

ITEM No ...6.....

REPORT TO: POLICY AND RESOURCES COMMITTEE – 6 DECEMBER 2021

REPORT ON: FINANCIAL OUTLOOK AND REVENUE BUDGET 2022/23

REPORT BY: EXECUTIVE DIRECTOR OF CORPORATE SERVICES

REPORT NO: 311-2021

1.0 PURPOSE OF REPORT

This report advises members of the financial outlook at a national level following the recent UK Budget and Spending Review announcements. The report also outlines the current position on the Council's Revenue Budget for 2022/23, in terms of required savings and next steps.

2.0 RECOMMENDATIONS

It is recommended that the Committee:

- 2.1 Notes the financial outlook at a national level following the recent UK Budget and Spending Review announcements.
- 2.2 Notes the range of projected savings that may be required for 2022/23 in order to deliver a balanced budget.
- 2.3 Notes the approved Long-Term Financial Strategy, as set out in paragraph 8.2 of this report.
- 2.4 Notes that a further report will be submitted to the Policy and Resources Committee on 10 January 2022, detailing the Council's actual grant settlement for 2022/23 and the associated implications. This report will include the proposed procedure for setting the Council's Revenue Budget and Council Tax for 2022/23.
- 2.5 Notes that it is anticipated that the Policy and Resources Committee will meet on 24 February 2022 to set the Council's 2022/23 Revenue Budget and Council Tax.
- 2.6 Notes that, in line with Audit Scotland recommendations, the Council's longer-term financial forecasts will be updated and reported to elected members, by September 2022.

3.0 FINANCIAL IMPLICATIONS

- 3.1 The current estimate of savings required to achieve a balanced budget in 2022/23 is in the range £10.4m to £14.7m.
- 3.2 In line with the approved Long-Term Financial Strategy, the current financial projections assume that demographic growth will not be funded given the scale of the financial challenge. Rather, all services are expected to redesign services and work in partnership with other bodies to meet the cost of additional pressures.

4.0 BACKGROUND

- 4.1 The long-term financial outlook and financial strategy for 2020 to 2030 were set out in Report 274-2019, which was submitted to the Policy and Resources Committee on 19 August 2019 (article XII refers). The report identified that £78.1m of savings and efficiencies may be required over the 10-year period 2020-2030 in order to achieve a balanced budget. It should be noted that the long-term financial outlook and financial strategy for 2020 to 2030 were prepared prior to the onset of the Covid pandemic.
- 4.2 The Council's Revenue Budget for 2021/22 was agreed by the Policy and Resources Committee on 4 March 2021 (article II refers). In the covering budget report 108-2021, it was projected that additional savings of £7.3m would be required to achieve a balanced budget in 2022/23 (on the assumption that a balanced budget was set for 2021/22). This figure

subsequently reduced to £7.2m as a result of decisions taken when setting the 2021/22 budget. In light of additional cost pressures and risks emerging since the 2021/22 budget was set, the current estimate of savings required to achieve a balanced budget in 2022/23 is in the range £10.4m to £14.7m (see section 7 of report).

5.0 UK AUTUMN BUDGET AND SPENDING REVIEW 2021

5.1 On 27 October 2021, the Chancellor of the Exchequer published the 2021 UK Autumn Budget and a multi-year Spending Review. This followed on from the Spring Budget announcements in early March 2021. The Spending Review sets out, for the three-year period 2022 to 2025, budget allocations for UK Government departments and for the devolved administrations, including Scotland. The Budget and Spending Review announcements were accompanied by updated economic forecasts by the Office for Budget Responsibility (OBR). The OBR forecasts generally highlight a better than expected economic recovery, compared to the position set out in the March 2021 budget announcements.

The key economic measures are set out in Table 1 below.

Table 1: Key UK Economic Measures (Central Scenario)

	2020	2021	2022	2023	2024	2025	2026
Gross Domestic Product (real terms)	-9.8%	6.5%	6.0%	2.1%	1.3%	1.6%	1.7%
Unemployment	4.6%	4.9%	4.8%	4.3%	4.2%	4.2%	4.2%
Inflation (CPI)	0.9%	2.3%	4.0%	2.6%	2.1%	2.0%	2.0%
Interest Rates	0.1%	0.1%	0.5%	0.8%	0.8%	0.9%	0.9%

Key points to note from Table 1 are:

GDP – recent economic growth has been faster than expected, however post-recovery the growth forecasts remains relatively poor. In the longer term, it is now forecast that the pandemic will have a less damaging “scarring” effect on the size of the UK economy.

Unemployment – is now expected to be lower than before, peaking at 5.2% (as opposed to 6.5%) in the 4th quarter of 2021.

Inflation – is forecast to peak at 4.4% in the 2nd quarter of 2022, however the OBR note that based on the latest data available the peak would rise to 5%.

Interest Rates – reflecting inflation pressures, interest rates are now projected to increase higher and faster than previously, levelling off at 0.75% in the 4th quarter of 2023.

Table 2 below sets out the key measures for the UK public finances.

Table 2: UK Public Finances – Key Measures

	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27
Receipts (£bn)	795	862	962	1,020	1,061	1,102	1,148
Expenditure (£bn)	1,115	1,045	1,045	1,081	1,108	1,148	1,192
Borrowing (£bn)	320	183	83	62	46	46	44
Debt as % of GDP	97%	98%	98%	98%	95%	91%	88%

Key points to note from Table 2 are:

Receipts – significant increase from previous projection, due to both higher than expected economic growth and tax rises (mainly the recently announced increase in National Insurance Contributions).

Expenditure – significant increase from previous projection, reflecting increase in receipts. Overall, public expenditure falls in 2021/22 and is flat in 2022/23, reflecting reducing Covid related spend.

Borrowing – reducing profile as a result of increased receipts and reducing Covid related spend.

Debt as a % of GDP – as a result of lower borrowing, hovers just under 100% over the next few years than starts to reduce in 2024/25, in line with a new fiscal rule that national debt should be on a downward profile.

6.0 IMPLICATIONS FOR THE SCOTTISH BUDGET

6.1 The Budget documentation states that Scotland will receive “an additional £4.6 billion per year on average through the Barnett formula over the SR21 period, on top of its annual baseline funding of £36.7 billion.” The total unadjusted Scottish block grant will increase from £36.7 billion (excluding Covid funding) in the current year (2021/22) to £41.8 billion by the final year of the Spending Review period (2024/25). This equates to a 2.4% real-terms increase over the Spending Review period. However, as the table below shows, the increase is largely front-loaded, with large real terms increases next year (+7.7%), followed by two years where the Scottish Budget stands still in real terms.

The figures for the Scottish block are set out in Table 3 below.

Table 3: Budget for Scotland (Cash Terms, Excluding £2.5bn Covid Funding in 2021/22)

	Baseline 2021/22 (£bn)	Plans 2022/23 (£bn)	Plans 2023/24 (£bn)	Baseline 2024/25 (£bn)
Resource DEL	31.6	35.0	35.7	36.3
Capital DEL	5.2	5.6	5.6	5.5
Total DEL	36.7	40.6	41.2	41.8
% Increase		10.7%	1.48%	1.46%

DEL = Departmental Expenditure Limit

Note: the above figures exclude Covid funding

- 6.2 Whilst Scotland has received substantial Barnett Consequentials as a result of the UK Government’s Spending Review, the underlying funding position is not entirely clear due to the one-off Covid funding received for this financial year and last. As a result, it is difficult to say how generous the settlement for Scotland is, although the funding profile shows a distinct tightening over time, with a real-terms cut in both 2023/24 and 2024/25. The NHS in Scotland is expected to benefit from above inflation settlements throughout the Spending Review period which may, in turn, result in significant real terms cuts elsewhere.
- 6.3 For capital funding, the figures in Table 1 above show an increase from £5.2 billion in 2021/22 to £5.6 billion in 2022/23. Thereafter, the figures remain flat for 2023/24 before reducing to £5.5 billion in 2024/25. The Scottish Government’s Capital Spending Review shows a cumulative gap of £0.4 billion by 2025/26, when compared to the funding being made available by the UK Government.
- 6.4 The Autumn Budget confirmed that Scotland would receive £172 million in total for 8 projects from the first tranche of Levelling Up Fund allocations. Scotland’s allocation of the UK Shared Prosperity Fund, which is set to replace EU Structural Funds in 2022, has still to be determined.
- 6.5 The outcome of the 2021 Spending Review has been, as expected, more generous than was suggested by the spending envelope outlined in the Spring 2021 Budget. However, even this relative generosity leads to quite tough spending settlements for 2023/24 and 2024/25. Widespread uncertainty and risk remains around key economic and fiscal issues such as economic recovery, inflation and interest rates. The Chancellor’s Budget and Spending Review announcements will help inform the Scottish Government’s budget process, however they offer little insight as to the likely level of government grant support that the Council will receive for 2022/23 and beyond.

7.0 BUDGET SAVINGS REQUIREMENT

7.1 Since the 2021/22 revenue budget was approved in March 2021, there have been a number of emerging cost pressures and risks that will impact on the Council's budgetary requirements going forward. The key areas are:

Pay Awards

The Council's financial projections assume an annual pay award of 2% for all categories of staff, with each additional 1% adding around £2.4m to the pay bill. The 2021 pay award has still to be settled, with the current offer from the employer side as follows:

Staff earning under £25,000	£850 flat rate award
Staff earning between £25,000 and £40,000	2%
Staff earning between £40,000 and £80,000	1%
Staff earning over £80,000	£800 flat rate award

As part of the offer, the pay award would be backdated to 1 January 2021, although this backdated element would not be consolidated in pay rates going forward. It is estimated that the consolidated element of the pay award offer equates to around 3% on the pay bill, resulting in a 1% shortfall against the budgetary allowance. This shortfall would have to be absorbed in the current financial year and reflected in future years' revenue budgets. At this stage, no additional funding from the Scottish Government has been confirmed to help meet any additional costs arising from the 2021 pay award. Looking ahead, inflationary pressures in the economy are likely to impact on future pay awards.

National Insurance / Social Care Levy

In September 2021, the UK Government announced a 1.25% increase in employee and employer national insurance contributions, to help fund the escalating costs of health and social care. The increased contribution rates will apply from 6 April 2022 but will be replaced with a new Health and Social Care Levy from 6 April 2023, which will operate in the same way. The estimated annual additional cost to the Council is £1.7m. It is understood that the UK Government has provided additional funding to help meet this new cost pressure and that the Scottish Government has received additional funding as a result of Barnett Consequentials. As this stage, there is no firm indication as to whether the Scottish Government will provide additional funding to Councils to help meet this new cost pressure.

Energy Costs Inflation

In line with the Council's approved Long-Term Financial Strategy, the Council's financial projections include only limited allowances for specific areas of price inflation. There are, however, emerging inflationary pressures in the economy with general inflation forecast to peak at 4.4% in the 2nd quarter of 2022. A specific area of concern for the Council is around energy costs, where supply-side issues in the sector have led to significant price increases. It is currently forecast that the Council will experience electricity and gas prices increases of 12% and 24% respectively for the 2022/23 financial year. Actions are on-going across the Council to maximise energy efficiency and reduce the Council's property foot-print, however it will not be possible to absorb the projected tariff increases within existing budget levels.

Grant Funding

The Council's financial projections assume that annual grant settlements from the Scottish Government will be flat in cash terms. There is a real risk, however, that the Council will suffer a cash-terms reduction in its grant settlement for 2022/23. This could arise due to the overall level of the settlement being worse than flat cash and / or the effects of grant distribution using the latest spending needs assessment indicators. There is a further risk around the operation of the grant floor mechanism which has, in recent years, limited the Council's grant losses arising from grant distribution. If the floor were to be set at a lower level than previously (in relation to the overall movement in the grant settlement), then the Council would suffer a higher reduction in grant. To illustrate the magnitude of the risk around grant funding, a 1% reduction would equate to a loss of income for the Council of around £3m.

Taking all of the above factors into account, the current estimate of savings required to achieve a balanced budget in 2022/23 is in the range £10.4m to £14.7m.

7.2 The figures in paragraph 7.1 above do not include any allowance for the additional income that would be generated by an increase in the Council Tax. A 1% increase in the current Council Tax level would generate net additional income of around £0.560m. It should be noted that, as part of the 2021/22 local government finance settlement, Councils received additional funding to allow them to freeze Council Tax levels.

7.3 The Council is continuing to incur a significant amount of additional costs in the current financial year related to Covid-19, including reduced income streams in many areas. Some of these cost pressures will continue beyond the end of the current financial year and into 2022/23, and possibly even beyond. Specifically, it is anticipated that shortfalls in some income streams (eg car parking, building control, trade waste collection etc) will not recover fully in the short to medium term due to the continuing economic downturn and new ways of working post-Covid 19 (eg more homeworking). This is a particular concern for Leisure and Culture Dundee, where it is anticipated that an income shortfall may occur across several financial years. The figures in paragraph 7.1 above do not include any allowance for additional costs relating to Covid-19. For the purposes of the Council's financial projections, it is assumed that additional costs related to Covid-19 can be met from confirmed Government funding and from the amounts ear-marked within General Fund balances.

8.0 LONG-TERM FINANCIAL STRATEGY

8.1 The long-term financial outlook and financial strategy for 2020 to 2030 were set out in Report 274-2019, which was submitted to the Policy and Resources Committee on 19 August 2019 (article XII refers).

8.2 The updated approved Long-Term Financial Strategy was set out in Report 62-2021 which was submitted to the Policy and Resources Committee on 22 February 2021 (article V refers), as follows:

- the Council's corporate approach to identifying savings and efficiencies will be coordinated through the Changing for the Future transformational change programme (C2022) as agreed by Committee on 25 June 2018 (Article V of the minute of meeting of the Policy and Resources Committee of 25 June 2018, Report 223-2018 refers).
- the Organisational Change Fund, together with any capital receipts set aside to fund costs associated with future transformation projects, will help support and resource, on a spend-to-save basis, the organisational transformation that will be needed to deliver the required savings and efficiencies. This may include costs associated with VERs / VRs however, if no balances are available, then the initial costs associated with VERs / VRs will normally be met from service revenue budgets. On-going staff costs savings from VERs / VRs will be reflected in service revenue budgets.
- the Council will set annual balanced budgets, taking on board the prevailing constraints e.g. limits on Council Tax increases, reducing grant settlements, unavailability of balances etc.
- the Council will seek to achieve an overall outturn position each year in line with or below budget.
- the minimum uncommitted element of the General Fund balance will be the lower of £7 million or 2% of budgeted revenue expenditure but, ideally, a higher level will be held for operational purposes.
- services will be expected to operate within the limits of their overall revenue budget allocation. Cost pressures which emerge in-year should, where possible, be accommodated within the relevant service revenue budgets. The General Contingency should normally be used to fund items of a non-recurring or emergency nature. Expenditure of a recurring nature should normally be funded from within service revenue budgets.
- allocation of resources will be informed by a thematic approach designed to reflect the strategic priorities of the Council.

- budget provision will be made for estimated pay awards and, in limited circumstances, for areas of specific price inflation. The costs of incremental progression for staff will be funded from service revenue budgets.
- demographic growth will not be funded given the scale of the financial challenge. All services are expected to redesign services and work in partnership with other bodies to meet the cost of additional pressures.
- the reduction of grant that the Council receives after providing for new responsibilities will be shared by all directly provided and commissioned services, including Health and Social Care, Leisure & Culture Dundee and the Third Sector.
- Council Tax levels are planned to be increased by at least 3% per annum, but annual increases may be higher if allowed under the terms of the local government finance settlement.
- a review of resources within the Council will be undertaken to look at ways to deliver services more efficiently and effectively. Given employee costs currently account for around 65% of the net revenue budget, there is likely to be a significant reduction in the workforce of the Council.
- the Council's Capital Plan will be prudent, sustainable and affordable. In particular, affordability will be assessed with reference to the level of loan charges and additional running costs (including lifecycle maintenance) that can be reasonably included within future revenue budgets.
- the Council's immediate planning horizon for revenue expenditure will be three years and a rolling three-year revenue budget will be prepared annually and submitted to the Policy & Resources Committee as part of the budget approval process. In addition, projections covering a rolling ten-year period will be maintained and submitted, as necessary, to the Policy & Resources Committee.
- proposals for service re-design and service development will be underpinned by a comprehensive and robust business case, including options appraisal.
- the budget deficit associated with Covid-19 will be funded by applying one or more of the financial flexibilities made available by the Scottish Government.

9.0 **NEXT STEPS**

9.1 The next key budget milestone for the Council will be the Scottish Budget announcements, expected on 9 December 2021. These announcements will include aggregate capital and revenue figures for local government, but no detail on individual Council allocations. It is expected that the Scottish Government will also publish its Medium-Term Financial Strategy on this date. Details of individual Council allocations will be formally notified through the issue of a Scottish Government Finance Circular on 20 December 2021. The Local Government Finance Settlement will cover 2022/23 only, with little or no detail expected at this stage around future funding levels beyond then. The Scottish Parliament's budget scrutiny and approval processes will take place throughout January and into February, although there is, as yet, no detailed parliamentary timetable for the Budget Bill legislation.

9.2 A report will be submitted to the Policy and Resources Committee on 10 January 2022, detailing the Council's grant settlement for 2022/23 and the associated implications. This report will also include the proposed procedure for setting the Council's Revenue Budget and Council Tax for 2022/23. It is anticipated that the Policy and Resources Committee will meet on 24 February 2022 to set the Council's 2022/23 Revenue Budget and Council Tax.

10.0 **LOOKING TO THE LONGER TERM**

10.1 The Council's long-term financial outlook and financial strategy for 2020 to 2030 were set out in Report 274-2019, which was submitted to the Policy and Resources Committee on 19

August 2019 (article XII refers). Since then, the Council has continued to prepare 3-year revenue budgets and update its Long-Term Financial Strategy, based on the best information available. However, uncertainty regarding the longer-term financial impact of the Covid-19 pandemic has, to date, precluded any review of the 10-year projections.

10.2 The Scottish Government will publish its Medium-Term Financial Strategy on 9 December 2021. It is anticipated that this will be followed in the Spring of 2022 by a multi-year Spending Review, including 3-year grant allocation figures for Councils. This information, should it become available, would greatly assist the Council in updating its longer-term financial projections and strategies, to reflect the post-Covid landscape.

10.3 Audit Scotland's 2020/2021 Annual Audit Report was submitted to the Scrutiny Committee on 17 November 2021. This report made reference to the fact that the Council's Long-Term Financial Strategy has not yet been updated to reflect the impact of the Covid-19 pandemic. The report also included a related recommendation and the Council has responded positively, stating that the long-term forecast will be updated and reported to elected members, by September 2022.

11.0 **CONCLUSION**

11.1 The Council is facing a significant challenge to deliver a balanced budget in 2022/23, against a back-drop of significant risk and uncertainty around the continuing impact of Covid-19, Brexit, government grant support, pay awards and inflation. There is a real risk that the actual grant reductions could be more severe than those currently being assumed.

12.0 **POLICY IMPLICATIONS**

12.1 This Report has been screened for any policy implications in respect of Sustainability, Strategic Environmental Assessment, Anti-Poverty, Equality Impact Assessment and Risk Management. There is a real risk that the actual grant reductions could be more severe than those currently being assumed.

13.0 **CONSULTATION**

13.1 The Council Management Team have been consulted on the content of this report.

14.0 **BACKGROUND PAPERS**

14.1 None.

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26 NOVEMBER 2021

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