.8 Taking this approach would seek to focus on creating efficiency savings through Improvement and Modernisation of services through our change programme. This will be challenging, given the timescale in which savings require to be found, with significant savings unlikely to be generated through this approach until 2024/25 at the earliest. Further complications arise from the impact of the pandemic and of the wider economy on Council services. The next priority would be to generate more income for the Council, and this will require an ability to identify opportunities to generate income and awareness of the local economy and of the impact of the cost of living on Moray residents and businesses. The last resort would be to reduce or cease services, but realistically inclusion of options from that lower category in the hierarchy of preference seems unavoidable in bridging the gap for 2023/24.

5.9 The projected budgets for 2023/24 and 2024/25 included in **APPENDIX 1** assume that the savings approved for 2022/23 are achieved and the rest of the budget rolled forward, with adjustments for one-off funding and one-off savings. The baseline budget has not yet been adjusted for inflationary pressures in 2022/23 which were higher than budgeted for. Pay awards are still unknown. In common with most other Scottish Local authorities the Council budgeted for a 2% pay award in 2022/23. If a higher pay award is agreed without additional recurring funding from Scottish Government then the structural deficit in the budget will increase. As a rule of thumb, 1% pay increase across the workforce equates to an increase of £1.5 million.

5.10 The following areas are considered to represent high risk areas for the Council's budget in 2022/23 and future years:

- Pay awards;
- Increasing inflation rates and interest rates;

- Future Local Government settlements and level of effective ring-fencing of funds;
- Social Care and Additional Support Needs, where demand is escalating;
- Early Learning and Childcare, where funding is decreasing and significant budget cost pressures have been identified;
- Climate Change – the Council has a stated aim of being carbon neutral by 2030, but that will require very significant investment and there is little budgetary provision for this;
- Council Tax receipts – the Council has a good track record for collecting Council Tax, but early indications are that the rate of payment is less than last financial year.

5.11 To address the budget gap, a range of options are being developed, including income generation proposals, small scale efficiencies and some options for service reduction. These will be brought to the Council in early course. By themselves they will only partly bridge the gap and some continued reliance on reserves in the short term will be required. The more and the quicker the budget gap can be narrowed the better for the Council's financial stability and sustainability. The position regarding savings and emerging budget pressures will be monitored and reported, moving towards budget setting in February 2023. Active steps must be taken to reduce the budget gap, following the hierarchical approach outlined above. This will be accompanied by a proactive approach to ensuring there is no non-essential growth in the gap (where the Council has discretion over spend) and careful monitoring of the impact of growth where the Council has no discretion (e.g. pay awards).

10. SUMMARY OF IMPLICATIONS

(a) Corporate Plan and 10 Year Plan (Local Outcomes Improvement Plan (LOIP))

Financial Planning is integral to the Council's overall planning processes and allows the Council to direct resources to its agreed priorities.

(b) Policy and Legal

The Council is required by statute to set a balanced budget before the start of the financial year. The requirement is set out in the Local Government Finance Act 1992 (section 93).

(c) Financial implications

The Council has an underlying structural deficit which will be met from reserves in 2022/23 but this cannot continue as reserves are finite. A continued and heightened budget gap is forecast for 2023/24 and 2024/25.

Early action to tackle the projected funding gap for 2023/24 and 2024/25 is required. As a first step some income generation and other savings proposals will be brought forward. There are considerable uncertainties regarding a number of potential budget pressures. To achieve financial stability and sustainability the creation of further non-essential budget pressures must be avoided.

(d) **Risk Implications**
The forecast deficits for 2023/24 and 2024/25 represent a significant risk to the Council. There is also a risk that the deficits are understated.

(e) **Staffing Implications**
There are no staffing implications arising directly from this report.

(f) **Property**
There are no property implications arising directly from this report.

(g) **Equalities/Socio Economic Impact**
No implications arise directly from this report.

(h) **Climate Change and Biodiversity Impacts**
There are no implications for climate change and biodiversity arising from this report.

(i) **Consultations**
CMT have been consulted in the preparation of this report and Heads of Service involved in discussions on constituent elements, with full consultation being impossible over the summer period.

11. CONCLUSION

11.1 There are considerable uncertainties regarding the Council's budgetary position in 2022/23, however the underlying position is a deficit, funded by use of ear-marked reserves to balance.

11.2 Significant further savings are forecast to be required in 2023/24 and 2024/25.

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Background Papers:
Ref: SPMAN-1293228629-732 / SPMAN-1293228629-733