AGENDA ITEM NO 12

REPORT NO 178/22

ANGUS COUNCIL – 30 JUNE 2022

REVENUE AND CAPITAL BUDGETS – UPDATE ON BUDGET RISKS AND ACTIONS

REPORT BY IAN LORIMER, DIRECTOR OF FINANCE

ABSTRACT
This report updates members on a number of concerns and risks regarding the Council's 2022/23 revenue and 2021 to 2026 capital budgets and outlines the actions being taken to try to manage those risks. The report focusses on the Council's General Fund revenue and capital budgets but some of the risks will also affect the Council's Housing Service. The report also sets out the concerns arising from current levels of inflation and the direction of travel in the Resource Spending Review which seem likely to require reductions in the level of services the Council can provide on a scale not previously seen.

1. RECOMMENDATIONS

1.1 It is recommended that the Council:

a) note the contents of this report and the actions being taken by officers to try to manage the effects of inflation and other risks on the Council's budgets;

b) note that further action and revisions to the Council's 2022/23 revenue and 2021 to 2026 capital budgets seem likely to be required and that proposals in this regard, should they prove necessary, will come to members for approval after the recess;

c) note the summary of key points and implications for the Council from the Scottish Government's recently published Resource Spending Review covering the period 2022/23 to 2026/27;

d) note the concerns set out in the report arising from current levels of inflation and the direction of travel in the Resource Spending Review which seem likely to require reductions in the level of services the Council can provide on a scale not previously seen.

2. ALIGNMENT TO THE COUNCIL PLAN

2.1 Managing the Council's finances is central to the delivery of the Council's objectives and priorities so this report contributes as a whole to delivery of the Council Plan. The Council must manage its finances carefully to ensure it remains financially sustainable because if that does not happen many of the Council's services and priorities will be put at significant risk.

3. BACKGROUND

3.1 In setting the 2022/23 General Fund revenue and capital budgets in March 2022 the Council noted a number of specific risks that could affect those budgets and agreed contingency measures to try to mitigate those and provide funding options should those risks materialise. The budget reports to the 3 March 2022 Special Council meeting also noted the projected funding gaps into future years and the challenges the Council faced in trying to address them.

3.2 It is reasonable to conclude that due to various world events and in particular the current level of inflation that the Council's budget and financial situation is now in an even more difficult position than had been expected in March 2022. High levels of inflation are now a major and very real threat to the Council's financial sustainability which will have far reaching consequences for the services the Council provides.

3.3 The purpose of this report is to update members on specific concerns and risks regarding the Council's 2022/23 revenue and 2021 to 2026 capital budgets and to outline the actions being taken to try to manage those risks. The report also looks ahead to the challenges facing the Council in setting its 2023/24 budgets.

4. FUNDING GAPS – GENERAL FUND REVENUE BUDGET

4.1 Table 1 below provides a reminder of how the funding gap on the Council's 2022/23 General Fund Revenue Budget was addressed. It will be noted that £4m, 28% of the gap was addressed on a one-off basis using Council reserves. That use of reserves to achieve a balanced budget is the extent to which the Council is incurring costs which it cannot afford on an ongoing basis.

Table 1 – 2022/23 Revenue Budget – Funding Gap & Measures to Address

	£Millions
Gross Funding Gap	**14.0**
Less Change Programme Savings	(6.8)
Less Additional Fees & Charges Income	(0.1)
Less Use of Reserves for One-off Issues	(0.8)
Less Additional Council Tax Income	(2.3)
Balance – Funded from Reserves on a One-off Basis	**4.0**

4.2 Table 2 below shows the projected funding gaps on the General Fund Revenue Budget for financial years 2023/24 and 2024/25 updated to reflect the final decisions made at the 3 March budget setting meeting and the additional cost arising from the COSLA pay award offer made a few days before that meeting. Additional grant funding of £2.5m provided for 2022/23 on a one-off basis has been confirmed as having been made permanent in the Government Resource Spending Review (see Section 9) so has been removed as a potential funding gap for 2023/24.

Table 2 – Projected Funding Gaps 2023/24 and 2024/25

	2023/24 **£m**	**2024/25** **£m**	**2 Year Total** **£m**
Projected Funding shortfall (Oct 21 assessment)	9.7	11.8	21.5
Add previous years funding gap dealt with on a one-off basis - use of reserves	4.0	2.0	6.0
Impact of 22/23 Pay Provision Shortfall (COSLA 2% offer)	0.9	0.0	0.9
Sub-total – Total Funding Gap	**14.6**	**13.8**	**28.4**
Projected Change Programme savings	-6.1	-7.2	-13.3
Less 3 year General Fund Reserves Drawdown	-2.0	-1.0	-3.0
Estimated funding gap still to be addressed	**6.5**	**5.6**	**12.1**

4.3 The projected funding gaps in Table 2 are mainly based on projections undertaken in the last update of the Council's Medium Term Budget Strategy (MTBS) in October 2021. As such they underestimate the impact of inflation which has risen considerably since then. In relation to the funding levels assumed for government grant the 2022-2027 Resource Spending Review (see Section 9) sets out a direction of travel which would see grant funding levels remain static in cash terms meaning a reduction in real terms.

4.4 A full update of the Council's 3 year MTBS which will include an updated assessment of future budget funding gaps will be brought to members in the October / November cycle of meetings. However based on the information currently available it is inevitable that the projected funding gaps for future years will be higher than previously assumed and shown in Table 2.

4.5 For the 2023/24 financial year the Council will need to set a budget by early March 2023 at the latest which means we have only 8 months to identify all of the savings required to ensure a balanced budget can be set (a legal requirement). As the statutory finance officer of the Council I have to advise at this early stage in the process of setting the budget that the scale of the financial challenge facing the Council for 2023/24 is of significant concern.

5. FUNDING CHALLENGES – CAPITAL BUDGETS

5.1 Issues in supply chains, disruption due to the war in Ukraine and huge increases in oil and energy prices are resulting in high inflation and rising costs which affect all areas of the Council's capital budgets for General Fund and Housing services. Report 152/22 – Monifieth Learning Campus – Costings Update highlighted the financial impact of market conditions on that single project and the Policy & Resources Committee agreed revisions to other planned capital spend in order to address the funding gap on that project.

5.2 It seems likely that further revisions to capital budgets will be required over the course of the 2022/23 financial year if tender pricing for other capital projects comes in above the budget estimate. This may require some projects to be cancelled or deferred. For those parts of the capital budget where there are block programmes of work and funding (e.g. in road maintenance) the budget can be maintained but the scale of work able to be carried out with that budget will be reduced if inflationary pressures affect pricing from contractors.

6. 2022/23 BUDGET RISKS AND FUNDING

6.1 A budget is a best estimate of what an organisation expects to happen financially over a particular period and by definition involves uncertainty and assumptions. In setting its budget the Council has for many years always accepted an element of risk taking and the pressures on the Council's finances and the need to make substantial savings year on year have generally meant accepting higher levels of risk with each budget that is set.

6.2 The 2022/23 revenue budget was set on the basis of taking risk in a number of areas the two largest in value terms being:-

- 2022/23 Staff Pay Award – a budget provision of £2.8m (1.5%) was made even though trade unions were seeking much higher levels. A few days before the Council set its budget COSLA Leaders agreed to make a 2% offer. That offer has been rejected by trade unions but even at this level results in an additional unbudgeted cost to the Council of circa £0.9m.

- Energy cost inflation – a budget increase of £1.035m was made towards a projected £1.5m additional cost on the assumption that consumption could be reduced and that some additional costs relating to early years provision could be charged against the ring-fenced grant provided for that service.

An update on these two risks is given in Section 7 of this report.

6.3 In setting the 2022/23 General Fund revenue and capital budgets the Council noted the numerous budget risks and uncertainties and agreed the following funding measures to provide some protection against those budget risks:-

- Revenue Budget – Provision for Additional Burdens - £0.3m
- Provision for General Inflation Risks (earmarked in Reserves) - £0.5m
- COVID-19 Contingency Reserve - £1.75m
- General Contingency Reserve - £4.7m
- General Fund Capital Contingency Provision - £3.76m

6.4 With the exception of the Provision for Additional Burdens budget of £0.3m the other funding is one-off in nature and therefore cannot be used as means of funding permanent and ongoing increases in the Council's costs such as, for example, a higher pay award.

7. INFLATION RISKS & IMPLICATIONS

7.1 For the purposes of this report inflation risks have been categorised into 4 types:-

- Inflation on directly employed staff – what is usually referred to as our pay award costs
- General inflation – across all of the goods and services we need to buy from suppliers
- Specific inflation – inflation on contracts and agreements which is linked to RPI or CPI
- Energy inflation – inflation on the Council's energy costs

<u>Pay Inflation</u>

7.2 Pay inflation is the area of most concern at present because staff and unions are, understandably in the current high inflation environment, seeking higher levels of pay increase than the 2% offered. The facts are though that the Council does not have the ongoing funding which would be required to meet a higher level of pay increase. Each 1% increase in pay beyond what has been offered would cost the Council at least £1.4m and possibly more depending on how the deal is structured and how it impacts onto partners including ANGUSalive and Tayside Contracts. As noted above an offer of 2% has already been rejected by trade unions and industrial action is therefore a possibility.

7.3 The Council also buys in services from other suppliers/providers including Tayside Contracts and pay inflation will also affect those providers and eventually how much they charge the Council for providing services on the Council's behalf.

7.4 The Council already has a £0.9m funding gap on pay to address for financial year 2022/23 which will need to be met on a one-off basis from Reserves and added to the projected funding gap for 2023/24. Any increase beyond the 2% offered, unless fully funded by additional grant from the Scottish Government, would require a further draw on Reserves in 2022/23 as a one-off funding solution and would increase the already very large funding gap for 2023/24.

General Inflation

7.5 The Council needs to buy a range of goods and services to provide the services Angus citizens rely on including food for school meals and community meals, fuel for our bin lorries and other vehicles and energy to heat and light our schools, offices and other buildings. General inflation also affects the costs of our suppliers and those who provide services on the Council's behalf. With some exceptions and for affordability reasons departmental budgets were not increased for 2022/23 to recognise the potential impact of general inflation with the expectation that services would need to manage any inflationary impacts from within their existing budgets.

7.6 At present the main areas of concern are the impact of rising fuel prices on the Council's own costs and those of our transport providers. Rising prices and supply chain issues have also been affecting materials such as bitumen used in road repairs. Cost increases on many of the materials required for Council service provision are exceeding the levels of general inflation as measured through the Consumer Prices Index (CPI).

7.7 At the time of writing officers are still assessing where and to what extent general inflation is affecting costs and therefore putting the ability to live within the budget set at risk. Discussions with the Council's suppliers are also ongoing for those areas of service where the Council buys in services.

Specific Inflation

7.8 The Council spends significant sums annually buying in services from suppliers and the vast majority of these are covered by contracts or other forms of legal agreement some of which will span a number of years. Those contracts covering more than one year will usually include provision for how inflation will be dealt with.

7.9 In setting the 2022/23 revenue budget the Council included a large uplift in budget for our schools PPP contracts which rise in line with RPI inflation.

7.10 At the time of writing the effects of specific inflation are considered to have been covered in the 2022/23 budget but this is being kept under review as part of our normal budget monitoring arrangements.

Energy Inflation

7.11 When the Council set its budget in early March final pricing for 2022/23 from Scottish Procurement wasn't available. Based on the updated pricing now received and using the same assumptions regarding consumption there is now projected to be an additional cost of circa £0.6m compared to what has been allowed for in the budget. Unless consumption can be further curtailed beyond what had already been assumed this additional cost will need to be paid for. This will most likely need to be by using reserves on a one-off basis for 2022/23 and unless energy prices fall this additional cost will increase the Council's funding gap for 2023/24.

Implications – 2022/23

7.12 The financial impact of pay, general, specific and energy inflation on the Council's budget is still emerging in terms of direct impacts and secondary impacts on our suppliers and therefore requires further assessment by officers over the summer. It does however seem likely that some revisions to the 2022/23 General Fund revenue budgets set in March will be required in specific areas to deal with the effects on inflation. Such revisions may require the curtailment or deferral of other planned spend, use of reserves on a one-off basis or adjustments to income assumptions where the Council's budgeted income may be higher than expected due to inflation. It could also be necessary to reassess the fees and charges the Council levies for some services or curtail certain types of services in order to contain costs. Any proposals of this nature will come to members for prior approval.

7.13 Review of the position on the housing revenue budget is also being undertaken and it may also be necessary to make revisions to the 2022/23 housing revenue budget agreed in February 2022.

8. MANAGEMENT OF BUDGET RISKS AND ACTIONS TAKEN

8.1 In view of the threat to the Council's financial position posed by inflation and other risks officers have agreed to take a number of initial actions as set out below. These are very much a first set of measures and others may be required as we move through the financial year.

8.2 Pay inflation risks – the Council is part of the national pay negotiation arrangements led by COSLA on behalf of Scottish Local Government. As such we are tied into the results of those national negotiations. Actions to date include providing information and comments on affordability and other implications to COSLA directly and through professional advisers (Directors of Finance and Directors of HR). Officers have made clear the Council's position in terms of affordability and the consequences for jobs if a higher level of pay award is agreed and has to be fully funded by the Council.

8.3 Energy cost risks – an action plan is being drawn up to remind staff across the Council of the need to conserve energy usage and adopt good practice. Work with schools will also be undertaken since schools are the Council's biggest users of energy. The financial and carbon implications of conserving energy will be highlighted all of which is aimed at reducing the Council's energy use. Particular challenges lie ahead in relation to ventilation during the colder months – the Council will not be able to afford increasing heating output to compensate as was the case during the COVID pandemic – this isn't a sustainable approach environmentally or financially.

8.4 Postponement of Discretionary Revenue Spending - the Council's Officer Leadership Team (CLT) has agreed to defer until at least 31 August 2022 any revenue spend which is discretionary and not time critical to service delivery to provide additional financial flexibility should it be required. This deferral approach will be reviewed over the summer alongside the assessment of the impact of inflation on existing budgets.

8.5 Capital Project Prioritisation – CLT has also agreed an approach whereby those capital projects being committed in the first half of 2022/23 will, where feasible, be those which are of the highest priority. This will limit the risk of higher priority projects potentially having to be deferred later in the financial year if revision to capital budgets is required to ensure the overall capital programme remains affordable.

8.6 Review of General Fund Commitments – CLT has also agreed to review all existing commitments within the Council's General Reserve to try to free up resources on a one-off basis. This would mean the cancellation or curtailment of previously planned uses for these funds. This review work is ongoing and proposals for any changes to what has previously been approved will be brought to members for consideration after the summer recess.

8.7 2021/22 Final Outturn & 100% Budget Carry Forwards – this is the subject of a separate report for the June Council meeting – the year end position is more favourable than expected albeit some of this is as a result of deliberate action to generate additional one-off savings. Only those budget carry forwards considered essential are being recommended for approval in that report to maximise the level of uncommitted reserves available to support other financial pressures.

9. SCOTTISH GOVERNMENT RESOURCE SPENDING REVIEW 2023-2027

9.1 Over the last few months the Scottish Government has been undertaking a multi-year "Spending Review" on the "resource" (revenue) part of its budget looking at both spend and income raised through taxation. The outcomes from this Spending Review are crucial to the Council - most Council services rely on government grant to a very significant extent to pay for those services (81% of the Council's net revenue budget is funded by government grant).

9.2 The Resource Spending Review (RSR) was published on 31 May 2022 alongside the Government's Medium Term Financial Strategy and an update on the Government's Capital Spending Review. The RSR is pitched at what government call Level 2 which is high level and provides only portfolio totals for the Scottish Budget including the portfolio which covers local government funding. The RSR sets out a direction of travel for the next 4 years but funding allocations for all parts of the Scottish Budget including local government and grant allocations to individual Councils will need to be confirmed as part of the Government's annual budget setting process.

9.3 Although the RSR is high level and actual funding to local government could change (positively or negatively) from that assumed it shows an intention for revenue funding for local government as a whole to be the same in cash terms (what is sometimes called "flat cash") between 2022-23 and 2025-26 with a small uplift in 2026-27. In real terms this would represent a significant cut given current levels of inflation. There is also uncertainty at this stage as to whether within the local government totals in the RSR there will be new burdens and initiatives to be funded which if that were the case would mean a cash reduction would apply to existing services.

9.4 What the RSR figures mean is that Councils would be expected to self-fund all inflationary pressures including pay. Given the scale of savings already made by Angus Council over the last decade that is going to be exceptionally difficult. There is also an intention to maintain the overall public sector pay bill in Scotland at current levels over the period of the RSR which means pay rises would need to be offset by reductions in head count. That approach to self-funding pay is something the Council has had to do for the last decade and is partly why savings of £78m over that period have been required.

9.5 The Scottish Government and COSLA are working on a new Fiscal Framework for local government which should provide more information and clarity of future funding arrangements and expectations. Further details on this will be provided to members once available.

9.6 The RSR also included three other significant points for local government:-

- The RSR has confirmed that additional funding of £120m which was provided on a one-off basis for 2022/23 is to be "baselined" (permanently added) to the total funding for local government. The Angus share of this funding was £2.5m. This is welcome news and removes a risk which would otherwise have meant a £2.5m higher funding gap for 2023/24.

- Agreement to a request from COSLA for changes in how service concession payments are accounted for which is expected to provide some one-off financial benefits to those Councils which have PPP/PFI contracts. This is a very welcome development. Details of exactly how the flexibility will apply are awaited and once that is received an assessment of the financial benefit for the Council can be made.

- The Government intend to commission an independent review of local government capital accounting and the extent of statutory mitigation which applies in local authority accounting arrangements. Statutory mitigation allows adjustments to standard accounting practice generally to avoid a significant negative impact on the bottom line financial position. A reduction or withdrawal in statutory mitigation is therefore likely to have a significant negative effect on the Council finances should that be implemented following the review.

9.7 It has been many years since a national RSR has been published and therefore able to be used to inform the Council's medium term financial planning so this is a welcome development as is the service concession flexibility. The proposed flat cash allocation to local government as a whole over the next few years will however present major challenges especially given current levels of inflation and the capital accounting review will require close attention to avoid unintended consequences for the Council's finances.

10. IMPLICATIONS – 2023/24 AND BEYOND

10.1 Although dealing with the effects of pay and other inflation in financial year 2022/23 will be very difficult the contingency provisions (paragraph 6.3 refers) provide a reasonable degree of protection to deal with these effects on a one-off basis. The primary concern is what those inflationary effects and expected government grant funding mean for financial year 2023/24 and beyond.

10.2 As highlighted in Table 2 the Council's projected funding gap for 2023/24 is £6.5m (assuming all projected Change Programme savings are achieved) but as also highlighted in this report that estimate, due to the effects of inflation, is now likely to be a significant underestimate of the scale of the problem. With such substantial savings having already been made by the Council (£78m over the last 10 years) the options for closing the funding gap in 2023/24 in a way which doesn't impact on service provision are very limited.

10.3 It is important to state that there are many factors which will affect the Council's final 2023/24 budget and the position could potentially be less severe in practice if for example the service concession flexibility provides significant benefit to the Council. Nevertheless I have to warn members of Council that at this stage the combination of the huge savings already made by the Council, the effects of high inflation on all of our costs and the expectation that government grant will remain static in cash terms over the next few years is likely to require reductions in the level of services the Council provides on a scale not previously seen. Significant increases in fees and charges and potentially Council Tax may also be required to balance the books in 2023/24 and the years immediately thereafter.

10.4 The Council already faced huge challenges in future years to balance budgets and remain financially sustainable but the scale of inflationary pressures now prevalent across our revenue and capital budgets takes those challenges to a new and unwelcome level. Elected members and the general public need to be ready for significant cuts to General Fund services and increases to fees, charges and Council Tax for the foreseeable future.

11. FINANCIAL IMPLICATIONS

11.1 There are no additional financial implications for the Council beyond those set out in the body of this report. Further reports will be provided when necessary for decisions to be made.

12. EQUALITY IMPACT ASSESEMENT

12.1 An equality impact assessment is not required.

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