

The Highland Council

27 June 2013

Agenda Item	
Report No	

Revenue Budget: Longer-term Financial Planning

Report by Director of Finance

Summary

This report sets out the current forecast for the Revenue Budget for the 5 year period 2014/15 – 2018/19, and outlines an initial strategy for addressing the funding gap.

1. Background

- 1.1 On 7 February 2013 the Council agreed the revenue budget for 2013/14, and noted the proposal within that report to develop longer-term financial planning, covering 5 forward years. Members were advised at that time, that a report would come back to the Council before the summer recess.
- 1.2 This report sets out proposals to take forward longer-term financial planning, covering the years 2014/15 to 2018/19.
- 1.3 As Members will recall, the budget for 2014/15 had been substantially balanced as a result of decisions made in February 2013, however, there remained a residual budget gap (at that time) of £3.3m to be closed for year. This report also sets out an updated position for 2014/15 and proposals to address that remaining budget gap during 2013.

2. Economic Context

- 2.1 It is expected that the current period of austerity and public sector spending restraint will continue for a number of years. The most recent UK Budget, announced on 20 March 2013, confirmed that public sector spending in 2016/17 and 2017/18 would “continue to fall at the same rate as over the Spending Review 2010 period”. (UK Budget – Executive Summary P3).
- 2.2 Many commentators continue to express concerns about the economic growth, inflation and debt assumptions which underpin the Chancellor’s budget, and as such there are concerns that austerity measures may have to continue beyond 2017/18, if the UK Government does not meet its fiscal targets.
- 2.3 UK Government has again indicated its desire to protect Health, Social Care and Schools spending. In terms of Barnett formula consequentials, if this is

the case then this would provide some degree of protection to the Scottish Government budget also. However, the protection of these budgets clearly implies more significant reductions in other areas, the Barnett consequentials of which would also filter through. At this stage it is not known what degree of 'protection' may be offered, but based on recent budget trends it is likely this will be protection in real-terms. Recent years budget announcements, based on similar spending policies, have resulted in the Scottish budget being flat cash in broad terms.

- 2.4 At a UK level, the latest Spending Review, expected to be announced towards the end of June 2013, will determine public spending for 2015/16 and 2016/17, cutting across the period of the next UK election (May 2015). At a Scottish level, the Scottish Government has stated its aim to undertake a budget review, with the expectation this will follow the UK's spending review announcement. At this stage it is unclear if the Scottish Government budget review will be for a single, or 2 forward years.
- 2.5 There is further uncertainty around the impact of the Referendum in 2014, subsequent Scottish and UK elections, and the implications for future grant settlements.
- 2.6 The context facing the Council's longer-term financial planning is therefore an expectation of continued challenging financial settlements, and a degree of uncertainty given future financial settlements may only be known up to and including 2015/16.

3. Financial Outlook

Funding

- 3.1 In relation to grant funding, and based upon the context set out earlier, it would be prudent to assume that the 'flat cash' settlements experienced at present will continue at least until 2017/18. For the purposes of the financial model, it is assumed 2018/19 is flat also. In terms of financial planning, there is a downside risk that public sector reductions may be more severe, the consequences of which have been set out within this report. Any 1% movement in revenue grant support, from the 'flat cash' assumptions, equates to £4.5m.
- 3.2 There is also the potential risk to the previously announced grant settlement for 2014/15. An effect of the UK Government Budget of March 2013 was a reduction in the Scottish Government resource (revenue) budget of £103m. At this stage it is not known what course of action the Scottish Government will take to address the resource budget reduction, but there may be some risk some of this passes through to the Local Government grant settlement. No reduction has been assumed at this time, but if applied would reduce the baseline grant level across the plan period. It is expected that Cosla will mount a strong case to avoid any reduction being applied to grant settlement figures which Council's will have viewed as reasonably firm.

- 3.3 In relation to council tax, for planning purposes, the continuation of the freeze in council tax has been assumed. Grant funding to support the freeze, equivalent to a circa 3% increase in tax income p.a., has to date been built into the grant settlement and it is assumed again within the baseline grant figures modelled. Current rates of housing growth, feeding through to the council tax base, have also been assumed at 0.75% growth p.a.
- 3.4 No income gain from the Non Domestic Rates Incentivisation scheme (BRIS) has been assumed, given uncertainty relating to scheme targets going forward. No use of balances to support the budget has been assumed at this time.
- 3.5 The funding position modelled is as follows.

	2014/15 £m	2015/16 £m	2016/17 £m	2017/18 £m	2018/19 £m
Grant incl NDR income	449.0	449.0	449.0	449.0	449.0
Council Tax	111.8	112.6	113.4	114.3	115.1
Total Funding	560.8	561.6	562.4	563.3	564.1
Year on Year Movement		+0.8	+0.8	+0.9	+0.8
		+0.14%	+0.14%	+0.14%	+0.15%

Budget Assumptions

- 3.6 The following budget planning assumptions, and associated comments and risks, are used for the financial plan. Financial modelling requires the use of assumptions and estimation, and particularly for a longer-term financial model, the further forward assumptions are made, the greater the risks and uncertainties relating to those assumptions. Given the current uncertainty in the economic environment, and in relation to future public sector spending levels, there is the potential for significant volatility in the assumptions used.

Budget Line	Assumption	Comments	Risks	Sensitivity Modelling
Pay Awards	1% p.a.	Continuation of current (2013/14) pay award proposals	Likelihood of achieving 1% p.a. over the 5 years	+/-1% equals c£3.1m p.a.
Inflation	NIL	Continuation of expenditure freeze	Inflationary pressures squeeze spending	+/-1% equals c£2.5m p.a.
Pay Increments & Pensions	c£3.2m p.a.	Average annual cost based on recent year trends	Subject to future staff turnover levels, and pension valuations	10% movement in assumption = £0.3m p.a.
Loan Charges	£2.5m p.a. increase	Estimated average annual increase to meet	Interest rate movements beyond those	1% increase in in-year borrowing

		capital programme	forecast. Changes to capital programme.	cost could equate to c£0.5m increase in loan charges
Budget Pressures	£9m p.a.	Continuation of recent trends in budget requirement	Inflationary and other pressures result in increasing demands	More or less than £9m could be considered. Affordability and demands being main consideration.
Preventative Spend	£3m p.a.	Continuation of current levels of provision	Realisation of savings from investment.	N/A

3.7 Pay award and inflationary pressures, represent the two most significant risks affecting the financial plan. After a period of pay-freeze, and with ongoing price rises affecting consumers, the ability to cap pay settlements at 1% p.a. across the period of the plan is a significant challenge. With pay costs being approaching half of the Council's cost base, rises in pay settlements would have a significant bearing on the outlook. The financial plan continues to assume a cash freeze on all other expenditure budgets (other than pay). With inflation remaining higher than the government's target, the multi-year cash freeze represents a real terms reduction in spending power of those budgets. For wholly unavoidable price rises, for example contracted rates or fuel/energy costs, the Council would consider each case on its merits, to be met from the budget pressures provision.

3.8 During the period covered by the financial plan, other known or potential financial challenges to be considered may include:

- Welfare reform and ongoing risks and challenges to the Council arising from the council tax reduction scheme, 'bedroom tax' and other welfare reform issues.
- Pensions reform and implications for employers, including removing the contracted out-rebate with potential cost impact £5m.
- Capital programme and financing cost risks. While the Council's capital programme makes some provision for an increase in interest rates, and further increases, or any additional demands on capital, may add further pressure to the revenue budget.

3.9 To mitigate risks associated with longer-term forecasting, budget assumptions will be kept under regular review, and as part of the annual budget-setting process the Council will have the opportunity to refine budget assumptions for the short-term period, where greater certainty may be expected. The general provision for pressures and preventative spend, until such time as these are committed, can be viewed as some level of contingency against budget risks.

Budget Forecasts

- 3.10 Based on the assumptions set out above, the following budget forecasts have been developed. The sensitivity modelling comments set out above, give an indication of the financial impact of revising assumptions in light of potential risks to the base assumption. Further details are set out on **annex 1**.

Year	Funding £m	Budget £m	Funding Gap £m
2014/15	560.8	564.4	3.6
2015/16	561.7	581.2	19.6
2016/17	562.5	582.1	19.6
2017/18	563.3	583.0	19.7
2018/19	564.2	583.9	19.7
5 year total			82.2

The total funding gap of £82.2m equates to 14.6% of the current base budget for 2014/15.

2014/15

- 3.11 In relation to 2014/15, the reasons for the change in forecast gap from £3.3m as at February 2013 are as follows.

	2014/15 £m
Forecast budget gap as at February 2013	3.3
Increase in loan charge budget to meet proposed revisions to capital programme (see separate agenda item of this Council meeting)	0.5
Reductions in pay/inflation calculation as a result of changes to the base budget	-0.2
Revised budget gap June 2013	3.6

4. Budget Strategy

- 4.1 The development of a longer-term financial plan, allows the Council the opportunity to take a longer-term view of its budget position, and critically, also develop longer-term solutions to addressing any funding shortfall identified.
- 4.2 The longer-term approach also provides opportunities to more closely align the financial plan with the Council's capital programme, and the Council's 5 year programme – Working Together for the Highlands. This will focus on outcomes and the resources required to deliver these.
- 4.3 The Council has successfully developed a multi-year approach to its budget in recent years, with budget savings developed on a 2 to 3 year basis. This has allowed the Council to take a longer-term approach to achieving savings, and

undertake some more fundamental reviews of the services it provides, and how these are delivered.

4.4 The report to the Highland Council on 7 February 2013 identified a number of further areas for potential future savings which are largely for 2015/16 onwards. Many of these areas required detailed reviews before a decision can be taken and need to be considered from the perspective of service outcomes. Officers are currently undertaking this work and will report their findings in due course. The main areas for further review are summarised below.

- Customer Contact Arrangements - potential for further review, beyond the reviews and savings undertaken to date. Exploring alternative and more efficient mechanisms for the Council's customers to make contact with the Council.
- Sustainable School Estate Review – provision has been made within the capital programme to support this review of the school estate. Revenue consequences of any change, including any savings which may arise, will be considered as part of future years budget planning.
- ASN Provision – a review to look at longer term planning for meeting the needs of children and young people, including purpose built, remodelled and/or upgraded facilities that are better able to meet the identified needs.
- School week – another examination of class contact time and other activities around the school week.
- Out of authority placements – review to explore options to address the service and financial challenges.
- Insurance and risk management – review of insurance and risk management strategy, including approach to self-insurance and excesses.
- Waste Management – Review and re-design of waste treatment service to increase recycling /composting and reduce waste going to landfill. Requires significant capital investment in infrastructure or contractual arrangements with private sector providers.
- Energy generation – exploring options to utilise Council assets from which energy could be generated, and income provided to the budget. To be based on a business case approach considering costs, risks and benefits.

4.5 At the start of the budget process for 2013/14 all Services were asked to identify savings of 5% per annum for the period 2013/14 to 2014/15. A number of proposals were not progressed at that stage, some of which are covered by the reviews referred to at paragraph 4.4. It is intended that these will now be revisited to assess the potential to deliver savings to address the funding gap identified at paragraph 3.10 above.

4.6 At this stage no specific provision has been made for preventative spend beyond 2014/15. Additional funding will require a commitment to continue to switch expenditure towards prevention as well as clarity on the financial implications.

5. Closing the 2014/15 Budget Gap

- 5.1 The budget strategy set out in the previous section focused on the longer-term approach across the 5 year period. In relation to 2014/15 in particular, given the work already undertaken by the Council, and decisions made to date, the remaining budget gap to be addressed stands at £3.6m. This will be actively reviewed over the next few months.
- 5.2 That figure is predicated upon the decision already made by the Council, relating to a package of agreed savings for that year of £12.1m.
- 5.3 As is normal practice the Council would be expected to formally agree the budget and council tax for 2014/15 in February 2014.
- 5.4 In relation to measures to address that budget gap, it is proposed to undertake a thorough review of existing budget assumptions in light of the out-turn for 2012/13. This will determine the need for, and extent of, any further savings.
- 5.5 To achieve a balanced position, however, it will be essential for all Services to manage budget pressures within existing resources, and to deliver the savings of £12.1m that were agreed by the Council in February.

Recommendations

Members are asked to consider this report and:-

- (a) agree the budget strategy outlined in Section 4, and
- (b) agree the action proposed to address the funding gap in 2014/15.

Designation: Director of Finance

Date: 17 June 2013

Author: Brian Porter, Finance Manager

Background Papers: Highland Council Revenue Budget 2013/14 – 2014/15

7 February 2013 HC44-12

<http://www.highland.gov.uk/NR/rdonlyres/E039A9B8->

[0352-4E82-98AB-B7F76BB62A66/0/Item3HC4412.pdf](http://www.highland.gov.uk/NR/rdonlyres/E039A9B8-0352-4E82-98AB-B7F76BB62A66/0/Item3HC4412.pdf)

Annex 1

Roll Forward Budget 2014/15 - 2017/18											
				2014/15	2015/16	2016/17	2017/18	2018/19			
Base budget for year				561.9	560.8	561.7	562.5	563.3			
<i>Roll Forward Adjustments</i>											
Previous year one-off funding from balances				-2.1							
Remove 2013/14 Teacher Induction Scheme funding				-0.5							
				-2.5	0.0	0.0	0.0	0.0	0.0		
Add :	<i>Inflation, Increments & Pensions</i>										
	Pay Awards 1%	Teachers		1.2	1.2	1.3	1.3	1.3	1.3		
		Other Staff		2.2	1.5	1.5	1.5	1.5	1.5		
	Inflation	Other Costs - cash freeze		0.0	0.0	0.0	0.0	0.0	0.0		
		Income		-1.6	0.0	0.0	0.0	0.0	0.0		
	Increments	Teachers		0.7	0.8	0.8	0.8	0.8	0.8		
		Other Staff		1.1	0.9	0.9	0.9	0.9	0.9		
	Pension Increases	Teachers		0.7	0.7	0.7	0.7	0.7	0.7		
		Other Staff		0.0	4.4	0.8	5.9	0.8	6.0	0.8	6.0
Add :	<i>Funding Increases Passed to Services</i>										
	Free Personal & Nursing Care			0.1							
				0.1	0.0	0.0	0.0	0.0	0.0		
Add :	Provision for Budget Pressures (incl £1m contingency 14/15)			7.2	12.0	12.0	12.0	12.0	12.0		
Add :	Preventative Spend			3.0	0.0	0.0	0.0	0.0	0.0		
Add :	Valuation Joint Board Requisition			0.0	0.0	0.0	0.0	0.0	0.0		
Add :	Estimated Increase in Loans Charges				2.5	2.5	2.5	2.5	2.5		
Less :	Savings Already Agreed			-12.1	0.0	0.0	0.0	0.0	0.0		
Estimated Roll Forward Budget				564.4	581.2	582.1	583.0	583.9			
Revenue Grant				449.0	449.0	449.0	449.0	449.0	449.0		
Council Tax											
	Excluding Second Homes			109.2	110.0	110.8	111.7	112.5			
	Second Homes (landbanking)			2.6	111.8	2.6	112.6	2.6	113.4	2.6	114.3
Use of Balances				0.0	0.0	0.0	0.0	0.0	0.0		
Total Resources				560.8	561.7	562.5	563.3	564.2			
Budget Gap				3.5	19.6	19.6	19.7	19.7			