Governance, Risk and Best Value Committee

10.00am, Tuesday 11 October 2022

Revenue Budget Framework 2023/27: progress update – referral from the Finance and Resources Committee

Executive/routine	
Wards	
Council Commitments	

1. For Decision/Action

1.1 The Finance and Resources Committee has referred a report on the Revenue Budget Framework 2023/27: progress update to the Governance, Risk and Best Value Committee for scrutiny as part of its work programme.

Richard Carr
Interim Executive Director of Corporate Services

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Referral Report

Revenue Budget Framework 2023/27: progress update – referral from the Finance and Resources Committee

2. Terms of Referral

2.1 On 8 September 2022, the Finance and Resources Committee considered the Revenue Budget Framework 2023/27: progress update report. The report provided updates on the outcome of the most recent review of the Council's financial planning assumptions, resulting in an increased estimated savings requirement of £70.4m in 2023/24 and £152.9m by 2026/27. An update was also provided on the development of the Council's Medium-Term Financial Plan.

2.2 The Finance and Resources Committee agreed:

2.2.1 To note the updates to financial planning assumptions set out in the report, resulting in increased overall estimated savings requirements of £70.4m in 2023/24 and £152.9m over the period to 2026/27 respectively.

2.2.2 To note the further risks outlined in the report, particularly those in respect of inflationary-linked pressures.

2.2.3 To note progress in the development of the Council's Medium-Term Financial Plan and the intention to present draft budget proposals for 2023/24 and broad programmes of activity to contribute towards future years' savings requirements at the Committee's meeting on 10 November 2022.

2.2.4 To refer the report to the Governance, Risk and Best Value Committee for scrutiny as part of its work programme.

3. Background Reading

3.1 Finance and Resources Committee – 8 September 2022 - Webcast

3.2 Minute of the Finance and Resources Committee – 8 September 2022

4. Appendices

4.1 Appendix 1 – report by the Interim Executive Director of Corporate Services

Finance and Resources Committee

10.00am, Thursday, 8 September 2022

Revenue Budget Framework 2023/27: progress update

Executive/routine
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1. Recommendations

1.1 Members of the Finance and Resources Committee are asked to:

1.1.1 note the updates to financial planning assumptions set out in the report, resulting in increased overall estimated savings requirements of £70.4m in 2023/24 and £152.9m over the period to 2026/27 respectively;

1.1.2 note the further risks outlined in the report, particularly those in respect of inflationary-linked pressures;

1.1.3 note progress in the development of the Council's Medium-Term Financial Plan and the intention to present draft budget proposals for 2023/24 and broad programmes of activity to contribute towards future years' savings requirements at the Committee's meeting on 10 November 2022; and

1.1.4 refer this report to the Governance, Risk and Best Value Committee for scrutiny as part of its work programme.

Richard Carr

Interim Executive Director of Corporate Services

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Report

Revenue Budget Framework 2023/27: progress update

2. Executive Summary

2.1 The report updates members on the outcome of the most recent review of the Council’s financial planning assumptions, resulting in an increased estimated savings requirement of £70.4m in 2023/24 and £152.9m by 2026/27. An update is also provided on the development of the Council’s Medium-Term Financial Plan.

3. Background

3.1 At the Committee’s meeting on 16 June 2022, members considered an update on the Council’s revenue budget framework, including the results of a review of financial planning assumptions over the period to 2026/27. The report noted that the Scottish Government had confirmed, as part of the Resource Spending Review, that the £120m of additional Scotland-wide funding provided as part of the 2022/23 Scottish Budget’s Parliamentary approval would be baselined, with Edinburgh’s share of £9.7m thus representing a favourable movement relative to these assumptions.

3.2 In view of the range of wider inflationary risks, including but not limited to energy costs and pay, however, the report noted the likelihood that additional recurring funds would be required to manage these pressures and, as a result, the £9.7m of additional grant income noted above has been earmarked for this purpose. As such, the framework continued to show an incremental savings gap of £63m in 2023/24, increasing to £144m over the period to 2026/27.

3.3 The report to the June meeting of the Committee also outlined the current status of discussions with the Scottish Government concerning the basis on which the service concession “financial flexibility” might be made available to councils.

3.4 Given the fast-moving nature of the external environment, a further review of these assumptions has been undertaken and this report sets out the results of this consideration and the proposed next steps in developing measures to address the resulting funding gaps, particularly for 2023/24. An update on the service concession flexibility is also provided.

4. Main report

4.1 The report to the Committee's meeting on 16 June highlighted the main contributing factors to the gap between anticipated expenditure requirements and available funding over the period to 2026/27. The Council continues to face significant financial pressures resulting from increased demand for services, inflation, legislative reform and increased citizen expectations, as well as the on-going financial impacts of the pandemic. These factors are set against a backdrop of core grant funding (accounting for around three quarters of the Council's overall income) that is not increasing. Based on existing planning assumptions, significant cumulative recurring savings are therefore required as shown below:

	2023/24	2024/25	2025/26	2026/27
	£m	£m	£m	£m
Estimated funding gap, June 2022	62.6	88.3	115.8	143.8

4.2 Even within this timeframe, the assumptions underpinning the above gaps are subject to considerable uncertainty with regard, in particular, to the level of required pay award provision, other inflationary pressures and grant funding. The Council's assumptions are, however, regularly reviewed against a range of independent sources and those of other Scottish local authorities, with any material variation from these considered and justified, or the assumptions revised, as appropriate.

4.3 Other planned structural reforms over the period of the current Scottish Parliament, including the creation of the National Care Service (NCS) and replacement of the current Council Tax system, may give rise to further changes. With this in mind, any projections beyond this timeframe are inherently speculative although, based on past years' requirements, available projections and the level of efficiencies assumed by the Scottish Government, an incremental annual requirement of £28m is assumed. This would result in a need to identify recurring savings of £172m over the five-year period to 2027/28 and £312m over the ten-year period to 2032/33 (the latter some 26% of the Council's net budget).

Inflationary pressures

4.4 Even since the approval of the 2022/23 budget, the wider environment within which the Council operates has also been subject to significant change. The UK is facing rates of inflation not seen for many decades, fuelled by supply chain shortages exacerbated by international events, alongside the challenges of recovering from the COVID-19 pandemic.

4.5 Inflation levels affect the Council's activities in a number of ways; directly through increasing prices of purchased goods and services and the level of uplifts applied to relevant contracts and indirectly through consumer spending and expectations for wage awards.

4.6 The rate of inflation for July 2022 as measured by the Consumer Price Index (CPI) was 10.1%, with the Retail Price Index (RPI) standing at 12.3%, the highest such rates since 1982. While the detail of forecasts varies by source, the Bank of England expects CPI to peak at just over 13% in the final quarter of 2022 and not fall back below 10% until the second half of 2023. This emphasises that the Council's assumptions on inflation levels will continue to be a key consideration, at least into the medium term.

PPP contracts

4.7 While in some instances (such as the ICT contract) the uplift to which the Council is exposed is capped, in a number of other cases, such as the PPP1 and PPP2 schools contracts, the applicable uplift is calculated with reference to current actual inflation rates. As the PPP uplift is based on the annual level of RPI in February, this now gives the likelihood of two successive years' significant uplifts. Although the uplift applied in February 2022 was reflected in the report to June's Committee, it is now considered prudent to increase provision for 2023/24 by a further £2.5m.

Energy costs

4.8 The largest single known non-pay pressure facing the Council is energy costs. The report to the Committee's meeting on 16 June estimated a cumulative pressure (relative to the approved 2021/22 budget) of £14m in 2023/24. Updated estimates, however, point to an increase of £1.9m in the likely overall level of pressure in 2023/24 (i.e. to £15.9m) and a further £4.5m in 2024/25, albeit the lower pre-purchased volumes for the later year make these projections inherently more uncertain.

Other inflationary pressures

4.9 Many other areas of the Council's expenditure are also affected by exceptional inflationary pressures. Requests for significant uplifts to existing contract rates have been received in respect of food and catering, fuel and home-to-school transport provision, as well as children's services contracts. While by no means exhaustive, requests across these areas alone have given rise to a £4m annual, and likely recurring, pressure in 2022/23. While service areas are being asked to mitigate these pressures wherever possible in the current year, in light of the projections for inflation to increase and continue at high levels well in to 2023/24, it is now considered prudent to introduce a general inflationary provision of £5m in 2023/24, the need for which will be reviewed as greater certainty is obtained. An element of this provision may also be retained as a contingency against increased demand for Council services.

Homelessness

4.10 A report elsewhere on today's agenda points to estimated pressures of £5.5m in homelessness services in 2022/23. The budget framework assumes a reduction of

£3m in the level of homelessness service investment in 2023/24 relative to 2022/23, based on an assumption that demand would begin to reduce following the relaxation of public health restrictions introduced at the outset of the COVID pandemic.

4.11 At this stage, however, estimated gross pressures in 2023/24 have increased to £13m above the base budget assumption, with the main elements comprising:

(i) **households in temporary accommodation** – an anticipated in-year increase of 120 households in 2022/23, alongside an assumption of no change in the number of clients with no recourse to public funds (NRPF) being accommodated, would give rise to a combined pressure of £5.6m. There is the potential for this pressure to grow further when the removal of "local connection" takes effect from November 2022;

(ii) **contract inflation** – the majority of the estimated pressure of £4.5m in this area relates to the pass-through of increased utility costs from temporary accommodation providers;

(iii) **support for rough sleepers** – a pressure of £1.9m is projected on the assumption that costs incurred to provide the Welcome Centre at Haymarket and Housing First service will be met in full by the Council; and

(iv) **preventative support, advice and income maximisation services** – investment of £1.2m is required to replace time-limited funding in these areas which has delivered estimated net financial benefits of £1.27m over a twelve-month period.

4.12 A more detailed report, including options for the mitigation of demand-led pressures, will be considered by the Housing, Homelessness and Fair Work Committee on 29 September.

Budget framework provision for continuing COVID impacts

4.13 The budget framework currently provides for £11m of continuing COVID impacts in 2023/24, reducing to £9m in 2024/25 and continuing at that level thereafter. Based on an analysis of the 2021/22 outturn and relevant forward projections, it is proposed to re-align this provision as follows, the appropriateness of which will be kept under review:

	2023/24
	£m
Lothian Buses - loss of dividend	6.0
Reductions in parking income	3.0
ALEO support	2.0
Total funding for COVID impacts	**11.0**

4.14 At this stage, allocation of the £9m in 2024/25 is assumed to comprise £6m for continuing loss of the Lothian Buses dividend, £2m for reductions in parking income and £1m for ALEO support.

4.15 As each of these reallocations is within the existing level of provision, there is no change to the overall funding gaps in these years.

Pay award, 2022/23

4.16 The 2022/23 revenue budget monitoring report elsewhere on today's agenda notes that COSLA, as employer, has now made a pay offer for 2022/23 of an overall value of 5%, alongside increasing the Scottish Local Government Living Wage to £10.50 per hour. When the Council's baseline assumption of 3% and a recurring Scottish Government contribution equal to 1.5% of the overall Local Government paybill are offset against this offer, a 0.5% shortfall remains. Based on the Council's in-scope employee cost budget, this equates to a recurring shortfall of up to £3.1m, depending upon the allocation basis agreed by COSLA Leaders, subject to compounding thereafter. It is also worth emphasising that continuing high inflation rates are likely to put pressure on the level of award for 2023/24, where provision for an average increase of 3% is included in the budget framework.

Revised gap before mitigations

4.17 The additional pressures noted in the preceding sections would give rise to increased revised gaps before mitigations over the years of the framework as follows:

	2023/24	2024/25	2025/26	2026/27
	£m	£m	£m	£m
Updated estimated funding gap, June 2022	**62.6**	**88.3**	**115.8**	**143.8**
Increases in provision:				
PPP contracts	2.5	2.5	2.5	2.5
Energy costs	1.9	6.4	6.4	6.4
Other inflationary pressures	5.0	5.0	5.0	5.0
Homelessness services	13.0	13.0	13.0	13.0
Pay award, 2022/23 – recurring impact	3.1	3.2	3.3	3.4
Revised gap before mitigations	**88.1**	**118.4**	**146.0**	**174.1**

4.18 In view of the extent of these additional pressures, a thorough review of corporate budgets and reserves has been undertaken, including consideration of any favourable variances apparent in 2022/23 that would be expected to recur. This consideration has resulted in the following savings being identified at this time:

(i) **Council Tax** – a favourable variance against budget of £3m is being forecast in 2022/23. Based on an assessment of the level of buoyancy (i.e. changes in the size and profile of the Council Tax base) implicit in existing projections, additional income of £3m is anticipated in 2023/24 relative to these assumptions, increasing to £5m by 2026/27;

(ii) **Investment income** – following recent increases in interest rates, the Council's available cash balances have generated additional investment income. While the level of this additional income will reduce over time as these sums are applied to support the capital programme in lieu of undertaking external borrowing, additional income of £1.5m is anticipated in 2023/24, reducing by £0.5m each year thereafter;

(iii) **Millerhill Recycling and Energy Recovery Centre** - the Council is entitled to a share of the net income generated by the facility under a heat off-take agreement, estimated at £2m for each year of the budget framework. Additional details are included in a separate report elsewhere on today's agenda;

(iv) **Inflationary provisions/additional income** – a number of inflationary provisions contained within the budget framework have not yet been fully utilised or have been supplemented by the receipt of external income. These include a residual element of the sums put aside to address the increase in employer's National Insurance rates from April 2022, sums originally earmarked to meet increases in the Non-Domestic Rates poundage (where these then decreased in 2021/22 and have only returned to 2020/21 levels in 2022/23) and a redirection of additional provision made for demographic-related demand where updated projections suggest this may not be required. Taken together, these measures provide savings of £6.2m in 2023/24, increasing to £9.2m by 2026/27; and

(v) Application of the **budget framework risk contingency** for 2023/24, reducing the residual gap by £5m in each of the years of the framework.

4.19 The net effect of these mitigations is summarised in the table below:

	2023/24	2024/25	2025/26	2026/27
	£m	£m	£m	£m
Updated estimated funding gap before mitigations, September 2022	**88.1**	**118.4**	**146.0**	**174.1**
Offset by savings as follows:				
Council Tax	(3.0)	(4.0)	(4.5)	(5.0)
Investment income	(1.5)	(1.0)	(0.5)	0.0
Millerhill heat off-take agreement	(2.0)	(2.0)	(2.0)	(2.0)
Inflationary provisions/additional income	(6.2)	(7.2)	(8.2)	(9.2)
Risk contingency	(5.0)	(5.0)	(5.0)	(5.0)
Revised gap after mitigations	**70.4**	**99.2**	**125.8**	**152.9**

4.20 The revenue budget outturn 2021/22 report elsewhere on today's agenda indicates that the actual net in-year call on the Council's COVID reserves was some £30m[1] less than assumed at the time of setting the 2021/22 budget. While, by definition, not a sustainable funding source, these reserves are therefore also available to offset costs or loss of income due to COVID over the period to 2026/27.

Edinburgh Integration Joint Board (EIJB)

4.21 The Chief Finance Officer of the EIJB presented a Finance Update to the Board's most recent meeting on 9 August 2022. While focusing primarily on achieving a balanced position for 2022/23, the need to develop a sustainable medium-term plan has been acknowledged and corresponding updates will therefore be provided to the Board as this progress develops.

Links to capital programme

4.22 A report elsewhere on today's agenda highlights an expectation that the current capital programme will come under further financial pressure as a result of higher tender prices caused by current market conditions. This will result in a need to consider re-profiling of priorities, reduction in scope of projects and/or additional revenue savings to fund the borrowing costs to deliver the Capital Budget Strategy to comply with the terms of the Prudential Code. This is likely to mean that later phases of the programme will be unable to be delivered within the ten-year strategy.

Service concession financial flexibility

4.23 The report to the Committee's last meeting confirmed that the Cabinet Secretary for Finance and the Economy had agreed to the main elements of COSLA's request on changes to accounting for service concession arrangements, thus allowing councils to spread the principal element of capital repayments over the (longer) life of the asset as opposed to the existing contract term. The Scottish Government has now issued a consultation draft Finance Circular outlining the basis of the change and good progress has been made in ensuring the intended flexibility can be effectively applied in practice. As of the time of writing, the finalised guidance has not been issued but a verbal update will be provided at the meeting.

4.24 While it is important to emphasise that the service concession flexibility mechanism is a timing-related one that merely spreads an unchanged overall level of liability over a longer period, modelling is continuing to determine the extent of any potential retrospective and prospective benefit to the Council and the associated required considerations and actions to demonstrate that any decision to adopt is prudent. A more detailed update will be provided in November once this modelling has been completed and necessary clarifications received.

[1] This sum comprises a combination of (i) a lower call in respect of COVID-specific impacts of £13.5m and (ii) savings in service and corporate budgets, reducing by a further £16.3m the level of funding requiring to be drawn down from reserves during the year.

Capital Accounting Review

4.25 The Scottish Government has now confirmed the appointment of an independent chair for the Capital Accounting Review (CAR) which will consider, amongst other things, the on-going appropriateness of statutory mitigation provisions alongside alignment to the Code of Practice on Local Authority Accounting. The Council will be represented on the CAR's working group by the Service Director: Finance and Procurement in his capacity as Chair of the Local Authority (Scotland) Accounts Advisory Committee (LASAAC).

4.26 Statutory mitigation is statutory guidance issued by Scottish Ministers for the accounting treatment for specified transactions or types of transactions undertaken by a local authority. It is usually issued where the accounting practice under the Code has been determined to result in an improper charge against the General Fund in the Local Authority financial statements and thus has a consequential impact on the funding available for the provision of local services.

4.27 While the Scottish Government has re-emphasised that there is no predetermined outcome of the review, there is nonetheless a risk that this outcome will result in a need to review the affordability of councils' existing capital programmes. Members of the Committee will be kept apprised of progress once the review gets underway.

Future years' savings requirements and development of corresponding savings proposals

4.28 The urgent need to initiate a structured medium to longer-term savings programme was highlighted in both the Council's Best Value Assurance Report and the external auditor's report for 2020/21. Since that time, a combination of the on-going impacts of the COVID pandemic and inflationary pressures resulting from global events have only re-emphasised the importance of developing this programme. While the year-on-year progress in savings delivery apparent in recent years[2] has been encouraging, budget implementation plans for 2023/24, particularly those relating to generic cross-cutting themes with implicit departmental savings targets, will also need to be suitably robust, with specific associated actions identified in advance of approval, for inclusion in the budget framework.

4.29 The Scottish Government's Resource Spending Review (RSR) set out clearly the extent of the challenge, with non-prioritised areas (including Local Government) facing significant real-terms reductions in funding over the coming years. Since its publication at the end of May, however, these inflation-driven pressures have only intensified and are anticipated to last well into 2023.

4.30 The Scottish Government has indicated that, in the absence of any additional block grant funding provided in recognition of these pressures, it can only improve pay deals for public sector workers in Scotland through deep cuts to public services. As has been indicated in previous reports, while opportunities for

[2] Some 89% of approved savings for 2021/22 were delivered during the year, compared to 80% in 2020/21, 77% in 2019/20 and 60% in 2018/19.

efficiencies will be examined in the first instance, members will therefore likely need to make increasingly difficult choices about the Council's priorities, including considering service reductions, across all service areas to maintain expenditure in line with available income.

Council's Medium-Term Financial Plan

4.31 Given this backdrop, work is continuing to develop the Council's Medium-Term Financial Plan (MTFP) to deliver a programme of strategic and structural change to address the four-year (medium-term) financial challenge and, more immediately, agree a set of proposals to set a balanced budget for 2023/24. The plan will be framed by a refreshed Business Plan that articulates the Administration's priorities, forms the basis of collaboration amongst political parties and sets out the narrative of a strategic case for change. It is envisaged that the plan will comprise:

(i) a set of fully costed and assessed proposals for budget 2023/24 (year 1); and

(ii) a set of strategic outline business cases for the major change projects that will primarily deliver in years 2 to 4 i.e. 2024/25 to 2026/27 and contribute towards later years' savings requirements.

4.32 A core project team has been established to progress development of the plan, with accountable owners being clearly identified for both Directorate-specific and cross-cutting savings proposals.

4.33 It is the intention, at this stage, to present for members' consideration at the Committee's next substantive meeting on 10 November a set of specific budget proposals for 2023/24 and this proposed longer-term programme of work.

5. Next Steps

5.1 The assumptions within the budget framework will continue to be the subject of regular review and material changes reported to members as appropriate.

5.2 There is an urgent need to identify and develop potential options to address increasing future years' savings gaps. Given the previous low rates of delivery associated with generic Council-wide savings, these proposals need to detail specific steps and measures to support delivery within each Directorate and an update will be provided at the Committee's meeting in November.

5.3 Executive Directors and Service Directors will also require to continue to manage proactively risks and pressures as they relate to their respective areas of responsibility.

6. Financial impact

6.1 The Council continues to face significant financial pressures resulting from increased demand for services, inflation, legislative reform and increased citizen expectations, as well as the continuing financial impacts of the pandemic. These factors are set against a backdrop of core grant funding (accounting for around three quarters of the Council's overall income) that is not increasing.

6.2 While the Council has approved a balanced budget for 2022/23, it faces significant financial challenges going forward. The revised projections in this report indicate a need to deliver at least £70m of recurring savings in 2023/24, increasing to £153m over the period to 2026/27.

7. Stakeholder/Community Impact

7.1 There is no direct relevance to the report's contents.

8. Background reading/external references

8.1 Cost of Living Support – response to a motion from Councillor Biagi, The City of Edinburgh Council, 25 August 2022

8.2 Revenue Budget Framework 2022/27: progress update, Finance and Resources Committee, 16 June 2022

8.3 Revenue Budget Update 2022/23 – Update, Finance and Resources Committee, 3 March 2022

8.4 Coalition Budget Motion 2022/23, The City of Edinburgh Council, 24 February 2022

8.5 Revenue Budget 2022/23 – Risks and Reserves, Finance and Resources Committee, 3 February 2022

9. Appendices

None