ITEM No …11……….

REPORT TO: **POLICY & RESOURCES COMMITTEE – 19 NOVEMBER 2018**

REPORT ON: **FINANCIAL OUTLOOK 2019-2022**

REPORT BY: **EXECUTIVE DIRECTOR OF CORPORATE SERVICES**

REPORT NO: **339-2018**

1.0 PURPOSE OF REPORT

This report advises members of the financial outlook at a national level for the three year period 2019-2022 and beyond. The report also outlines the current position on the Council's Revenue Budget for 2019-2022, in light of projected grant settlement figures.

2.0 RECOMMENDATIONS

It is recommended that the Committee:-

2.1 Notes the current position on the Council's Revenue Budget for 2019-2022.

2.2 Notes the financial outlook at a national level for the three year period 2019-2022 and beyond.

2.3 Notes the range of projected savings and efficiencies that may be required over the next three financial years in order to deliver a balanced budget.

2.4 Agrees the Council's updated Medium Term Financial Strategy, as set out in Section 9 of this report.

2.5 Notes that a further report will be submitted to the Policy & Resources Committee on 7 January 2019, detailing the Council's actual grant settlement for 2019/20 and the associated implications. This report will include the proposed procedure for setting the Council's Revenue Budget and Council Tax for 2019/20.

3.0 FINANCIAL IMPLICATIONS

3.1 Based on current projections of budgetary requirements and available grant funding, the following range of projected savings and efficiencies may be required over the next three financial years in order to achieve a balanced budget:

	Cum Savings Required - Flat Cash Settlement (£m)	Cum Savings Required - 1% Grant Reduction (£m)	Cum Savings Required - 2% Grant Reduction (£m)	Cum Savings Required - 3% Grant Reduction (£m)
2019/20	11.8	14.7	17.6	20.4
2020/21	27.7	33.4	39.1	44.7
2021/22	37.2	45.7	54.0	62.1

4.0 BACKGROUND

4.1 The Council's 2018/19 Revenue Budget was approved by the Policy & Resources Committee on 22 February 2018. The overall figures were as follows:

	£m
Net Revenue Expenditure	351.085
Funded by:	
General Revenue Funding / Non Domestic Rates	286.851
Council Tax	64.234
Total Funding	351.085

The above figures highlight the significance of central funding in local authority budgeting, with over 80% of the Council's net revenue expenditure requirement being met by Scottish Government funding.

4.2 The Council's medium term financial strategy states that:

"The Council's immediate planning horizon for revenue expenditure will be three years. In the continuing absence of three year grant allocations from the Scottish Government, years two and three of the budget period will, by necessity, be provisional in nature."

A three year Revenue Budget, covering the period 2018-2021, was presented to the Policy & Resources Committee on 22 February 2018. This three year Revenue Budget will be updated on a rolling basis. In light of the on-going uncertainties regarding public sector funding levels, the Scottish Government has for a number of years now issued grant settlements for one year only. It is anticipated that a one year grant settlement (for 2019/2020) will be announced by the Scottish Government in December 2018.

4.3 The Accounts Commission's report *Local Government in Scotland: Performance and Challenges* (March 2017) highlighted the importance of medium to long term financial planning given the continuing pressures that Councils face into the future. The Accounts Commission recommend that when future Scottish Government funding is not known, Councils should plan for a range of possible scenarios so they are prepared for different levels of funding.

There were further references to longer term financial planning in Audit Scotland's 2017/18 Annual Audit Report on Dundee City Council. Audit Scotland concluded that the Council's financial position is sustainable, currently and in the foreseeable future. However, rising demand, increasing costs of services and reduced central funding will continue to place a strain on the Council's capacity to deliver services at the current levels. Audit Scotland reported that the Council's new arrangements around three year revenue budgets and scenario planning are a positive step towards longer term financial planning and also identified some further improvements could be made. Accordingly, it was recommended that medium to longer term financial planning be further developed within the Council.

4.4 In May 2018, the Scottish Parliament Information Centre (SPICe) published its annual "Local Government Finance: Facts and Figures" report, covering the period 2013/14 to 2018/19. In terms of Local Government in Scotland as a whole, the key findings from the report include:

- between 2013/14 and 2017/18 there was a 7.1% reduction (-£745m) in the local government revenue settlement, but a small increase (0.3% or £29m) between 2017/18 and 2018/19
- between 2013/14 and 2017/18 the local government revenue settlement reduced at a much steeper rate (-7.1% or -£745m) than the overall Scottish Government revenue budget (-1.8% or -£547m), but there was a small reversal in the position between 2017/18 and 2018/19
- the local government revenue settlement, expressed as a proportion of the total Scottish Government revenue budget, reduced by 1.9% between 2013/14 and 2017/18, but increased slightly (0.2%) between 2017/18 and 2018/19

Despite the challenging financial climate which the Council has faced in recent years, the Council has achieved the required financial savings whilst transforming services.

(Note: all figures are expressed in real terms)

These figures illustrate the financial challenges that local government in Scotland has faced in recent years, with grant settlements falling in real terms and the share of the overall Scottish Government budget also reducing.

4.5 This report continues the process of looking ahead over next three financial years (2019-2022) and beyond, by setting out the current projections and the risks / uncertainties around both the expenditure and funding sides of the revenue budget.

5.0 **EXPENDITURE (PROVISIONAL REVENUE BUDGET 2019-2022)**

5.1 As noted in paragraph 4.2 above, three year budget projections are being updated on a rolling basis. For the three year period 2019-2022, the current total Revenue Budget requirements are as follows:

	Total (m)	Annual Increase (£m)	Cumulative Increase (£m)
2018/19 (Final)	351.1	-	-
2019/20 (Provisional)	362.9	11.8	11.8
2020/21 (Provisional)	371.9	9.0	20.8
2021/22 (Provisional)	381.4	9.5	30.3

5.2 The above figures represent the estimated cost of continuing to provide the current level of services (as reflected in the 2018/19 Final Revenue Budget) and also include the following:

i) the full year effect of savings and cost pressures that were already reflected in the 2018/19 Final Revenue Budget
ii) a 3% annual allowance for pay awards for all categories of staff – this is a particular risk area given that every additional 1% adds around £2.1m to the Council's pay-bill
iii) allowances for price inflation on specific budget heads
iv) a 2% annual increase in chargeable income arising from the annual review of charges exercise
v) the on-going effect of unavoidable cost pressures and savings reflected in the current year revenue monitoring
vi) new costs pressures and savings that will arise over 2019-2022, including an increase in the employers contribution rate for teachers pensions which will add £3.2m per annum to the pay-bill from 1 April 2019. Discussions are on-going at a national level with the Scottish Government around possible additional funding to help offset this particular cost pressure.
vii) provision for capital financing costs to support the new borrowing included in the 2019-2024 Capital Plan.

5.3 There are risks and uncertainties around all of the above items. The assumptions underpinning the current figures will be reviewed as part of the on-going budget process, particularly to identify any areas where the budgetary impact can be reduced without introducing an unacceptable level of financial risk.

6.0 FUNDING (GRANT SETTLEMENTS 2019-2022)

6.1 **The Scottish Government's Five Year Financial Strategy**
Following on from recommendations from the Budget Process Review Group, the Scottish Government has recently introduced a revised Parliamentary budget process and a year-round approach to budget scrutiny. Part of this process is the annual publication of a Medium Term Financial Strategy (MTFS), setting out broad financial projections for at least 5 years ahead. The Scottish Government's first MTFS, covering the period 2018 to 2023, was published in late May 2018. (Note: all figures in the paragraphs 6.1 to 6.3 are stated on a cash basis). The Resource Budget accounts for over 85% of the total Scottish Government budget and provides funding for the day-to-day costs of public services, including local government. The MTFS includes three different scenarios for the Resource Budget:

	2018/19 £bn	2019/20 £bn	2020/21 £bn	2021/22 £bn	2022/23 £bn	5 Year Increase
Upper Range	28.238	28.736	30.355	33.214	34.189	21.1%
Central Scenario	27.860	28.129	29.510	32.070	32.824	17.8%
Lower Range	27.481	27.522	28.664	30.926	31.458	14.5%

The use of three different scenarios reflects significant uncertainties around the amount of funding that the Scottish Government will have at its disposal over the next five years. The key risk areas are:

i) The amount of Block Grant received from the UK Government, as determined by the Barnett formula and largely dependent upon the amount of UK tax revenues which is, in turn, dependent upon UK economic growth.

ii) The value of the Block Grant Adjustment (BGA). The BGA reflects the fact that an element of the Scottish Government budget is now funded by Scottish tax revenues that were previously retained by the UK Government. The Scottish Government considers that the value of the BGA is the single biggest risk factor, with a potential variance of +/-£930m by 2022/23.

iii) The amount of revenues raised in Scotland from devolved taxation streams, which is largely dependent upon economic growth in Scotland.

iv) The terms of the UK's exit from the European Union (Brexit) and the subsequent impact on economic growth and taxation revenues, both in the UK generally and in Scotland specifically.

6.2 Within the overall funding envelope identified above, the MTFS identifies the following spending priorities for the Resource Budget:

<u>Health</u> – funding shows a 12% increase from £12.87bn in 2018/19 to £14.37bn in 2022/23. This increase is part of the Scottish Government's commitment to increase health spending by £2bn over the term of the current Parliament (2016 to 2021).

<u>Police</u> – an annual budget of around £1bn is shown as growing in line with projected inflation over the 5 year period ie the Scottish Police Authority budget is protected in real terms.

<u>Early Learning & Childcare (ELC)</u> – funding shown as increasing from £96m in 2018/19 to £567m in 2022/23, in line with the commitment to increase funded ELC entitlement to 1,140 hours per year.

<u>Attainment</u> - £750m is being made available over the term of the current Parliament to raise attainment levels and closing the attainment gap.

<u>Higher Education</u> – an annual budget in excess of £1bn to fund 125,000 free places.

<u>Social Security</u> – an annual budget which grows from £0.4bn in 2018/19 to £3.75bn in 2022/23, reflecting the phased transfer of responsibility from the UK Government for a range of benefits. This budget growth accounts for a significant proportion of the overall increase in the Scottish Government's Resource Budget. Social Security's share of the total Resource Budget increases from 1% in 2018/19 to 11% in 2022/23.

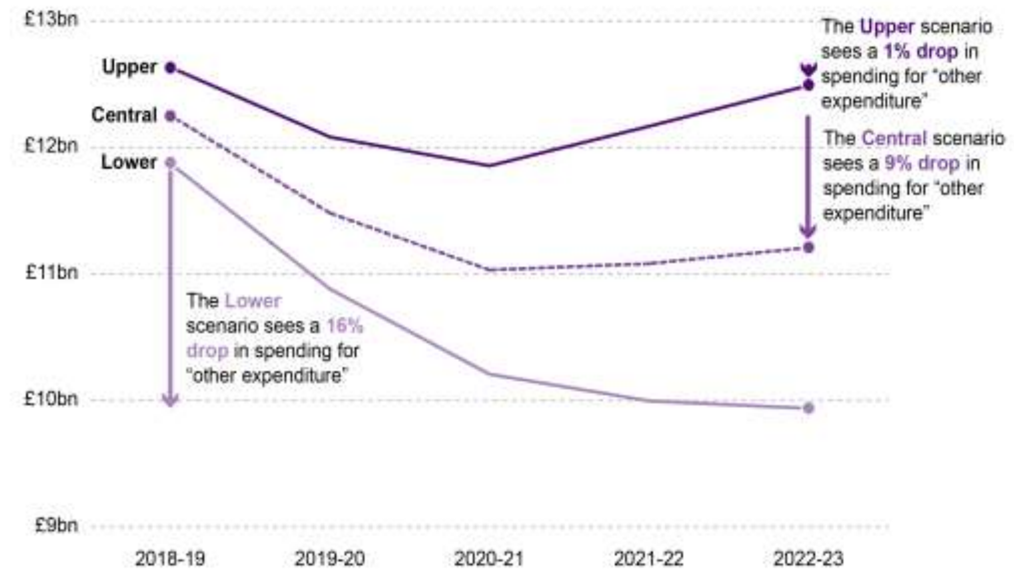
Whilst some of the above priorities are directly relevant to local government (ie ELC and Attainment), it should be noted that the vast majority of the funding for local government sits outwith these priority areas.

6.3 The Scottish Government has assumed that spending on the identified priority areas would remain unchanged under the three scenarios for the Resource Budget. This means that the funding available for other areas, the majority of which relates to local government, is as follows:

	2018/19 £bn	2019/20 £bn	2020/21 £bn	2021/22 £bn	2022/23 £bn	5 Year Movement
Upper Range	12.6	12.3	12.2	12.8	13.4	+6.3%
Central Scenario	12.3	11.7	11.4	11.6	12.0	-2.4%
Lower Range	11.9	11.1	10.5	10.5	10.6	-10.9%

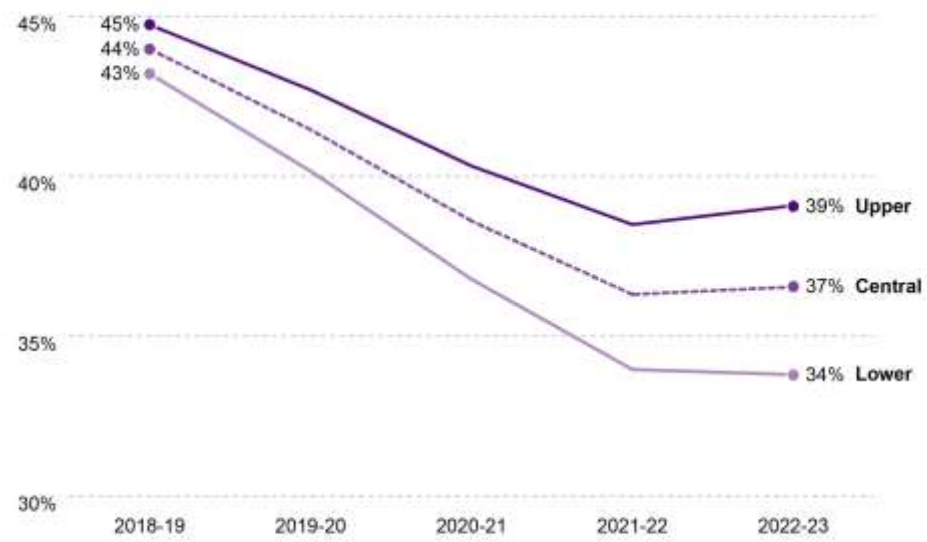
Only under the Upper Range scenario is there a cash increase in funding over the five years, but even then this represents a 1% real terms decrease once inflation is factored in. The real terms decrease under the Central Scenario is 9% and under the Lower Range scenario is 16%. Under the Central Scenario, the share of the total Resource Budget falls from 44% in 2018/19 to 37% in 2022/23. These factors are illustrated in the following charts:

Real terms change in other expenditure areas under different scenarios



Source: SPICe adapted from Scottish Government

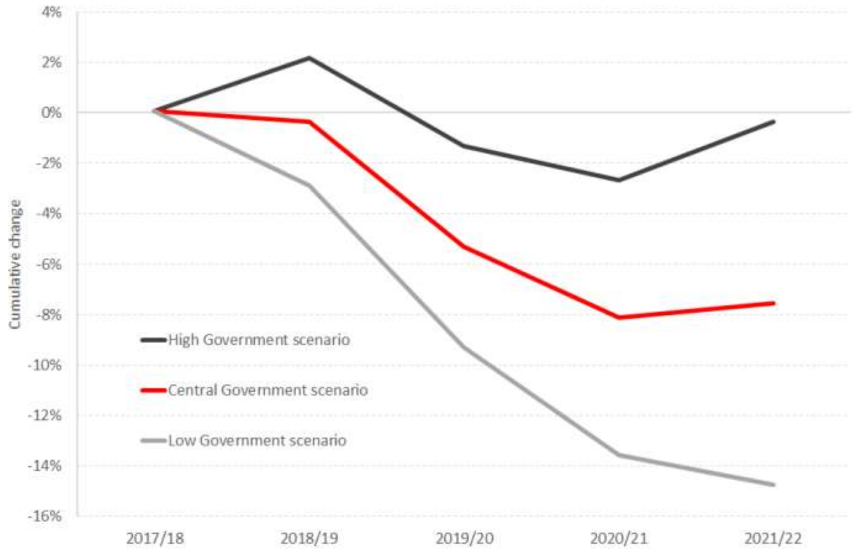
Other expenditure as a percentage of total Resource Budget under different scenarios



Source: SPICe adapted from Scottish Government

6.4 The Fraser of Allander Institute, a leading economic research body, has published a commentary on the Scottish Government's MTFS. In it, they note that once the growth in the Social Security budget is stripped out, the Scottish Government's Resource Budget is expected to be around 0.5% lower in real terms by the end of the current Parliament term, compared to the end of the preceding Parliament. This has significant implications for those spending areas (including local government) that are not included on the list of specific priorities. Under the Central Scenario, the Resource Budget available for these other areas will fall by around 10% in real terms between 2016/17 and 2021/22. Once projections of non-domestic rate income are factored in, the reduction is around 8%. This is demonstrated in the following chart:

Cumulative real terms change in spend on other areas



Source: Fraser of Allander Institute

6.5 It will be appreciated that the impact of protecting certain policy priorities will mean particularly challenging grant settlements for local government over the period of the MTFS.

6.6 **The UK Government's Budget**
The Chancellor of the Exchequer made his annual Budget announcements in the Westminster Parliament on 29 October 2018, including the block allocations for the Devolved Administrations. An updated economic and fiscal outlook was also issued by the Office for Budget Responsibility (OBR).

6.7 The OBR has revised its estimate of UK tax revenues and these are now significantly higher than previously estimated. This has afforded the Chancellor some flexibility, which has been used to bolster public spending levels rather than to help balance the budget. The additional public spending is mainly in relation to the Resource Budget which funds day-to-day spending, with the NHS in England and Wales being the main beneficiary. The Scottish Government budget will benefit from these increased spending commitments through the Barnett formula consequentials, with additional funding of £960m in the period to March 2021 as follows:

	2018/19 £m	2019/20 £m	2020/21 £m	Total £m
Resource Budget	123	720	0	843
Capital Budget	91	4	8	103
Financial Transactions	0	0	14	14
Total	214	724	22	960

Within this amount around £550m arises from increased spending on the NHS in England and Wales, with the majority of the balance relating to local government. It is emphasised, however, that decisions on how the £960m of additional funding is spent in Scotland are a matter for the Scottish Government. Income tax rates and thresholds in Scotland will also be determined by the Scottish Government.

6.8 The total allocation to the Scottish Resource Budget shows a real terms increase of 0.7% between 2018/19 and 2019/20, which is an improvement on the position shown in the previous Budget. The UK Budget also included the announcement of £150m for the Tay Cities Deal. The Scottish Government had previously pledged £200m of funding for the Tay Cities Deal.

6.9 **The Scottish Government's Budget**

The Cabinet Secretary for Finance, Economy and Fair Work will make announcements on the Scottish Budget to the Scottish Parliament on 12 December 2018. This will be followed on 17 December 2018 by notification of provisional grant allocation levels for individual Councils. It is expected that these provisional grant allocations will be for 2019/20 only.

6.10 **The Potential Impact on Dundee City Council**

In light of the limited information currently available and the significant risks and uncertainties set out above, it is prudent to base projections of future funding levels on a range of scenarios, rather than a single, absolute assumption. Accordingly, projections of the Council's grant allocation for 2019-2022 have been made based on four scenarios: a flat cash settlement and annual cash reductions of 1%, 2% and 3%. Two other anticipated high-level changes to grant allocation figures have also been factored in, as follows:

i) removal, from 2020/21 onwards, of Level Playing Field Support for the original 20 year waste-to-energy contract (£2.1m per annum)

ii) reduction, from 2020/21 onwards, in support for loan charges to reflect the pattern of repayment of the Council's debt (£4.8m per annum)

No adjustment has been made for the impact of distributional changes within the grant settlement process. These distributional changes, largely based on various population counts, can have a significant impact of the relative distribution of grant across Councils. The changes are, however, diluted to some extent through the operation of the floor mechanism which affords some degree of protection to those Councils facing the biggest grant reductions.

The projected grant allocation figures are set out in the following table.

	Grant Allocation Based on Flat Cash Settlement (£m)	Grant Allocation Based on 1% Reduction (£m)	Grant Allocation Based on 2% Reduction (£m)	Grant Allocation Based on 3% Reduction (£m)
2018/19 (Final)	286.9	286.9	286.9	286.9
2019/20 (Provisional)	286.9	284.0	281.1	278.2
2020/21 (Provisional)	280.0	274.3	268.6	263.0
2021/22 (Provisional)	280.0	271.5	263.2	255.1

It is emphasised that there is a significant degree of uncertainty over these projections. It is understood that the assumptions underpinning the Council's projections are consistent with those being used by other Councils across Scotland.

7.0 **SAVINGS & EFFICIENCIES REQUIREMENTS 2019-2022**

7.1 Based on current projections of budgetary requirements, ranges of available grant funding and Council Tax income, the following levels of savings and efficiencies may be required in order to achieve a balanced budget over the next three financial years:

	Cum Savings Required - Flat Cash Settlement (£m)	Cum Savings Required - 1% Grant Reduction (£m)	Cum Savings Required - 2% Grant Reduction (£m)	Cum Savings Required - 3% Grant Reduction (£m)
2019/20	11.8	14.7	17.6	20.4
2020/21	27.7	33.4	39.1	44.7
2021/22	37.2	45.7	54.0	62.1

The above projected budget shortfalls are based on a combination of the new Budget requirement shown in paragraph 5.1 and the ranges of reduced grant settlements set out in paragraph 6.10.

7.2 To set these figures in context it is estimated that a 3% increase in Council Tax, all other things being equal, would yield additional income of just over £1,500,000 (after allowing for additional Council Tax reductions). Therefore, most of the savings and efficiencies requirement will have to be found from within the Revenue Budget. There is currently a cap of 3% on annual Council Tax increases in Scotland and it is thought likely that this cap will remain in place, at least for the term of this Parliament.

8.0 RESERVES AND BALANCES

8.1 The Council's audited annual accounts for 2017/18 show the following position on usable cash-backed reserves that are available to fund future revenue expenditure:

Reserve	As at 31 March 2018 (£m)
General Fund - Earmarked	6.837
General Fund - Uncommitted	7.009
Renewal & Repair Fund – General Services Element	2.172
Insurance Fund	1.563
Total	**17.581**

The Council's approved reserve policy is to maintain an uncommitted General Fund balance at a minimum level of the lower of £5 million or 1.5% of budgeted revenue expenditure, but ideally a higher level will be held for operational purposes. The Council's General Fund balance as at 31 March 2018 (£7.009m) exceeds the minimum requirements of the policy.

8.2 In their 2017/18 Annual Audit Report, Audit Scotland noted that although usable reserves had increased in 2017/18, the Council still had the lowest level of total usable reserves (expressed as a percentage of net revenue expenditure) across Scottish Councils. Audit Scotland commented that the Council's flexibility to respond to unforeseen events is limited and that the Council will need to continue to monitor the level of usable reserve held.

8.3 The savings and efficiencies requirements shown in paragraph 7.1 assume that there will be no reserves available to help address the projected budget shortfalls over the next three financial years. Indeed, of light of Audit Scotland's observations, the Council should actually be looking to increase its reserves over the short to medium term.

9.0 MEDIUM TERM FINANCIAL STRATEGY

9.1 The key aspects of the Council's Medium Term Financial Strategy (MTFS) have been set out in various budget reports to the Policy & Resources Committee. The MTFS has been updated to reflect current circumstances and projections, and is as follows:

- the Council's corporate approach to identifying savings and efficiencies will be coordinated through a new Changing for the Future transformational change programme (C2022) as agreed by Committee on 25 June 2018.

- the Organisational Change Fund 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.

- 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 £5 million or 1.5% 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 3% per annum over the next 3 years.

- a review of resources within the Council will be undertaken to look at ways to deliver services more efficiently and effectively. Given employee costs account for around 62% of the net revenue budget, there is likely to be a signification reduction in the workforce of the Council over the next 3 years.

- the initial costs associated with VERs / VRs will be met from service revenue budgets. On-going staff costs savings from VERs / VRs will be reflected in service revenue budgets.

- 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. In the continuing absence of three year grant allocations from the Scottish Government, years two and three of the budget period will, by necessity, be provisional in nature.

- proposals for service re-design and service development will be underpinned by a comprehensive and robust business case, including options appraisal.

It should be noted that many of the above areas are already covered by the Council's Financial Regulations, reflect previous Committee decisions or are in line with established custom and practice.

10.0 THE WAY FORWARD

10.1 A further report will be submitted to the Policy & Resources Committee on 7 January 2019, detailing the Council's actual grant settlement for 2019/20 and the associated implications. This report will include the proposed procedure for setting the Council's Revenue Budget and Council Tax for 2019/20.

11.0 **LOOKING TO THE LONGER TERM**

11.1 In their 2017/18 Annual Audit Report, Audit Scotland recommended that medium to longer term financial planning be further developed within the Council (see paragraph 4.3 above). It will be appreciated that, currently, even short term financial planning is fraught with significant risks and uncertainties, particularly around the impact of Brexit. It is, however, possible to identify some macroeconomic factors that will heavily influence the Council's revenue budget over the medium to longer term, both on the expenditure and funding side.

Pay Awards – the Scottish Government removed its 1% pay cap in the 2018/19 budget round and it is likely that there will be a growing expectation that annual pay awards will increase going forward, returning to a level that is in line with inflation (or even exceeds it). The Council's annual revenue budget requirement increases by £2.1m for every 1% of pay award.

Inflation – latest forecasts from the OBR show UK inflation hovering around the 2% mark up to 2024, which is within the 1% to 3% target that the UK Government has set for the Bank of England. Any increase in inflation could put pressure on future pay awards, as well as on the general cost base.

Interest Rates – the Bank of England raised the base lending rate from 0.5% to 0.75% in August 2018 and this could be a signal of a slow return to "normal" rates, with commentators predicting a rate in the longer term of between 2% and 3%.

Economic Growth – projections published by the Scottish Fiscal Commission (SFC) show Scottish GDP growth at below 1% per annum for the foreseeable future, which is below the figure for the UK economy (which is itself sluggish in growth terms). These factors could constrain the level of taxation revenues that are available to fund public services. At a more local level, slow economic growth could impact on the Council Tax base and the amount of local taxation revenue.

The Local Taxation Base – CoSLA have long campaigned for an increase in the local taxation base to reduce local government's dependence on government grant and to strengthen local accountability. Recent focus has been on a Transient Visitor Tax (TVT), which would be a levy on visitors and is becoming increasingly common across the globe. The First Minister recently announced that there would be a "national conversation" on TVT and the Cabinet Secretary for Finance, Economy and Fair Work has stated that this would explore the benefits and drawbacks on all sides.

Demographics – the ageing population and its impact on public services are well documented, with particular service and cost implications for local government and the NHS. The National Records of Scotland (NRS) recently published updated projections of Scottish household numbers and age distributions across Scotland. These show the following projected increase in households for Scotland:

Category	**Increase**
All Households	5% by 2023
Households Aged 60-74	9% by 2023
Households Aged 75+	17% by 2023
Households Aged 75+	72% by 2041

12.0 **CONCLUSION**

12.1 The Council is facing a significant challenge to deliver a balanced budget over the next three years and beyond. This is due to anticipated inflationary pressures and other cost pressures, together with projected annual cash reductions in grant funding or, at best, flat cash settlements.

13.0 **POLICY IMPLICATIONS**

13.1 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.

14.0 **CONSULTATION**

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

15.0 **BACKGROUND PAPERS**

15.1 None.

GREGORY COLGAN
EXECUTIVE DIRECTOR OF CORPORATE SERVICES **8 NOVEMBER 2018**