REPORT TO: **SPECIAL MORAY COUNCIL ON 16 DECEMBER 2020**

SUBJECT: **FINANCIAL PLANNING**

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

1. REASON FOR REPORT

1.1 To update the Council's financial position following the projected out-turn for 2020/21; financial flexibilities given to Scottish local authorities by Scottish Government, and the UK Spending Review.

1.2 To consider proposals to reduce budget pressures in 2020/21 and 2021/22.

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

2. RECOMMENDATION

2.1 It is recommended that the Council approves:

(i) One-off savings for 2020/21 as set out in the report;

(ii) Recurring savings from 2021/22 as set out in the report; and

(iii) Ear-marking savings from Children's Services as funding to transform Children's Services.

2.2 It is recommended that the Council notes:

(i) The high level of uncertainty regarding key financial planning assumptions;

(ii) The consequent requirement to be prudent regarding the Council's finances;

(iii) The updated financial sustainability PI relating to use of free reserves and the need to remove the underlying overspend in the Council's core budget which this indicator measures;

(iv) Current plans to address the underlying overspend; and

(v) The financial flexibilities agreed by Scottish Government and the likely impact for the Council.

3. BACKGROUND

Estimated out-turn

3.1 The estimated out-turn for 2020/21 was reported to the Economic Growth, Housing and Environmental Sustainability Committee on 1 December. Key headline figures from the estimated actuals are: estimated cost of the pandemic reduced to £7.8 million by application of £0.6 million funding for the expansion of Early Learning and Childcare (ELC) according to guidance from Scottish Government; increased vacancies from inability to recruit during lockdown (£2 million); loans charges reduction arising from slippage in the capital programme and reduced interest rates since the budget was set (£2.4 million); projected underspend in Children's Services (£1.9 million). The projected out-turn is an underspend of £959,000, reducing the need to use reserves to £1.7 million. Current projected free general reserves at 31 March 2021 is £12.9 million.

3.2 This is clearly a stronger position than had been expected. However, there are always uncertainties in the first estimated out-turn and this is heightened this year as a result of the pandemic. In particular, it is anticipated that there will be significant additional costs arising from the requirement to ventilate classrooms during the winter and the financial impact of that remains unknown.

3.3 Elements of projected variances for 2020/21 will be one-off but there are elements which are projected to carry forward into 2021/22. The Public Works Loans Board (PWLB) has recently announced a reduction in its borrowing rates. The Office of Budget Responsibility (OBR) has reduced its forecast interest levels for 2022 to 2025 and these were announced as part of the UK Sending Review on 25 November. Both of these suggest a lower rate of loans charges for the next three years than previously forecast and this should go some way towards reducing the projected funding gap.

UK Spending Review

3.4 The UK Spending Review on also increased the block grant to Scottish Government for 2021/22 by £2.4 billion, £1.1 billion core budget and £1.3 billion for COVID-19 related purposes, although the capital budget has been reduced by £0.3 billion. How that will be allocated by Scottish Government remains unknown until 28 January 2021.

3.5 The OBR have produced a range of forecast economic growth, taking into account different COVID-19 outcomes and assuming an "orderly transition" Brexit. Unsurprisingly this range is very wide, particularly in 2021/22. This will influence tax take for both Scottish and UK governments, which will filter through into government funding for local authorities as well as into local authorities own income generated.

3.6 The UK Spending Review also includes a provision for a “pay pause” for most non-NHS public sector staff. The Cabinet Secretary for Finance has indicated that Scottish Government is unlikely to be following suit. The pay award is a key figure for the budget. It is unclear what Scottish local authority staff might expect by way of pay award. It is almost certain that local authorities will be setting their budgets without an agreed pay award. This significantly increases uncertainty about future years.

3.7 The UK Spending Review was for one year only and consequently Scottish Government has confirmed that the Scottish Government budget will be for one year only.

3.8 Part of the cost of the pandemic is projected to be a continuation of the reduced level of Council Tax currently being seen. It is unclear at this stage how quickly the collection rate can be recovered and how quickly the buoyancy from new build can be recovered. An increase in Council tax Reduction of £330,000 has been funded for 2020/21 but it is unclear whether there will be any funding for that in future.

3.9 The level of uncertainty about economic growth and government and other funding and the lack of an agreed pay award combine to suggest that the Council needs to be very prudent in terms of budgeting for 2021/22.

Temporary savings 2020/21

3.10 In order to preserve the Council’s financial position as much as possible, the following temporary savings have been proposed by services: use of one-off funding for transportation; training, Children’s Services.

3.11 The Council was awarded grant funding for the Spaces for People initiative. Under the terms of the grant it is permissible to use the grant funding to cover staff time spent on the initiative. It is recommended that this is done, with an estimate of staff cost of £12,000.

3.12 During the first 6 month of lockdown / restricted activity no training activity took place across the Council. It is proposed that around half the corporate training budget is taken as a temporary saving in 2020/21. This amounts to £100,000.

3.13 Children’s Services were underspent by £846,000 in 2019/20, as reported to Council on 2 September 2020 (paragraph 9 of the Minute refers). The estimate underspend for 2020/21 is £1,880,000, showing continued trends in spend from 2019/20 and impacted also by the pandemic. It is proposed that this projected underspend is taken as a temporary saving in 2020/21 and the saving is transferred to an ear-marked reserve to fund transformation of Children’s Services as part of the Improvement and Modernisation Programme. As there were also significant underspends in 2019/20 it is considered likely that there are recurring savings from this service area and the level of savings will be considered with the service and proposals brought back as part of the budget setting process for 2021/22.

Saving 2021/22

3.14 In recent years the Council has considered savings in advance of the budget setting meeting, particularly when early consideration would facilitate consultation or other requirements for action prior to savings being realised. There is one savings proposals is brought for consideration today which would benefit from early consideration: ceasing the use of a software finance package.

3.15 For the last six years the Payments section has used AP Forensics, a software data gathering and analysing tool designed to minimise the risk of the Council overpaying suppliers. The licence to use the software is due for renewal and would cost £31,000 for the next three years if payment is made in advance. AP records show that overpayments of £96,000 were prevented or recovered during that period. However, AP Forensics is not the only tool used to catch potential overpayments and further analysis shows that the Council's financial management system caught and prevented £26,000, reducing the added value from AP Forensics to £70,000 against a total cost of £62,000 for the same period. Overpayments avoided or recovered have been reducing year by year and totalled £31,000 for the period 2016/2017 to 2019/2020, with a total of less than £2,000 in 2019/20. The Council has procedures in place to avoid paying the wrong supplier, which is considered to be the main risk associated with Accounts Payable. The risk exists but is mitigated and considered to be low. It is therefore recommended that the licence is not renewed.

Financial Sustainability

3.16 At its meeting on 2 March 2020, the Council approved a medium to long term financial strategy (paragraph 5 of the Minute refers). This strategy included a small suite of Performance Indicators (PIs), the first of which related to reliance on use of free reserves to balance the budget. The Council needs to reduce reliance on use of free reserves to balance the budget, as such use masks an underlying overcommitment of funds. The position over the last four years is as follows:

	Budget		Actual (est act 2020/21)	
	£m		£m	
2017/18	7.611	3.8%	4.615	2.3%
2018/19	4.720	2.4%	3.787	1.9%
2019/20	2.094	1.0%	-	0%
2020/21	2.348	1.1%	1.715	0.8%

3.17 When the current budget was set, it was overcommitted by over £2 million. Current projections are for this to reduce in this year. Without savings in 2021/22 the underlying overspend will increase by the amount required to fund inflationary increases and approved budget pressures. As indicated in paragraphs 3.3 and 3.13, it is considered that there is likely to be scope to reduce the budget for loans charges and Children's Services whilst still retaining the current planned levels of capital expenditure and spend on Children's Services. It is intended that these areas are assessed and reported to Council in January 2021. Based on the estimated out-turn for 2020/21 it would appear to be reasonable to anticipate that the historic underlying overcommitment of funds could be eliminated (or largely eliminated) in this way.

3.18 If the historic overspend is eliminated then the Council is in a much stronger position to tackle the impact of inflationary increases and movement in funding from Scottish Government and Council Tax. The January report will look at the current level of estimated free general reserves and the leeway this gives to address the significant uncertainties set out in paragraphs 3.4 to 3.9 above.

3.19 Following the January report, a detailed list of proposed charges for services will be submitted in February. The Housing Revenue Account budget proposals will be submitted in February, as council house rents need to be set then, but in recognition that the local government settlement will be late again this year it is proposed that the Council meets to set its budget and Council Tax for 2021/22 on 3 March 2021.

3.20 Funding from Scottish Government will be confirmed when the budget is set but it is unlikely that a pay award will have been agreed and the on-going impact on Council Tax collection is likely to take some time to become clear. When these issues crystallise it may be necessary to bring back a report looking for in-year savings in 2021/22.

Financial Flexibilities

3.21 The Cabinet Secretary for Finance wrote to the COSLA Resources Spokesperson on 8 October setting out the financial flexibilities agreed with the Chief Secretary to the Treasury as available for Scottish local authorities to mitigate the impact of the pandemic on Council finances. Since then the technical implementation of these has been discussed by the Local Authority (Scotland) Accounts Advisory Committee (LASAAC). Scottish Government requested four financial flexibilities: then ability to use capital grant to fund revenue costs arising from the pandemic – this was refused; the ability to use capital receipts to fund revenue costs of the pandemic in 2020/21 and 2021/22; the ability to vary the accounting requirements for the debt element of service concession arrangements (PPP/PFI arrangements); and the ability to take a loan fund repayment holiday in either 2020/21 or 2021/22. The potential impact of each flexibility for Moray is discussed below.

Capital receipts

3.22 Permission to use capital receipts to fund expenditure on transformation projects which generate savings or reduced demand for services was given by the then Cabinet Secretary on 10 December 2018 for financial years 2018/19 to 2021/22. The Council has approved use of capital receipts to fund transformation projects as part of its budget for 2020/21 and 2021/22. If transformation projects do not require the level of expenditure projected to be covered by capital receipts then the Council can allocate to cover costs relating to the pandemic. It is not recommended that the Council use this facility in 2020/21. There may be scope to use it in 2021/22. It should be noted that the level of capital receipts generated in 2020/21 is likely to be lower than originally anticipated due to the pandemic.

Credit arrangements

3.23 The flexibility agreed for credit arrangements is to account for the debt component of the service charge to be written off over the expected life of the asset, stated to be 50 years. Currently there is a statutory requirement for the debt element to be written off over the period of the contract, matching the cash payments made. The Council has two contracts – a PPP for Elgin Academy and Leith Primary School and a PFI for Elgin High School – the accounting for which could be varied under this flexibility. When the impact of the flexibility was estimated, it was assumed that the debt element of service concession arrangements was depreciated on a straight line basis across the life of the contract ie an equal instalment of the debt was written off each year. This is not the case and Moray Council, in following the model in use for accounting for PPPs at the time when the two schools were built, accounts for depreciation on an annuity basis. This has the effect of keeping the total debt repayment – principal and interest – at the same level throughout the life time of the contract, with lower levels of principal repaid and higher levels of interest on the outstanding debt paid at the beginning of the contract. Changing how this is accounted for would require prior year adjustments to account for the debt payment consistently over the life of the contract. Both contracts would show an increase in debt repayment in the first instance. The net impact of this for the two contracts would be an additional cost of £504,000 if the accounting method was changed in 2020/21 or £220,000 if changed in 2021/22. Savings would start to accrue from 2023/24, initially at around £200,000 pa. The annual level of savings increases until 2041/42 when the contracts cease. Thereafter the council would be committed to writing off debt at the rate of £1.2 million a year for a further 19 years and £0.5 million a year until 2067/68. In the short term adopting this flexibility would incur cost for the Council. It is not recommended that this flexibility is exercised in 2020/21. This flexibility can be kept under review for 2021/22 bit it seems unlikely to offer significant benefit to the Council in the short to medium term.

Loans Fund Payment Holiday

3.24 This flexibility is to take a loans fund payment holiday in either 2020/21 or 2021/22. The amount saved must then be repaid to the loans fund over a period of not more than 20 years, depending on the life of the assets funded through the loans fund. In her letter the Cabinet Secretary made it clear that this flexibility should be considered only after other flexibilities had been considered:

"I wish to be clear that this should not be seen as an opportunity to maintain or grow reserves. Local authorities are expected to take into consideration the contribution their reserves can make to meet their funding pressures. In terms of the financial flexibilities my expectation is that local authorities will first consider the additional resources available from capital receipts and the change in accounting arrangements before taking advantage of a loans fund repayment holiday". It is unclear at present what the implications are of the statement that this is not be seen as an opportunity to maintain or grow reserves or whether any conditions will be placed on local authorities exercising this flexibility. However, at present this appears to offer a significant opportunity for the Council to contribute towards the additional costs of the pandemic. Detailed work will be undertaken to assess what the impact would be and which year it would be most advantageous to exercise the flexibility, although it is expected that this would be 2021/22. As an illustration of the likely level of impact, the current budget for loan repayments is £7 million.

4. SUMMARY OF IMPLICATIONS

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

Delivery of the Corporate Plan and the LOIP is underpinned by financial planning.

(b) Policy and Legal

There are no policy or legal implications arising directly from this report.

(c) Financial implications

The report identifies one-off savings of £1,992,000, £1,880,000 of which is proposed to fund transformation of Children's Services. It proposed recurring savings annual of £10,300 which would contribute towards reducing the Council's underlying overspend. It identifies two areas for consideration which have the potential to eliminate the historic underlying overspend. It identifies potential financial flexibility to assist in covering the cost of the pandemic, in the region of £7 million

(d) Risk Implications

No risks arise to the Council from the one-off savings proposed for 2020/21. There is a risk that the Council is more liable to overpay suppliers if AP Forensic is no longer used but there are other procedures and tools which mitigate the risk of overpayment. There is a risk that restrictions on the use of loans fund payments are made and that the Council is unable to exercise the flexibility.

(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

There are no implications for equalities or the socio-economic duty arising directly from this report.

(h) Consultations

CMT and Heads of Services have been consulted in the preparation of this report and any comments incorporated.

5. CONCLUSION

5.1 One-off savings for 2020/21 have been identified, and savings on Children's Services are recommended to be ear-marked for transformation of that service.

5.2 Recurring savings for 2021/22 have been identified and are brought for consideration now because the proposed saving arises from a contract currently due for renewal.

5.3 Current immediate plans to address the historic budget overspend are identified, based on estimated actuals. The level of uncertainty around key budget variables will require a different approach to setting the budget for 2021/22, taking a prudent approach to how key costs are to be budgeted for.

5.4 Of the three financial flexibilities notified to local authorities to assist in dealing with the pandemic the loans pool holiday appears to be the only realistic option for the Council to use.

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Background Papers:
Ref: LP/LJC/