Medium Term Financial Plan (update)
2023-24 to 2025-26

November 2022

South Ayrshire Council

Medium Term Financial Plan 2023-24 to 2025-26

Contents

1. Update Introduction

1.1 The purpose of a Medium-Term Financial Plan (MTFP) is to provide a clear direction on how the Council will manage its financial resources in the short to medium term to ensure they are deployed effectively to achieve Council Priorities and objectives. It plays a vital part of decision-making and forms the basis of the Council's stewardship over taxpayer's funds. It is an integral part of the Council's financial framework and draws much of its supporting context and evidence from the 2021 Long-Term Financial Outlook (LTFO).

1.2 Given the extent of financial challenges ahead, it is essential that the MTFP enables the Council to develop a better understanding of the wider policy and financial environment within which it operates and ensure that it can identify and respond flexibly to opportunities and threats and manage and mitigate risks whilst ensuring that financial resources are contributing to achieving Council objectives and outcomes. The principal objectives of the Financial Plan are:

- Outline the Council's high level financial position over the years 2023-2026 based on the range of assumptions identified in the LTFO.
- Update the key influential issues that have been considered in developing the plan.
- Ensure that limited available resources are focused on delivery of the Council's key priorities.
- Provide a financial planning platform for a sustainable revenue budget and capital investment programme which will support the Council's key priorities.
- Ensure that the Council is fully aware of the financial challenges and uncertainties that it faces and is in the strongest possible position to deliver the best possible quality and range of services within available resources.
- Increase both organisational awareness and wider community understanding of the Council's financial position and the challenges it is facing over the medium term in balancing and delivering against its budget.

1.3 This updated MTFP document utilises, as core source information, both the Long-Term Financial Outlook and Medium-Term Financial Plan approved by Cabinet in October 2021 and provides updates to various key assumptions contained therein. This provides a more up to date picture of the current medium-term outlook. The update to the Plan covers the three-year planning period from 2023-24 to 2025-26.

1.4 **Financial Forecast risk.** A scenario-based approach has been taken as there is significant uncertainty in a number of the assumptions therefore taking this type of approach allows for a range of possible risk outcomes driven by changes to various assumptions. The assumptions on which the financial projections are built upon are the best estimate of the likely future movement in the financial environment. The actual outcome will no doubt differ from the various scenario however the assumptions will continue to be kept under review and updated as appropriate.

2. Financial Outlook - update

2.1 The Council's Long-Term Financial Outlook (LTFO) identified several key factors affecting the financial position and financial sustainability of the Council over the longer term. The LTFO considered four key contributing factors as shown in Fig 1 below. These key factors were then broken down into various sub-categories and the effect of each on the Councils financial position was then considered further, contributing to the overall financial outlook over the longer term.

Fig 1 – key contributing factors

2.2 The Medium-Term Financial Plan (MTFP) then focused on the first three years of the budget outlook position contained in the LTFO and provided an update on of key material matters affecting the next three-year budget position.

2.3 The following sections, from 2.4 to 2.11, builds and enhances the information contained in the 2021 LTFO and MTFP by providing material updates to key contributing factors that are expected to impact on Council funding and spending activity in the medium term 2023-24 to 2025-26.

2.4 **Updated Material Medium Term Matters.** The following matters are considered as material financial issues that require to be updated as they that will impact in a significant way on the Council over the next three years and have been used to provide an updated overall financial position and assessment of the expected budget gap as identified in Section 3 below.

2.5 ***Local Government Funding*** – The primary source of funding for the Council is Scottish Government funding which provides 79% of net revenue funding each year.

2.5.1 The Scottish Fiscal Commission (SFC), published Scotland's Economic and Fiscal Forecasts in May 2022 to accompany the Government's Medium Term Financial Plan (MTFP). In its publication the SFC noted that spending in most areas is expected to fall in real terms and in 2025-26 only the Net Zero, Energy and Transport portfolio is expected to increase and all other portfolios will see real terms reductions in spending in every year of the MTFP.

2.5.2 The Scottish Governments Resource Spending Review set out details of the grant funding settlement to local government from 2022-23 through to 2026-27, with the multi-year funding being held at flat cash for all years except 2026-27. With inflation forecast to reach 13% this year, a flat cash settlement presents a significant budgetary pressure to the Council and will deepen the budget gap for forthcoming years. Fig 2 below provides the expected Local Government revenue grant funding in the period to 2026-27

Fig 2 - Local Government Block Grant 2022-23 – 2026-27 (Cash Terms)

	2022-23 £bn	2023-24, £bn	2024-25 £bn	2025-26 £bn	2026-27 £bn
Local Government	10.616	10.616	10.616	10.616	10.716

Source: Scottish Government - Investing in Scotland's Future: Resource Spending Review May 2022

2.5.3 The SFC acknowledge that the Scottish Government's spending plans have been set at a time when inflation will erode the purchasing power of the resultant grant settlements. It is clear from the analysis undertaken that the forthcoming years will be extremely challenging and that Council budgets will be under enormous strain. Fig 3 below shows the real terms impact of the Government's spending proposals for local government:

Fig 3 - Local Government Block Grant 2022-23 – 2026-27 (Real Terms)

	2022-23 Real Terms %	2023-24 Real Terms %	2024-25 Real Terms %	2025-26 Real Terms %	2026-27 Real Terms %
Local Government	100	98	96	94	93
Impact - Reduction	-	-2	-4	-6	-7
	£bn	**£bn**	**£bn**	**£bn**	**£bn**
Real terms block grant	**10.616**	**10.404**	**10.191**	**9.979**	**9.873**

2.5.4 For the purposes of updating the medium-term financial outlook a flat cash approach has now been taken across all scenarios.

2.6 ***Council Tax Income*** **–** This is the main fiscal lever that local authorities have, setting the Council Tax.

2.6.1 Councils have discretion to increase Council Tax levels however this has been capped or severely limited in recent years through conditions contained in the annual local government settlement. Councils were given the flexibility to increase their Council Tax for 2019-20 and 2020-21 by 3% in real terms, which equated to increases of 4.79% and 4.84% respectively however this was followed with a further freeze on Council Tax increases in 2021-22, funded through additional Council Tax freeze funding. Council Tax levels were increased in 2022-23 by 2.9%.

2.6.2 For each 1% increase in Council Tax rates, the Council is able to raise approximately £0.740m in income. This ability to raise income through Council Tax is important as any increase is mainlined into the base income for the following year and has a compound effect on future years income levels. For scenario planning the following key assumptions have been made in relation to Council Tax increases.

Fig 4 – Council tax increases assumptions.

Best Case	Mid Case	Worst Case
Year 1 to 3 4% increase	Year 1 to 3 3% increase	Year 1 to 3 2% increase

2.7 ***Public Sector Pay Settlements*** - Pay-related costs are a major component of the Council's overall expenditure and represents 49% of Council net spend each year. The Council's financial planning requires to take account of likely future pay settlements and other pay-related costs.

2.7.1 Original assumptions in relation to the 2022-23 pay award for all staff groups were aligned to the Scottish Government's Public Sector Pay Policy. However the continuing increase in inflation and energy costs as well as other factors has seen negotiations remain open in an attempt to increase the pay uplift from the level set in the pay policy.

2.7.2 Following negotiations with Trade Unions, councils and Government, COSLA submitted an offer of a 5% uplift which was considerably more than the rate set in the pay policy. This offer was subsequently revised with an enhanced, differentiated offer, with lower paid workers receiving an increased rate over that of higher paid workers. With the exception of Teachers this enhanced offer for 2022-23 has been accepted by most Trade Unions.

2.7.3 The Scottish Government has so far agreed to provide £260.6m of recurring funding to local government to help meet some of the cost of the enhanced offer above the pay policy rate. The contribution from Scottish Government represents around 67% of the overall cost of the enhanced offer. Further discussions are ongoing between COSLA and the Scottish Government to identify a further £140m of recurring funding to meet the remaining unfunded element of the pay offer.

2.7.4 The Deputy First Minister has subsequently written to Cosla stating that:

"it is for individual councils, as democratically elected bodies, to consider the needs of their communities with a focus on the most vulnerable, their legal obligations and the totality of resource funding available to them, and to then take the decisions necessary, openly and transparently, to operate as effectively as possible within this context. In doing so, I would request that councils remain mindful of our shared priorities in the National Performance Framework. Where funding is provided as specific revenue grant (and therefore legally ring-fenced), councils should engage with the relevant Scottish Government directorate."

This effectively confirms that no new funding will be forthcoming from the Scottish Government to assist in meeting the shortfall in the 2022-23 pay offer and that it is for each council to find the resources from within current funding streams. Consideration will need to be given around the approach to be taken in relation to this latest intelligence for 2022-23 and the ongoing impact going forward. For the purposes of the MTFP no additional funding has been assumed across any scenario thereby increasing the budget gap for each in 2023-24 accordingly.

2.7.5 The recent Bank of England report noted that inflation will remain high until 2024-2025 meaning that pay uplifts for the 2023-24 financial year will likely be at levels higher then seen in most preceding years up to 2022-23 which will cause further pressure on Council budgets.

2.7.6 Public sector pay will be a significant risk going forward and, while inflation is expected to fall back to 2% over time, this will not mitigate the risk that now exists in local government. For scenario planning the following revised key assumptions have been made in relation to pay uplifts.

Fig 5 – Pay uplift assumptions

Best Case	Mid Case	Worst Case
2% uplift	3% uplift	4% uplift

2.8 **National Insurance rates -** The recent announcement by the UK Government to reverse the 1.25% National Insurance increase introduced in April 2022, for both employee and employer, will go some way towards reducing pay pressure on Council budgets for 2023-24 and beyond.

2.9 ***Inflationary Pressures*** – Budgets have traditionally not been routinely increased to reflect inflationary pressure as pressure of this type remained at a relatively low risk levels, however recent national and international events, such as the war in Ukraine, gas and electricity price increases, the general cost of living crisis and the recent upheaval at a national political level have all created an unprecedent level of uncertainty which has resulted in levels of inflation not seen for many decades.

2.9.1 Many of the Council's contracts, such as the Schools PPP contract, have direct links to inflation indices and will require to continue to be funded. However, the lack of future years forecasts, due to the recent political uncertainty means that attempting to model inflation rates is challenging.

2.9.2 The most recent forecasts by analysts suggests that inflation will remain high at around 9% throughout 2023-24 with expectations being that CPI will return to previous levels of around 2% in 2024-2025. However, it will be important to continue to track inflation especially given the impact that even a slight rise can have on the Council.

2.9.3 The impact of inflation, particularly at such high levels, means that significant pressure is placed on service budgets as goods and services cost more and the purchasing power of existing budgets is diminished. Moreover the need to provide inflationary uplifts for specific contracts, will inevitably lead to further budgetary pressures in 2023-24 and beyond. For scenario planning the following revised key assumptions have been made in relation to inflationary.

Fig 6 – Inflation pressure

Best Case	Mid Case	Worst Case
Year 1 - 5% Year 2 – 2% Year 3 – 2%	Year 1 - 9% Year 2 – 2% Year 3 – 2%	Year 1 - 11% Year 2 – 5% Year 3 – 2%

2.10 ***Revenue Implications of Capital Investment Decisions -*** In order to ensure there is a clear linkage between the longer-term capital investment decision making and the associated revenue impact for the Council; the resultant debt charges estimated for the period of the approved capital investment programme require to be incorporated into future financial considerations.

2.10.1 Consequently, when there is sustained pressure on the revenue budget this in turn causes pressure in capital finance and in the management of the capital programme and the debt and borrowing requirement that arises from it.

2.10.2 The current twelve-year Capital Programme was approved by Council in March 2022 with General Fund expenditure of around £460m planned from 2022-23 through to 2033-34 (£168m 2023-24 – 2025-26). The programme contains a range of projects including new and refurbished schools, Information Technology expenditure, roads and infrastructure expenditure and planned expenditure as part of the Council's Ayrshire Growth deal agreement.

2.10.3 Current assumptions in respect of the debt charges budget in the three-year period of this updated MTFP are as detailed in Fig 7 below:

Fig 7 – Current debt charge budget requirements 2023-24 to 2025-26

	2023-24 £m	2024-25 £m	2025-26 £m
Current debt charge budget	14.969	16.998	17.607
Required budget uplift from prior year	2.335	2.029	0.609

2.10.4 The revenue budget gaps noted in Section 3 below show a £14.7m gap for 2023-24 which includes a contribution to the debt charge budget in order to support the current capital expenditure based on the updated Period 6 Capital programme information. Given the scale of the financial challenges that lie ahead for the public sector it is prudent to review the overall quantum of the capital programme and the ability of the council to identify recurring debt charge budget increases.

2.10.5 In addition to an assessment of the borrowing implications in relation to the updated Period 6 capital programme information an allowance has been made for the additional revenue implications of the borrowing approved as part of the Ayrshire Growth Deal - Commercial Build Final Business Case, approved by Cabinet in August 2022. Cabinet agreed significant capital expenditure, with the cost of borrowing being met from rental income streams. The assumed rental income stream has also been included within the budget gap position.

2.10.6 The affordability of the capital programme will be assessed as part of the 2023/24 budget process and will inform the next iteration of the capital programme that will be presented to Members for consideration in March 2023.

2.11 **Capital Accounting Review -** The Scottish Governments Resource Spending Review also formalised the review of local government capital accounting which will assess whether the current statutory mitigation arrangements that are afforded to councils should continue in their current form or be removed.

2.11.1 The review has the potential to significantly impact on councils future capital expenditure plans and adds yet another element of uncertainty into what is already a crowded, uncertain and volatile public finance environment.

2.11.2 The review, which has been delayed until October 2023 to allow councils to concentrate on the cost of living crisis, has the potential to present real and lasting adverse risks to the Council and further information will be provided once the Group has met and the terms of reference have been agreed.

2.12 **Service Concession Arrangements Flexibility -** The Scottish Government's Resource Spending Review, contained details of the Service Concession Arrangement flexibility that relates to the Council's PPP schools.

2.12.1 The flexibility was provided due to the significant financial pressures experienced by local government as a result of the Covid-19 pandemic and more recently from the cost of living crisis.

2.12.2 The flexibility recognises that councils have planned to pay for these school assets over the 30 year term of the PPP/PFI contract despite the assets being available for use beyond the 30 years once they are returned to the Council at the conclusion of the contract period.

2.12.3 The flexibility permits councils to undertake internal accounting changes that extend the period over which the principal repayment of the unitary charge can be made which results in a one-off credit to the Council.

2.12.4 The Statutory Regulation was published and issued to councils in September 2022 and work on modelling the impact of the flexibility on the specific elements within our school estate is well advanced. A report seeking to implement the Service Concession Flexibility will be presented to Council in due course.

2.13 ***National Care Services - Feeley Review –*** The principal aim of the review was to recommend improvements to adult social care in Scotland, primarily in terms of the outcomes achieved by and with people who use services, their carers and families, and the experience of people who work in adult social care. The review is currently progressing through a period of consultation.

2.13.1 There is no doubt that the proposed changes will represent the biggest change to local government in Scotland since reorganisation in 1996. A new National Care Service undoubtedly represents a significant change to the duties and finances of councils. There are legitimate concerns about risks to councils' capacity if they are no longer legally accountable for significant parts of social care, alongside the risks of fragmentation with other key services.

2.13.2 In August 2021 the Scottish Government launched a consultation document – "A National Care Service for Scotland". The proposals in the consultation went wider than the policy areas covered in the Feeley Review, which focused on adult social care, to include children's social work and social care services. Following the submission of consultation responses, the Scottish Government published the National Care Service (Scotland) Bill in June 2022 with the intention being to see the National Care Service (NCS), established and operational within the term of the current Parliament.

2.13.3 The Bill noted that National Care Boards will be created across Scotland and the current plans will result in adult health and social care being commissioned by the NCS. The Bill also makes provision for a consultation on whether Children's Services and Justice Services, currently delivered by local government, should also be transferred to the NCS.

2.13.4 The transfer of adult care services from the Council to the NCS will impact the Council financially and structurally given the scale of the disaggregation and, while the precise NCS service delivery model is unclear, work will commence to model the potential impact on the Council.

2.13.5 The scale of the potential transfers of budgets and functions are substantial, and the Financial Memorandum provides analysis of the expected budget transfers that could take place from local government and Health as functions are transferred to the NCS. The memorandum identifies the potential for over £7bn of budgets to transfer from local government with a further £9bn transferring from Health Boards. The creation of the NCS presents a material risk to the operational and financial sustainability of local government as financial and structural change occurs and staff and integrated systems are disaggregated.

2.13.6 Initial analysis of the 2022-23 adult social care budget shows that there is the potential for £64m to be removed from the Council's funding allocation once the transfer to the NCS takes place. This represents around 21% of the Council's total revenue budget and demonstrates the scale of the change and the impact that the removal of such a large part of the budget will have on the financial resilience of the Council.

2.14 ***Covid-19 –*** The scale of the financial intervention by the UK Government during the pandemic was unprecedented with the resultant borrowing levels only surpassed by the relative borrowing that took place during the Great Depression and World War 2.

2.14.1 The initial indications at the start of 2020-21 were that the pandemic presented a significant risk to the finances of the Council which could result in reductions to services. This risk lessened considerably in 2020-21 and lessened further in 2021-22 as the Scottish Government reacted to the unprecedented events by providing support to local businesses and local communities across Scotland through substantial financial support packages to, and administered by, councils.

2.14.2 A significant amount of funds were passported through the Scottish Government to Councils to aid, firstly in the direct loss of income /additional expenditure being encountered by Council when front line service provision were suspended and secondly funds being provided to aid in the recovery process.

2.14.3 The financial impact on revenue budgets has been carefully monitored throughout the 2020-21 and 2021-22 financial years with regular reports being presented to the Leadership Panel/Cabinet detailing the ongoing impact on Council finances. It is recognised that there will continue to be additional costs incurred in supporting the recovery and renewal process as we continue to transition out of the crisis during 2022-23 with the cost of this being met from the Covid-19 reserves being held for this purpose.

2.14.4 The 2021 MTFP incorporated differing assumptions within each of the different scenarios. These assumptions have been re assessed as the financial risk to Covid-19 recedes.

3. 2023-24 to 2025-26 budget Gap update

3.1 The previous Long Term Financial Plan approved in October 2021 highlighted that for the three-year period, 2022-23 to 2025-26, a cumulative budget gap was estimated of between £4.5m for the best-case risk scenario, £25.7m for the mid-case risk scenario and £47.9m for the worst-case risk scenario. As outlined in section 2 some of the material assumptions contained within the report have been amended and updated to reflect the latest available information. In some cases this caused the gap to increase while in others, particularly around grant funding levels based on the recent Resource Spending Review, caused the gap to reduce.

3.2 The volatility of the economy means and the impact on the ability to provide certainty in terms of long-term forecasts means that assumptions will be reviewed on an ongoing basis and updates to the Strategy and the resultant budget gap provided at specific points. Moreover, the level of uncertainty that currently exists means that once again the projected budget gap through to 2025 is based on a range of assumptions and on a series of best, mid and worst-case risk scenarios.

3.3 The introduction of an in year recurring pressure from the 2022-23 pay offer means that there is an increased level of complexity in calculating the budget gap. This is due to the timing in identifying the recurring funding to meet the cost of the pay award.

3.4 Based on the assumptions and risk scenarios, the budget gap forecast for 2023-24 to 2025-26 are shown below:

Figure 8 – Three-year budget gap (scenario based)

Best Case	2023-24 £m	2024-25 £m	2025-26 £m	Total £m
Income	299.5	303.1	305.9	
Expenditure	309.5	314.1	313.6	
Budget gap	**10.0**	**11.0**	**7.7**	**28.7**

Mid Case	2023-24 £m	2024-25 £m	2025-26 £m	Total £m
Income	297.9	300.7	302.6.	
Expenditure	312.6	313.8	312.6	
Budget gap	**14.7**	**13.1**	**10.0**	**37.8**

Worst Case	2023-24 £m	2024-25 £m	2025-26 £m	Total £m
Income	295.2	296.6	298.1	
Expenditure	315.7	313.8	309.9	
Budget gap	**20.5**	**17.2**	**11.8**	**49.5**

3.5 The Medium-Term Financial Plan will proceed on the basis of the mid case risk scenario and take the necessary steps and actions to mitigate an anticipated cumulative budget gap of £37.8m by 2025.

4. Budget Strategy 2023-24 to 2025-26

4.1 Whilst acknowledging the likelihood of continued reductions in funding settlements and increasing cost pressures, the Council needs to continue to strive to achieve its key financial objectives including delivering a robust, sustainable, and balanced budget.

4.2 The Medium-Term Revenue Budget strategy, approved as part of the 2021 MTFP remains unchanged and the various guiding principles are outlined below:

4.2.1 Budgets should be developed to cover a rolling three-year period.

4.2.2 Budgets should be clearly linked to the achievement of Council priorities which may require decisions to reduce or cease spending in non-priority service areas.

4.2.3 Integrating workforce planning will be essential to ensure that future revenue budgets fully consider the overall size and shape of workforce required by the Council to deliver its strategic objectives.

4.2.4 The identification of savings opportunities should remain under continuous consideration rather than being restricted to deliberation as part of the annual budget setting exercise.

4.2.5 Opportunities for service redesign will inevitably flow from the Future Operating Model, reflecting lessons learned during the pandemic, and the associated programme of work will become the new drivers of future years' savings.

4.2.6 Delivering on the enhanced Transformational Change Programme that will deliver services more effectively to meet the new demands and pressures in line with the Council's aims and support the realisation of existing planned savings.

4.2.7 Maximise income generation opportunities available to the Council. This will include the exploration of new opportunities for income generation where possible.

4.2.8 Continue to explore options for the Council to become more entrepreneurial including developing new ways of ensuring services are provided in the most effective way possible. This might include developing new services that can make a 'return' for the Council.

4.2.9 Continuing to constrain cost growth – through effective demand management, continuous review of all expenditure commitments, good financial control by managers and by effective negotiation with suppliers.

4.2.10 Make efforts to shift the focus of spend on prevention and early intervention, which is designed to reduce future demand for council services by stopping problems arising or by addressing them early on.

4.2.11 Maximise the use of the Council's assets, reviewing our existing asset base to ensure that it meets the new Future Operating Model, and work in partnership with other public agencies to make best use of our assets and provide a more joined up service.

4.2.12 Continuing to invest where appropriate in the Capital Investment Programme, ensuring this will support the Council's key priorities, and critically remain affordable based on a clear understanding of both capital and future revenue costs.

4.2.13 Continuing to manage and review the General Services Loans Fund balance ensuring prudence, in order to minimise the future impact of debt charges.

4.2.14 Consideration will continue to be given to the planned, sustainable use of available uncommitted reserves balances.

4.3 Although the Budget Strategy quite properly covers the three-year period until 2025-26, given the uncertainty around the financial planning landscape within which the Council operates, the Strategy will be subject to an annual refresh to ensure that it remains appropriate and relevant and enables the Council to respond to any future financial challenge.