

The Highland Council

25 June 2015

Agenda Item	14
Report No	HC/24/15

Revenue Budget 2015/16 – 2018/19 Updated Financial Forecast

Report by Director of Finance

Summary

The purpose of this report is to provide an update on the present budget position, highlight new and additional financial risks in the current financial year 2015/16, and a significant amended budget gap for the three year period 2016-19.

1. Background

1.1 On 18 December 2014, Highland Council agreed a balanced budget for 2015/16, and an indicative budget for the three following financial years 2016/17 – 2018/19. At that stage the budget gap for the three year period was £13.251m, comprised as follows:-

2016/17 - £4.483m

2017/18 - £6.223m

2018/19 - £2.545m

1.2 Since the Council set its balanced budget for 2015/16 a number of factors have come to light which will place pressure on this budget. These are set out in Section 2 below, but will require adjustments to be made to the existing budget assumptions for the three year period 2016-2019. These were highlighted to the Council in December as budget risks, but developments since then have allowed greater clarity and require budget assumptions to be reviewed and updated.

1.3 In 2014/15 the Council agreed a financial strategy that moved from a three year rolling budget to a five year budget commencing in that year. Given the level of financial uncertainty covering future years, which are expanded upon later in this paper, officers have not attempted to continue the five year strategy at this stage, focussing instead on the existing indicative budgets for future years.

2. 2015/16 New Budget Pressures

2.1 Pay Awards

The current national pay negotiations suggest a two year deal for all categories of staff amounting to 2.5%. The Council's current budget assumptions assume a 1% pay increase per annum.

Whilst the current pay offer is beyond what the Council can afford, agreement has still not been reached with trade unions on this offer. The offer therefore needs to be viewed as the minimum increase that the Council can expect to pay.

This increase of 0.25% per annum above budget provision represents an

additional cost of £0.822m in 2015/16 with a similar additional cost in the following year. Whilst the proposed pay settlement will only affect financial years 2015/16 and 2016/17, it would appear prudent to make similar adjustments to future budget assumptions to aid future financial planning.

There is also the potential for the phasing of the deal to be negotiated further. At present this report assumes 1.25% increase in both years. Any “front loading” of the pay deal will create an additional budget pressure in 2015/16.

2.2 Teachers’ Pensions

The Scottish Government has indicated an increase in employers’ pension contributions with effect from 1 September 2015. Whilst COSLA has been pressing the Scottish Government for government funding to meet this additional cost there has been no response to date. Given the level of uncertainty it would now be prudent to make provision for this additional cost in the likelihood that no additional funding will be provided.

This cost is estimated at £1.259m for 2015/16, with a full year cost of £2.172m applicable from 2016/17.

2.3 Holiday Pay

The Executive Leadership Team recently received a report that indicated the additional costs associated with recent court rulings. Whilst some management action can be taken to mitigate the impact there seems no doubt that additional budget provision requires to be made. An additional budget provision of £0.4m is proposed, although at this stage there is a risk that the cost could be higher.

2.4 Winter Maintenance

Community Services Committee has asked that the saving of £0.12m for 2015/16 in respect of pre-treatment of rural roads with low traffic volumes be reviewed and an alternative saving proposed. For the purposes of this report it is assumed that Council will agree to this request.

Given the scale of the financial challenges facing the Council in 2015/16 and beyond, as outlined in this paper, reinstating budget savings previously agreed by the Council is not a policy that officers would support as this simply widens the funding gap and means that equally or more difficult savings decisions require to be made.

No alternative savings proposal has been made at this stage, with the funding gap for 2016/17 increased accordingly.

2.5 Teacher Numbers and Pupil/Teacher Ratio

£1.68m of savings agreed for 2015/16 have potential implications for teacher numbers. The Scottish Government has provided additional funding of £0.463m to help the Council deliver on the Government’s commitment to maintain both absolute numbers and the ratio. However there is a net budget risk of £1.217m. Should the Council fail to maintain both absolute teacher numbers and the ratio, then the Scottish Government could impose a grant penalty which is estimated to be £2.035m.

The Service is preparing actions that will deliver these budget savings whilst meeting the commitment. At this stage it is not proposed to make any

adjustments to budgets, however the Council is asked to recognise the significant financial risk, note that this will be closely monitored, and that further budget adjustments may be required in the event of the commitment not being achieved.

- 2.6 The table below indicates the financial impact of the above additional pressures on the 2015/16 budget. These total £2.601m.

Additional Budget Pressures	2015/16 £m
Pay Award	0.822
Teachers' Pensions	1.259
Holiday Pay	0.400
Winter Maintenance	0.120
	2.601

A separate report on today's agenda indicates the level of surplus from 2014/15. It is proposed that the above pressures are met from balances in the first instance in order to avoid the need to find additional budget savings during the current financial year.

This is a short term measure to address a specific problem, however it does mean that the impact on future years' budgets is greater, particularly 2016/17.

- 2.7 These additional budget pressures clearly make a significant difference to the current and future years' budgets. However they represent a real situation that has developed over the period since the budget was set. Whilst provision could have been made earlier, this would have resulted in additional savings being required for 2015/16 by December 2014.

The strong financial management during 2014/15, and the ability of services to manage pressures in year and deliver a small surplus, has therefore enabled budget savings of £2.601m to be delayed by a year.

3. Latest National Position

- 3.1 Two new pressures, or revisions to financial assumptions, have been identified. These are significant. The first relates to National Insurance Contributions, and the second relates to "flat cash" grant assumptions.

3.2 National Insurance

Legislation contained in the Pensions Act 2014 will see the introduction of a new single tier State Pension Scheme, replacing the current 2 tier scheme (state and state second pension (S2P)) with effect from 1 April 2016. This change will also mark the end of the "Contracted out" rate of National Insurance applied to earnings of employees enrolled in "Contracted Out" occupational pension schemes such as the Local Government (Scotland) Pension Scheme and the Scottish Teachers Pension Scheme.

- 3.3 "Contracted Out" rate of National Insurance currently allows a reduction or "rebate" of 3.4% to employers and 1.4% to employees on relevant insurable earnings. The relevant earnings for this purpose being employees' earnings between the Primary Threshold (£155 a week) and the Upper Accrual Point

(£770 a week). The removal of the rebate and the introduction of a single rate of National Insurance rate will have a financial impact on both the Council and employees currently paying the Contracted out rate.

3.4 Initial estimates suggest an unbudgeted **pressure of £5.45m** is anticipated in 2016/17. There is currently no provision in the roll forward revenue budget for this change as it was originally anticipated that additional resources would be made available to Local Authorities. This no longer appears likely.

3.5 Grant Settlement

The current budget assumptions of “flat cash” grant settlements are looking increasingly unlikely. Informal discussions with officers at COSLA and Scottish Government, combined with external advice commissioned by Directors of Finance, strongly indicate a real cash reduction in Scottish Government Grant.

3.6 Current projections, based on an analysis of the UK position, Barnett consequential, and Government policy to protect the NHS, suggest that local government could see a reduction of 1.6% in cash terms. This equates to a grant reduction from the current year of **£7.309m**. A similar reduction is forecast for 2017/18. This revised model assumes that a similar reduction is applied in 2018/19 as well, although the position for 2018/19 is less certain and could be lower.

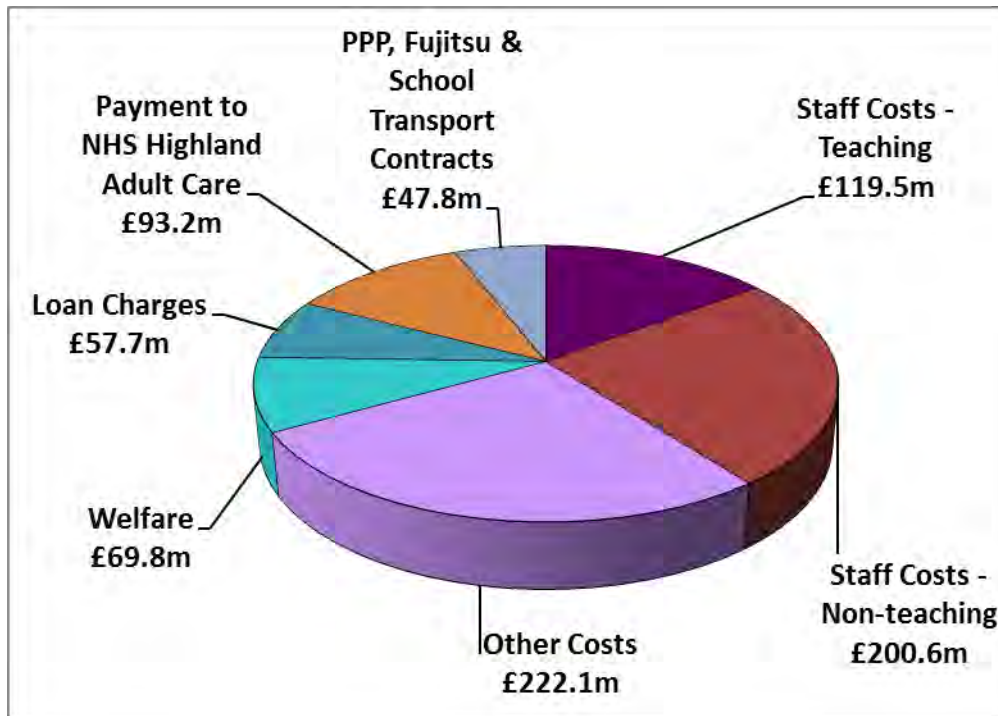
3.7 The absolute amount of grant received will depend on policy decisions taken by the Scottish Government, and the Spending Review decisions of the UK Government. At present the expected timescale for Government announcements is as follows:-

July 2015	-	UK Budget Review 2015/16 only
October 2015	-	UK Spending Review
November 2015	-	Scottish Government Spending Review
December 2015	-	Council Grant Announcement

3.8 At this stage the period covered by Government announcements is not known, and the Council could see different periods covered by the UK and Scottish Governments. Audit Scotland, in its recent review of Local Government 2015 stressed the need for long term financial planning. Uncertainty over grant levels and the period covered, makes accurate long term financial planning impossible.

3.9 Nevertheless it is essential that the Council progresses its own budget planning, and takes steps to make spending decisions based on the latest estimates of likely Government Grant. This will allow the Council time to consider options and react quickly to Government announcements.

3.10 One of the main challenges facing the Council is the degree of flexibility that is available to make budget decisions. The chart below shows that in reality the Council has limited flexibility over the areas of expenditure that it can make spending decisions upon.



Other costs consist of energy, property, transport, grants and payments to voluntary organisations, and other supplies and services.

This chart shows the gross revenue expenditure budgets for the Council in 2014/15. Out of the total of £810.7m, some £268.5m (33%) is largely committed on existing contracts and decisions taken by the Council and its predecessors over a number of years, or is demand led (welfare).

The decision by the Scottish Government to protect absolute teacher numbers and the pupil teacher ratio in 2015/16 has effectively ring fenced a further 15% of the Council's budget. Should this policy position continue in 2016/17 then it further restricts the Council's ability to balance its budget, and inevitably savings will have to be found from remaining services.

4. Revised Budget Forecasts

- 4.1 Sections 2 and 3 above indicated new and updated financial projections that show a significant and detrimental impact on the Council's estimated financial position for the three years 2016/17 – 2018/19. These are outlined in the table below and increase the forecast funding gap from £13.251m to £46.288m.
- 4.2 It is also clear, that given the financial challenges already faced and met by the Council, and reduced flexibility over service areas that further savings can be taken from, that this represents a further and significant challenge for the Council. Early action is essential in order that appropriate time is allowed to consider all options.
- 4.3 The current budget forecast assumes no increase in Council Tax over the next three year period. Current expectations are that the Scottish Government will expect the current tax freeze to continue for 2016/17, given its stated commitment to freeze the tax for the duration of the current Parliament.
- 4.4 A 1% increase in Council Tax would generate approximately an additional £1.1m. However the Scottish Government has indicated that the Council would

suffer a grant penalty, equivalent to 3%, should it opt to increase Council Tax. Any increase in Council Tax will also impact on the cost of the Council Tax Reduction Scheme, which is a cost that would be borne by the Council.

- 4.5 At this stage it is assumed that all savings proposals, agreed in December 2014, will be delivered on schedule. The widening budget gap makes delivery of these savings even more critical despite the undoubted challenges this brings. It would not be appropriate to recommend any change to these at this stage, however the situation will obviously be reviewed during 2015/16.

Summary of Revised Budget Gap

	2016/17 £m	2017/18 £m	2018/19 £m	3 Year Total £m
Budget Gap per HC 18.12.14	4.483	6.223	2.545	13.251
New Pressures 15/16 c/fwd				
- Pay Awards	1.841	1.100	1.113	4.054
- Teachers' Pensions	2.172	-	-	2.172
- Holiday Pay	0.400	-	-	0.400
- Winter Maintenance	0.120	-	-	0.120
New Pressures				
- National Insurance	5.450	-	-	5.450
- Grant Cut	7.309	7.180	7.068	21.557
Other Income adjustments	-0.153	-0.338	-0.225	-0.716
Revised Budget Gap	21.622	14.165	10.501	46.288

The revised Budget Gap of £21.622m in 2016/17 equates to 3.8% of the indicative budget but in reality is much higher due to the limited flexibility around many budget headings as outlined in paragraph 3.10.

5. Budget Implications

- 5.1 The figures presented in the table at paragraph 4.5 above show that the forecast budget gap for the period 2016/17 to 2018/19 has widened significantly.
- 5.2 The absolute gap will only be clarified once Scottish Government decisions around future grant levels is known, and the Council is able to consider levels of Council Tax. The budget gap of £46.288m needs to be seen in this context.
- 5.3 For financial planning purposes it is essential that work starts now to identify the significant service reductions that are inevitable in light of the scale of this reduced level of funding and significant additional cost pressures.
- 5.4 The Council should be under no illusion that the budget decisions that will require to be taken will involve reductions in service, some cessation of services, and downsizing of the workforce as a consequence.
- 5.5 The Council is also asked to note that Services need to manage this process

and will take steps to reduce expenditure now, in order to allow flexibility in the lead up to the Council making final budget decisions in February 2016, and the start of the new financial year on 1 April 2016. This is likely to lead to underspends in the current financial year, but this is part of proper financial management to deliver the required outcomes.

6. Implications

- 6.1 Resource implications are outlined within the report. Budget assumptions carry significant financial risk, and are dependent on policy decisions by the UK and Scottish Governments.
- 6.2 The need to deliver the scale of financial savings required has potential implications for equalities and rural communities. Full risk assessments will require to be carried out for all savings proposals.
- 6.3 There are no specific legal, climate change/Carbon Clever or Gaelic implications at this stage, but this situation may change depending on savings proposals.

Recommendations

Council is asked to:-

1. Note the additional budget pressures of £2.601m in 2015/16 and agree that these are met from the reported surplus from 2014/15.
2. Agree to set aside the budget saving of £0.12m in respect of Winter Maintenance, as agreed by Highland Council in December 2014, as outlined in paragraph 2.4.
3. Note and consider the forecast changes to the financial forecasts, and revised budget gaps for the following three financial years 2016/17 – 2018/19 of £46.288m.
4. Note and consider the budget implications set out in Section 5.

Designation: Director of Finance

Date: 16 June 2015

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