PERTH & KINROSS COUNCIL

21 DECEMBER 2022

REVENUE & CAPITAL BUDGET UPDATE

Contact Officer: Scott Walker, Chief Accountant
(Report No. 22/310)

1. PURPOSE

1.1 This report provides an update on progress with the preparation of the provisional Revenue Budgets for 2023/24, 2024/25 and 2025/26.

1.2 The report also provides elected members with an update on the current financial gap facing the Council and outlines several measures which may contribute towards closing the gap.

1.3 Finally, the report provides an update on the funding of the Council's Capital Budgets.

2. RECOMMENDATIONS

2.1 The Council is requested to:

(i) Note the revenue budget update presented in Section 4 of the report and the proposals illustrated which could potentially be adopted in managing the Council's budget position.

(ii) Approve the mid-range scenario on the Council's forecast consolidated loans fund rate as the basis for decision making on the Capital Budget at the Council meeting on 1 March 2023 – see paragraph 5.11.

3. BACKGROUND

3.1 On 22 June 2022, the Council approved the Financial Strategy which set out a number of principles to assist Medium Term Financial Planning and development of Revenue and Capital Budgets (Report No. 22/141 refers).

3.2 On 28 September 2022 the Council approved the updated Medium Term Financial Plan (Report No. 22/249 refers). Within this update the Council approved the setting of a final revenue budget for 2023/24 and provisional revenue budgets for 2024/25 and 2025/26 on 23 February 2023 (now 1 March 2023).

United Kingdom Autumn Statement

3.3 On 17 November 2022 the Chancellor of the Exchequer delivered the Autumn Statement. According to the Fraser of Allander Institute the policy measures for 2023/24 are largely neutral, with some additional spending compared to previous plans offset by tax rises. In subsequent years, tax rises and spending cuts are planned in order to meet, over the longer term, the Chancellor's fiscal rule that debt should be falling as a percentage of GDP within a five-year window.

3.4 The Autumn Statement did announce some additional departmental spending relative to previous plans, mainly on the NHS and education in England. This additional spending generates consequentials for the Scottish Government of around **£800 million** in 2023/24 and **£600 million** in 2024/25. How this additional funding is allocated will be a matter for the Scottish Government.

Scottish Budget

3.5 It is anticipated that the Scottish Budget will be published on 15 December 2022. A verbal update will be provided at the Council meeting.

4. REVENUE BUDGET 2023/24 TO 2025/26

Council Wide Expenditure Pressures

4.1 The Council is faced with several Council Wide expenditure pressures that it must address in preparing revenue budgets for 2023/24, 2024/25 and 2025/26 as follows –

- A **structural deficit** of **£10.015m** which is a consequence of using Reserves over several financial years to balance budgets.

- In relation to **staff cost expenditure** there is the unfunded element of the 2022/23 pay award of **£1.4 million** which must be funded on an ongoing basis. Furthermore, the Medium-Term Financial Plan assumes a 3% pay award in 2023/24, 2024/25 and 2025/26 which equates to approximately **£7.25 million** each year.

- As an employer, there is a positive impact of the recent reversal of the increase in **national insurance charges** of approximately **£1.5 million** from 2023/24.

4.2 The Council Wide expenditure pressures totalling **£31.665 million** are summarised in the following table.

	23/24 £m	24/25 £m	25/26 £m	Total £m
Structural Deficit	10.015	-	-	10.015
2022/23 Pay Award	1.400	-	-	1.400
Future Pay Awards	7.250	7.250	7.250	21.750
E'ers National Insurance	(1.500)	-	-	(1.500)
Total	**17.165**	**7.250**	**7.250**	**31.665**

Service Delivery Expenditure Pressures and Budget Reductions

4.3 The Executive Leadership Team has prepared revenue budget submissions that are aligned to the Council's new draft Strategic Objectives. Information on the contents of these submissions were shared in a high-level presentation to members of all budget review groups (BRGs) on 7 November 2022.

4.4 These submissions were shared in detail with individual BRGs on 30 November 2022. Since then, officers have met with individual BRGs to provide more details on individual proposals and assumptions. These proposals will evolve in the coming weeks / months as more information on key variables becomes more available, e.g. Scottish Government funding, inflation rates, energy increases.

4.5 The contents of the submissions are summarised in the following table with more analysis set out in **Appendix A** –

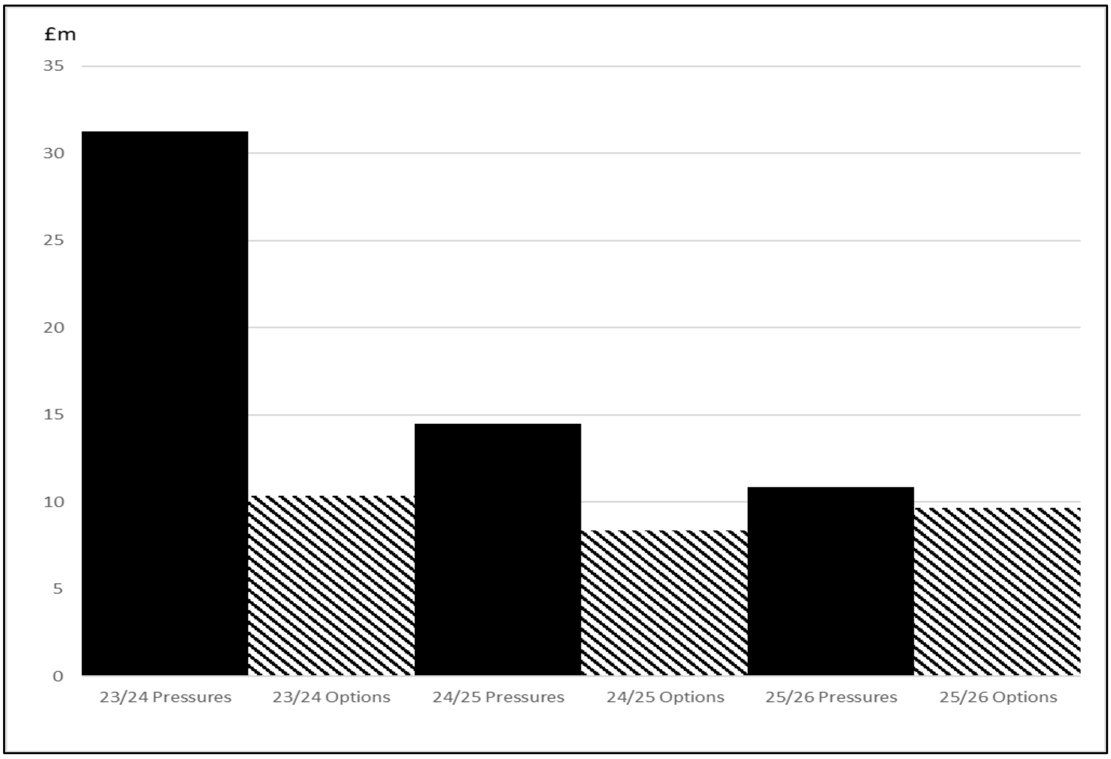
	23/24 £m	24/25 £m	25/26 £m	Total £m
Total Expenditure Pressures	14.111	7.238	3.608	24.957
Total Budget Reductions	(10.374)	(8.364)	(9.686)	(28.424)
Net Movement • positive = increase in deficit • minus = reduction in deficit	**3.737**	**(1.126)**	**(6.078)**	**(3.467)**

Summary of Financial Challenge (as at 15 December 2022)

4.6 When the Council wide pressures set out in paragraph 4.2 are amalgamated with the net Service Delivery position set out in paragraph 4.5, over the next three financial years the Council faces a gap of **£28.198 million**. This assumes that the Council accepts all the budget reduction proposals on 1 March 2023.

4.7 This position is summarised in the following table and graph.

	23/24 £m	24/25 £m	25/26 £m	Total £m
Council Wide Pressures	17.165	7.250	7.250	31.665
Service Delivery Pressures	14.111	7.238	3.608	24.957
Gross Pressures	**31.276**	**14.488**	**10.858**	**56.622**
Total Budget Reductions	(10.374)	(8.364)	(9.686)	(28.424)
Updated Gap	**20.902**	**6.124**	**1.172**	**28.198**



Management / Operational Decisions

4.8 Within the Service Delivery Expenditure Pressures and Budget Reductions summarised in the section above, there are several proposals that are operational in nature. These reductions, totalling **£4.742 million**, are actions that can be put in place by Service Management Teams and have no impact on the delivery of approved Council policy. Examples of the individual proposals are set out in **Appendix B** and the reductions would take effect as follows.

2023/24 £m	2024/25 £m	2025/26 £m
2.158	2.022	0.562

Options for Managing the Gap

4.9 The table at paragraph 4.7 identifies a total funding gap of **£28.198 million** in 2023/24, 2024/25 and 2025/26. This section provides several indicative proposals for managing this position. Formal approval for these indicative options will be brought to Council on 1 March 2023 when elected members will be asked to approve the final revenue budget for 2023/24 and provisional revenue budgets for 2024/25 & 2025/26.

Service Concession Agreements

4.10 Service Concessions agreements are contracts which provide the Council with a right to use an asset over a defined contract period. Typical agreements are Public Finance Initiative (PFI) / Public Private Partnerships (PPP) arrangements. For Perth & Kinross Council, the Investment in Learning (IIL) School Community Campus project, and the Design Build Finance Maintain (DBFM) Bertha Park Secondary School, are treated as service concession agreements.

4.11 Local authorities in Scotland have previously been required to account for these agreements on a different basis than that applied to other assets in that the Council currently accounts for these agreements over the contract term rather than the useful life of the assets concerned. The Scottish Government, in consultation with COSLA, CIPFA and representatives from the Directors of Finance section have agreed a review of the accounting treatment for service concession agreements with revised statutory guidance issued on 6 September 2022 in the form of Local Government Finance Circular 10/2022 - finance leases and service concession arrangements.

4.12 Recommendations on the proposed future accounting arrangements for service concession agreements in line with Finance Circular 10/2022 will be submitted to Council for approval as part of the consideration of the Revenue & Capital Budget on 1 March 2023. The opportunity will be taken to discuss any proposed changes with the Council's recently appointed external auditors, Audit Scotland, early in the new year.

4.13 Without prejudice to any future decision of the Council, given the value of service concession agreements the potential financial consequences of any change in accounting treatment are significant. It is currently estimated that a change in accounting treatment would generate non-recurring resources in the order of £30 million. This must be considered against the implications of potentially extending the period over which the Council may choose to account for these assets.

4.14 The potential use of the service concession flexibility has previously been discussed with members of the political Budget Review Groups. It's inclusion and possible use, as set out in the paragraphs below, is shown for illustration only at this time as one of a range of options available to the Council in managing the budget position and would be contingent on the Council approving a change in the accounting treatment of service concession agreements.

4.15 One of the main reasons the Council is facing this unprecedented level of financial challenge is the level of inflation that it may be exposed to in the short term. Some of the inflation may be transient rather than fixed so instead of making permanent reductions to levels of service, an earmarked Reserve of **£10 million** could be created to manage this. This would allow expenditure pressures to that value to be removed. The actual impact of inflation in 2023/24 would be monitored with any requests to draw down from the earmarked Reserve being considered by the Finance & Resources Committee. There is a risk that inflation does not subside, and additional budget reductions are required in future years. For the purpose of illustration, this is shown as potentially being funded from the service concession flexibility.

4.16 Again, for the purpose of illustration, the £20 million estimated balance of the service concession flexibility could be applied equally across the remaining financial years of this Council term i.e. 2023/24, 2024/25, 2025/26, 2026/27 and 2027/28 at **£4 million** per annum. In this scenario, the new Council administration would be required to identify recurring budget reductions of £4 million from 2028/29 because this non-recurring funding source will have ceased.

Council Tax – Number of Band D Properties

4.17 The Council has previously approved that the first £450,000 of growth in the Council Tax base is applied to the Loan Charges Budget to support the Capital Budget.

4.18 The mid-range assumption within the Medium-Term Financial Plan assumes growth of **600** band d equivalent properties each year. On that basis, there is approximately **£350,000** of additional Council Tax income each year, that amount can be applied towards the gap.

Council Tax Increase

4.19 Each 1% change in Council Tax level results in a movement in income of approximately £1 million. The Council's Medium Team Financial Plan included an increase of 3% in 2023/24, 2024/25 and 2025/26 which generated approximately **£3 million** of additional Council Tax income each year. This same assumption has been used in the modelling set out below.

4.20 If the Council were to agree an increase of more than 3% then this could provide elected members with scope to reject budget reductions or invest in the Council's strategic priorities. Conversely an increase of less than 3% would mean potentially, more budget reductions to be identified.

Updated Position (Indicative)

4.21 Based on the proposals illustrated above, the updated gap for the Council over 2023/24, 2024/25 and 2025/26 would potentially be a net **£4.148 million**.

	23/24	**24/25**	**25/26**	**Comment**
Updated Gap Per above	20.902	6.124	1.172	
Proposals illustrated within this report				
Inflation Pot (see 5.11)	(10.000)	-	-	Assumes inflation transient
Non-recurring contribution (see 5.12)	(4.000)	-	-	Unwinds in 28/29
Council Tax – Band Ds	(0.350)	(0.350)	(0.350)	
Council Tax Increase (indicative)	(3.000)	(3.000)	(3.000)	In line with MTFP
Updated Gap	**3.552**	**2.774**	**(2.178)**	

4.22 For the avoidance of doubt, the updated gap set out in the table above does assume that the Council accepts **all of the £28.424 million of budget reductions set out in paragraph 4.5.**

4.23 In addition, there are also several variables that could have a material impact on the Council's financial planning as follows.

4.24 Firstly, as agreed in the Medium-Term Financial Plan, all modelling is based on a flat cash financial settlement from the Scottish Government.

4.25 Secondly, the latest draft non-domestic rates valuation roll has recently been published. The provisional valuations indicate a significant increase in the rateable values of educational establishments, both locally and nationally.

4.26 And thirdly, inflation may continue to add further cost pressures. Most notably the investment in learning programme charges for 2023/24 will not be known until February and March which presents a further risk.

4.27 The Transformation & Change Strategy may also produce other efficiency savings that may contribute to the overall gap. However, these may be in later years and may be used to replace other budget reductions.

5. CAPITAL BUDGET 2023/24 TO 2028/29

5.1 In setting the 6 Year Composite Capital Budget 2022/23 – 2027/28 in February 2022, the Council approved a long-term Capital funding strategy to deliver the current programme. This is based on an annual and recurring increase to the Council's Loan Charges budget – which funds the revenue cost of Council borrowing – by an additional **£450,000** each and every year, together with the managed use of the Council's Capital Fund (Report No 22/36 refers).

5.2 The funding strategy approved in February created approximately **£190 million** of capacity within the Composite Capital Budget. Council approved **£119.5 million** of additional Capital expenditure in February, leaving approximately **£70.5 million** of capacity to either increase the funding for existing projects and programmes or finance new expenditure. In September, the Finance & Resources Committee approved the application of **£33.2 million** of this capacity to the delivery of existing projects on site to meet forecast increases in cost.

5.3 In common with all Scottish local authorities, other public sector bodies and the Scottish Government, the Council continues to experience significant inflationary pressures on the delivery of its Capital investment. These pressures have been driven by external factors, outwith the control of the Council.

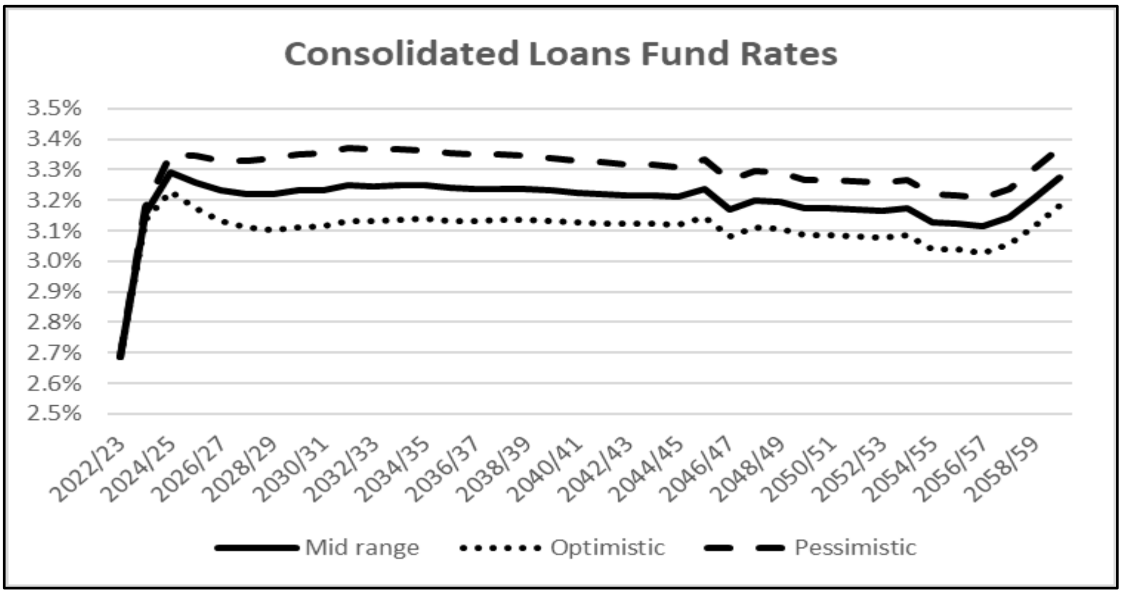
5.4 Between October 2021 and the meeting of the Finance & Resources Committee in September 2022, the Council has added £188 million of expenditure proposals to the Capital budget, of which £77.4 million (to date) reflects inflationary uplifts on existing projects.

5.5 Detailed work is currently being undertaken to review the projects within the Capital Programme which are not yet contractually committed or on site to test continued alignment with the Council's strategic priorities in light of the new Corporate Plan, value for money and overall affordability. Based on experience to date and the best information available at this time of unprecedented financial challenge, the forecast impact of cost inflation on major projects under development is expected to exceed the remaining capacity within the Capital Budget which elected members will need to factor into their budget deliberations and decision-making.

5.6 The level of capital investment which can be met from the current funding strategy is also determined by the cost of borrowing. Over 75% of the Council's capital expenditure is financed through borrowing from the Public Works Loans Board (PWLB).

5.7 As noted within the Treasury Activity and Compliance Report 2022/23 Quarter 2 (Report No. 22/295 refers), following the then Chancellor's fiscal statement to the UK Parliament on 23 September, the cost of UK government borrowing – which determines PWLB rates – increased markedly. PWLB borrowing rates have fallen from their recent high levels over the last few weeks and are anticipated to reduce further in the longer term. In terms of risk however, borrowing rates are unlikely to return in the short to medium term to the low rates previously experienced and are expected to be more volatile than previously assumed over the next few years which is, unfortunately the period during which the Council is anticipating significantly increasing its borrowing to meet the cost of the approved capital programme.

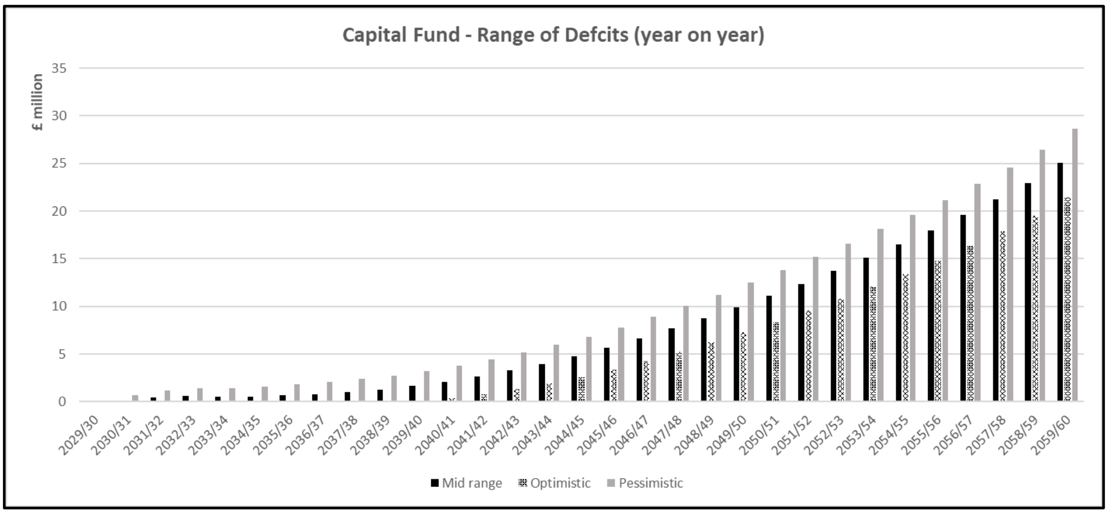
5.8 Three scenarios have been modelled (optimistic, mid-range pessimistic) to demonstrate how small changes in consolidated loans fund interest rates have a material impact on the sustainability of the Capital Fund in supporting the Capital Budget. The consolidated loans fund rate is the average rate incurred on all of the Council's long-term debt including historic debt borrowed at higher than prevailing Public Works Loans Board Rates (PWLB). The mid-range scenario is based upon economic and market forecasts, including current forecasts on future PWLB borrowing rates, which significantly influence the Council's consolidated loans fund rate. The following graph sets out the three scenarios from 2022/23 through to 2059/60.

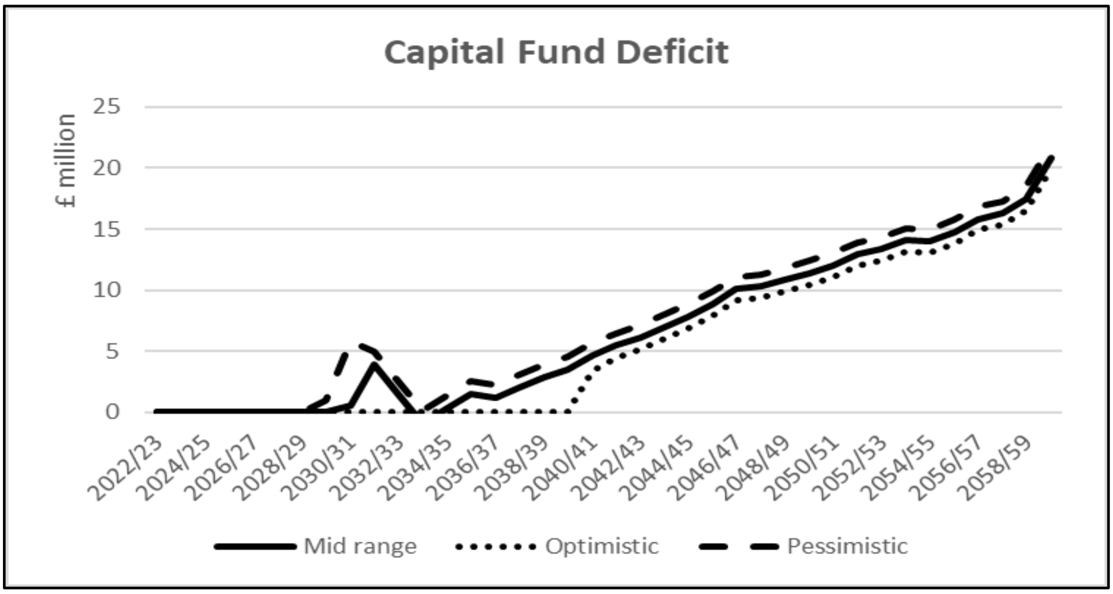


5.9 The following table sets out, under each scenario, when the Capital Fund is anticipated to be fully utilised and the size of the gap in the loans charges budget that emerges assuming the Council were to take no mitigating action.

5.10 In line with the approved Capital budget, the modelling from 2027/28 onwards is based on the Council borrowing to support £12 million of new Capital expenditure each year. This assumption has not been revised for a number of years and the level of investment supported is clearly being impacted by construction inflation. The size of the gap that the Council faces in future years will reflect both the level of Capital expenditure incurred and the mitigating action adopted by the Council, most notably a planned approach to incrementally increasing the loan charges budget over time.

	Deficit Emerges	Range of Gap
Optimistic	2039/40	£3.4m rising to £19.9m
Mid-Range	2030/31	£0.5m rising to £20.9m
Pessimistic	2030/31	£1.0m rising to £21.9m





5.11 **Action:** The Council is asked to approve the mid-range scenario on the Council's forecast consolidated loans fund rate as the basis for decision making on the Capital Budget at the Council meeting on 1 March 2023.

6. WORKFORCE MANAGEMENT

6.1 The shape and size of the Council will have to change to meet the current financial challenges. This includes a reduction in the Council's workforce. While no decisions have been taken yet, the number will be significant, and the impact will be felt across the whole Council.

6.2 The management of any workforce changes will continue to be mitigated by applying a positive and proactive approach, including:

- Transformation & Change Strategy agreed in June 2022 (5-year programme, currently undertaking 9 consolidation workstreams, other projects in Services progressing)

- Vacancy and post management measures introduced in September 2022 to limit increasing headcount and payroll costs and protect employment of existing workforce

- Increased management oversight and scrutiny of use of overtime and agency

- Continue to focus on building skills and capacity, optimising existing workforce opportunities as far as reasonably practical

- Expectation that a flexible and agile approach is adopted

- The Council will support people affected through workforce change

- Job families and job family moves

- Flexible working opportunities

- Choices for career change, moving or retirement

- Managing Workforce Changes Framework

6.3 The Medium-Term Financial Plan agreed in September sets out principles for how the Council will address this challenge, including removing its reliance on non-recurring funding so that it can properly plan for the future.

6.4 The Transformation & Change Strategy sets out a five-year plan for re-shaping the Council and the way it works with communities, partners and across the area.

6.5 The first programmes introduced are for the consolidation of some areas of work to improve the effectiveness and efficiency of how the Council works. A review of the Council's leadership structure is included as a specific workstream within the programme.

6.6 This work is ongoing and the Council is committed to working with Trade Unions and employees to ensure that it optimises their employment as far as reasonably practical.

7. NEXT STEPS

7.1 As set out above, at the time of writing this report it was anticipated that the Scottish Budget would be announced on 15 December 2022 with the Local

Government Finance Circular being issued on the same day. If this is the case, a verbal update will be provided at the Council meeting with a wider elected member briefing scheduled for the new year.

7.2 Budget Review Groups have started their review of budget submissions and this work will increase between now and the meeting of the Council on 1 March 2023. Budget Review Groups will also be kept up to date with the latest developments and how this may impact the Councils.

8. CONCLUSION

8.1 In common with all Scottish local authorities and the wider public sector, Perth & Kinross Council's budget is under unprecedented pressure reflecting the combined impact of historically high levels of inflation, continued financial constraint and the growing need for its services.

8.2 The potential use of the service concession scheme flexibility will require to be considered by Council and may provide non-recurring capacity to manage the financial challenge in the short term but does not detract from the level of change required to put the Council on a financially sustainable footing.

8.3 The approved Transformation & Change Strategy will contribute towards supporting the Council's financial position, but this will take time.

8.4 Challenging and difficult decisions will be required in relation to budget reductions and Council Tax strategy

APPROVED

Name	Designation	Date
Stewart Mackenzie	Head of Finance	13 December 2022
Karen Donaldson	Chief Operating Officer	13 December 2022

ANNEX

1. IMPLICATIONS, ASSESSMENTS, CONSULTATION AND COMMUNICATION

Strategic Implications	**Yes / None**
Community Plan / Single Outcome Agreement	None
Corporate Plan	Yes
Resource Implications	
Financial	Yes
Workforce	Yes
Asset Management (land, property, IST)	Yes
Assessments	
Equality Impact Assessment	Yes
Strategic Environmental Assessment	Yes
Sustainability (community, economic, environmental)	Yes
Legal and Governance	None
Risk	None
Consultation	
Internal	Yes
External	None
Communication	
Communications Plan	None

1. Strategic Implications

Corporate Plan

1.1 The Council's Corporate Plan 2022 – 2027 lays out seven outcome focussed strategic objectives which provide clear strategic direction, inform decisions at a corporate and service level and shape resources allocation. They are as follows:

(i) Tackling poverty
(ii) Tackling climate change and supporting sustainable places
(iii) Growing a sustainable and inclusive local economy
(iv) Enabling our children and young people to achieve their full potential
(v) Protecting and caring for our most vulnerable people
(vi) Supporting and promoting physical and mental wellbeing
(vii) Placing communities at the heart of how we work

1.2 This report relates to all these objectives.

2. Resource Implications

Financial

2.1 There are no direct financial implications arising from this report other than those reported within the body of the main report.

Workforce

2.2 There are no direct workforce implications arising from this report other than those reported within the body of the main report.

Asset Management (land, property, IT)

2.3 There are no direct asset management implications arising from this report other than those reported within the body of the main report.

3 Assessments

Equality Impact Assessment

3.1 Under the Equality Act 2010, the Council is required to eliminate discrimination, advance equality of opportunity, and foster good relations between equality groups. Carrying out Equality Impact Assessments for plans and policies allows the Council to demonstrate that it is meeting these duties.

3.2 The information contained within this report has been considered under the Corporate Equalities Impact Assessment process (EqIA) and has been assessed as **not relevant** for the purposes of EqIA.

Strategic Environmental Assessment

3.3 The Environmental Assessment (Scotland) Act 2005 places a duty on the Council to identify and assess the environmental consequences of its proposals.

3.4 The information contained within this report has been considered under the Act. However, no action is required as the Act does not apply to the matters presented in this report.

Sustainability

3.5 Under the provisions of the Local Government in Scotland Act 2003 the Council must discharge its duties in a way which contributes to the achievement of sustainable development. In terms of the Climate Change Act, the Council has a general duty to demonstrate its commitment to sustainability and the community, environmental and economic impacts of its actions.

3.6 The information contained within this report has been considered under the Act. However, no action is required as the Act does not apply to the matters presented in this report.

4. Consultation

Internal

4.1 The Executive Leadership Team have been consulted in the preparation of this report.

2. BACKGROUND PAPERS

2.1 No background papers, as defined by Section 50D of the Local Government (Scotland) Act 1973 (other than any containing confidential or exempt information) were relied on to any material extent in preparing the above report.

3. APPENDICES

- Appendix A – Summary of Service Expenditure Pressures and Budget Reduction proposals

- Appendix B – Examples of Management / Operational Actions