FINANCIAL STRATEGY

2018/19 - 2022/23

Dumfries & Galloway COUNCIL

Foreword

The purpose of the Council's Financial Strategy is to provide high level financial projections, supported by clear assumptions, to inform the development of the Council's medium term financial and service plans.

The value of such a strategy is that it enables the Council to develop better understanding of the wider policy and financial environment within which it operates, identify and respond flexibly to opportunities and threats, manage and mitigate risks and ensure that financial resources are contributing to achieving the corporate objectives.

In recognition of the need for medium term financial planning the Council has previously adopted an approach of seeking to agree revenue budgets over a 3 year period, with the Council's last financial strategy covering the period 2015/16 – 2017/18. Until recently this approach was supported through the release of 3 year funding settlements by the Scottish Government, which provided Councils with a degree of certainty regarding the level of funding available to support local services and corporate objectives. Unfortunately, recent years have seen the Scottish Government move away from multi-year budgeting with each of the last 2 years' budget details being provided for a single year only and the return to multi-year funding settlements does not appear to be imminent.

While the lack of multi-year funding settlements significantly increases the financial uncertainty faced by the Council, this does not reduce the need for the Council to develop a strategic, medium term financial strategy to provide a framework to address the challenges faced.

Taking into account indications of best practice identified by Audit Scotland and the Improvement Service, it is recommended that the Council extends its current approach to develop and approve a 5 year financial strategy. This will provide a sufficient timescale for the development of more complex service and savings proposals which cannot be appropriately progressed within a shorter planning timeframe.

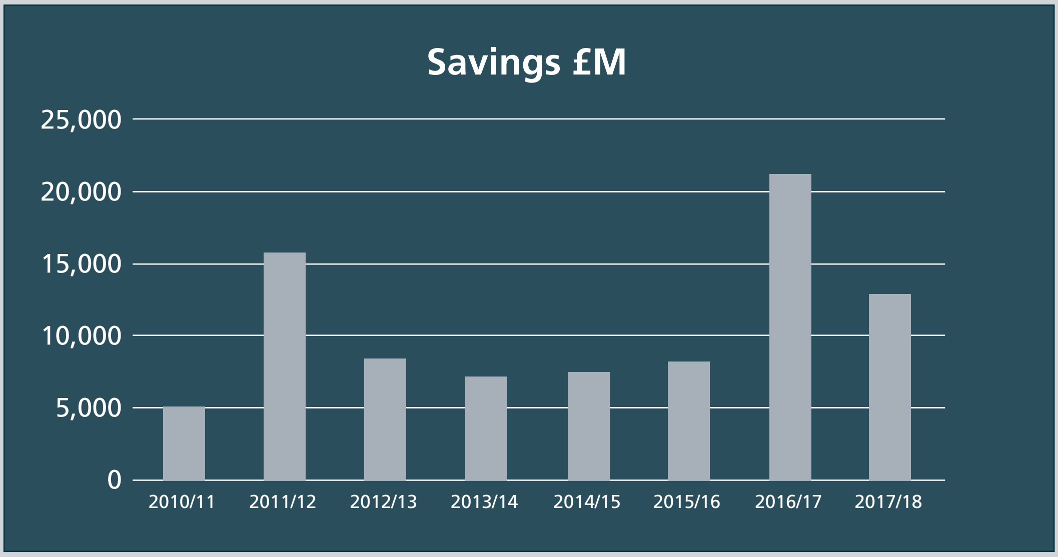
The Financial Strategy reflected within this document therefore covers the 5 year period 2018/19 - 2022/13, and provides an indication of the financial challenges facing the Council over the upcoming period.

While the Financial Strategy provides a framework from which to address the financial challenges that will be faced by the Council, it should be recognised that the estimates reflected within this strategy will change over time. The Strategy will therefore require to be reviewed and updated regularly so that the Council can respond proactively to any such changes.

Current Financial Context

Since financial year 2010/11, all Scottish Councils have faced a period of unprecedented reductions in funding available to support the delivery of local services. Between 2010/11 and the current year 2017/18, reductions in funding have required Members to agree budget savings totalling £86 Million (equivalent to 24% of annual spending) over that period. The table below illustrates the significant savings that have been agreed over this period, with peaks in 2011/12 and 2016/17.

Table 1: Agreed Savings per Financial Year



It is also important to recognise that a combination of increasing demand for some services, particularly in relation to care services, and restrictions on Councils in terms of how savings can be achieved (eg. requirements to maintain teacher numbers) have meant that the level of funding reduction required from non-protected services has been at a significantly higher level.

The Council has been successful in identifying and delivering savings in a manner that seeks to maximise efficiencies and protect agreed Council priority services. However, some reductions in services have been required and it is apparent that significant further reductions will be required over the upcoming period.

Ongoing reductions in funding and associated savings requirements will require to be fully taken into account as part of the development of Council priorities and service plans. As part of the development of these plans, it is important that the following key issues are taken into account.

- How much money will be available to fund Council services and deliver the Council's priorities and objectives over the upcoming period?
- To what extent will reductions/cuts in spending on Council Services be required over that period?
- How can the required reductions in funding be delivered in a manner that seeks to protect, where possible, the delivery of agreed Council priorities?

- How do we help the public and communities to understand the context and contribute to new models of delivery and reduce unsustainable demand

Interlinked to the Financial Strategy are the Council's budget principles, which set out the key requirements to be taken into consideration when setting the budget. The Council's current Budget Principles were agreed by Full Council in December 2014 and cover the following areas:

- The link between budgets and the achievement of all agreed corporate priorities
- The sustainability of all budgets over the longer term
- Medium Term Financial Planning
- The maintenance of a prudent level of General Fund Balances
- Ensuring capital investment levels are prudent, affordable and sustainable
- Council Tax considerations
- The need for strong and effective financial management arrangements

Although these Budget Setting Principles remain largely appropriate they will require to be reviewed and updated following the development of the Council Plan and this Financial Strategy. The Financial Strategy will be updated to include the revised Budget Principles once these have been considered as part of the budget development process.

The initial high level financial projections included within this Financial Strategy will help inform budget process improvements to allow these key issues to be effectively addressed as part of the development of medium term financial and service plans. A proposed timetable for the annual budget process was considered as a separate item at the September 2017 Full Council Committee, and set out the key requirements for the development of the budget process, including Members direction and Public Engagement.

Financial Projections – Identification of Key Variables

To be able to provide Members with a high level indication of the financial challenge that is likely to be faced by the Council over the upcoming period, we have identified a number of key variables which require to be taken into consideration in developing the Council's Financial Strategy. The key variables are summarised below, with further details on the Council's assumptions provided in the sections that follow this overview.

- The impact of Brexit – the departure of the United Kingdom from the European Union will have a range of implications for public sector funding levels and for the delivery of public services.
- Block Grant Funding made available to the Scottish Government
- The impact of the Scottish Government's own fiscal policies, particularly in relation to taxation and borrowing
- Scotland's economic performance, in both absolute terms and in relation/comparison to the economic performance of the rest of the UK
- The Scottish Government's priorities in relation to health, local government, policing, higher & further education and other spending portfolios.
- Economic/Cost Variables including pay & non-pay inflation and interest rates
- Demand for Services
- Increasing complexity of partnership delivery, public sector reform and regionalisation

Although there are considerable uncertainties association with each of these variables this does not reduce the importance of medium term financial planning. It does however highlight the need for financial plans to be flexible, and to be able to adjust to and accommodate variances from initial assumptions on an ongoing basis. Each of the key variables will therefore require to be subject to ongoing monitoring and review over the financial planning period. The Financial Strategy will be updated on a regular basis, following any significant changes in the Council's financial assumptions.

Key Variable: Impact of Brexit

The departure of the United Kingdom from the European Union in March 2019 will have a range of implications for the Council and for our communities. The level of funding available to the UK and Scottish Governments will be significantly affected by the economic impact of the revised arrangements and the removal, and potential replacement, of existing EU funding streams will also impact on the funding of Council services. The nature of changes associated with Brexit are highly uncertain at this stage but Brexit will undoubtedly have a range of implications for the Council's communities, households, workforce and partners with potential changes to procurement regulations, impacts on workforce availability and potential changes to legislation affecting issues such as waste and recycling being amongst the issues that will require to be assessed as the Brexit process is taken forward.

Key Variable: Block Grant Funding made available to the Scottish Government

The significant majority of the Scottish Government's spending has traditionally been financed through the Block Grant made available by the UK Government. The Block Grant has been determined through the Barnett formula which uses a population based formula to allocate to Scotland a proportionate share of changes to spending on comparable services in England. Under this approach, UK Government funding per capita is currently 16% higher in Scotland than the UK average.

The most recent UK Spending Review was completed in 2015 and provided detailed spending plans up to financial year 2019/20 as detailed in the table below.

Table 2: Scottish Budget (as per UK Spending Review)

	£ billion				
	2015-16	2016-17	2017-18	2018-19	2019-20
Resource DEL	25.9	26.1	26.3	26.3	26.5
Capital DEL	3.0	3.2	3.2	3.2	3.4
Total DEL	**28.8**	**29.3**	**29.5**	**29.6**	**29.8**

Before taking into account the impact of the new fiscal powers being made available to Scotland, and recognising that figures are subject to change particularly in relation to issues such as Brexit, it is currently projected that the level of funding available to support the Scottish Budget will increase slightly in cash terms, but fall by approx 4.4% in real terms, over the above period. This will have significant implications for public services, particularly those 'unprotected services' which will see more significant reductions as a result of commitments to support priority services (eg. health, policing, pre-school care) as outlined below.

The recent indications of an easing of UK fiscal policy and a reduced commitment to austerity measures following the recent UK Election results may impact on the above but unprotected services will still undoubtedly face significant reductions in funding over the upcoming period.

Key Variable: The Impact of the Scottish Government's Own Fiscal Policies

(particularly in relation to Taxation and Borrowing & Scotland's Economic Performance, in both Absolute Terms and in Comparison to the Economic Performance of the Rest of the UK)

Following the Scotland Act 2012 and the Scotland Act 2016, a number of new tax revenues are being devolved to Scotland as part of the new fiscal framework.

The Scottish Block Grant from the UK Government will continue to be calculated under the Barnett Formula but will then be adjusted (ie. reduced) to take account of the new taxes being transferred to the Scottish Government.

Funding available to support the Scottish Budget will be adjusted as follows for each devolved tax:-

	£M
Initial UK Block Grant	X
Less Removal of Block Grant Adjustment (BGA) consisting of 2 elements :-	
Initial Deduction of 'Value of Tax Revenues Foregone by UK Government'	(x)
Indexed annually to take into account the rate at which per capita revenues from the devolved tax have grown in the rest of the UK.	(x)
Replaced by the Amount Generated through the Devolved Tax	X

If the amount generated through the devolved tax exceeds the Block Grant Adjustment (BGA) then the Scottish budget will be better off, and vice versa if the amount generated is lower than the BGA. The 2 elements that will influence this will be:

- Scottish Government policy in relation to the Devolved Taxes
- Scotland's relative economic performance

The details of fiscal adjustments in relation to devolved taxes and the impact on the Scottish Budget will require close monitoring over the upcoming period.

Key Variable: The Scottish Government's Priorities

As has been seen in recent years, Scottish Government priorities in relation to health, local government, policing, higher & further education and other spending portfolios will have a significant impact on Councils' budget strategies.

The Scottish Government's election manifesto includes the following key commitments:

- To increase the NHS revenue budget by £500 Million more than inflation by the end of the parliament (2021). This would equate to a real terms increase in funding of around 3.7%.
- To protect the Police resource budget in real terms over the course of parliament term.
- To double the number of hours of free early years education and childcare to 1140 hours per year for vulnerable 2 year olds and all 3 and 4 year olds by 2020/21.

In a period of significantly reducing overall real terms funding, the impact of the above commitments will be to significantly increase the proportion of spending reductions that will require to be met from 'unprotected services'.

Other commitments, both existing commitments (eg. the requirement to maintain the teacher:pupil ratio) and those identified during the course of the Parliament, will also have a significant impact on the level of savings required from Council services and the approach to be taken to securing these savings.

One further issue that will require to be taken into account will be the impact of changes to the distribution of Scottish Government funding between individual Councils. This distribution is based on a needs based formula which recognises a range of factors including relative population levels and relative levels of groups with particular needs (eg. school aged pupils, over 65s, those with special needs). In recent years distribution changes have reduced the percentage of local government funding allocated to our Council, mainly as a result of a reduction in our relative share of the overall population and of the school aged population. The potential for further movements in funding distribution will require ongoing analysis over the upcoming period.

The above analysis highlights the number of variables that will influence the level of funding that will be available to support Scottish local government services over the upcoming 5 year period. However, seeking to estimate this level of funding is the key element of the financial projections required to support medium term financial and service planning. Taking into account current projections and information from recognised sources, including the Fraser of Allander Institute, the table below provides details of projected reductions in Scottish Government grant funding over the next 5 financial years covering 3 scenarios (high, mid-range and low).

Table 3: Projected Reductions in Scottish Government Grant funding (AEF)

	2018/19	2019/20	2020/21	2021/22	2022/23
Percentages					
High	4.50%	3.50%	3.00%	3.00%	3.00%
Mid-Range	3.50%	3.00%	2.50%	2.50%	2.50%
Low	2.50%	2.50%	2.00%	2.00%	2.00%
Values (£M)					
High	12.56	9.77	8.37	8.37	8.37
Mid-Range	9.77	8.37	6.98	6.98	6.98
Low	6.98	6.98	5.58	5.58	5.88

Note

For each of the above scenarios it is assumed that funding will be reduced in cash terms in each of the upcoming 5 years and that the next 2 years (2018/19 and 2019/20) will see the most significant year on year reductions.

The above figures also assume that the additional funding included in the 2017/18 Local Government Finance Settlement, following an announcement in February 2017 as part of the Scottish Parliament's debate on the Budget Bill, will be baselined for subsequent years. This announcement increased our Council's 2017/8 funding settlement by £3.896 Million (revenue) and £1.218 Million (capital). The Scottish Government has yet to confirm whether these amounts will be baselined and, if this is not the case, the 2018/19 reductions are likely to be at the pessimistic (high) end of the projections.

Key Variable : Economic/Cost Variables including Pay & Non-Pay inflation and Interest Rates

Pay Increases

There are also a range of variables that impact on the cost of the Council's Services. The Council's existing staff costs budget is £170 Million so changes that impact on staff costs (annual pay award, movements in the living wage, changes to National Insurance and Pensions Contributions) will have a significant impact on the Council's overall costs.

National public sector pay policy continues to limit pay increases to 1% per annum but it is important to recognise that local government pay awards are subject to a separate bargaining process and that measures to support the low paid, with annual uplifts in the Living Wage well above the 1% level, are expected to continue to increase pay levels over the upcoming period while increases in the cost of living will add further pressure.

The details provided in the table below assume an increase in pay costs (covering the pay award, increases in the Living Wage and pension cost increases) of 1.5% - 2.5% (mid-range 2%) for 2018/19, with slightly higher increases projected for the following 4 financial years. This to some extent reflects the recent indications, from both the UK and Scottish Governments, of a potential easing of public sector pay policy although this will require to be subject to ongoing review.

Table 4: Projected Pay Increases

	2018/19	2019/20	2020/21	2021/22	2022/23
Percentages					
High	2.50%	3.00%	3.00%	3.00%	3.00%
Mid-Range	2.00%	2.50%	2.50%	2.50%	2.50%
Low	1.50%	2.00%	2.00%	2.00%	2.00%
Values (£M)					
High	4.25	5.10	5.10	5.10	5.10
Mid-Range	3.40	4.25	4.25	4.25	4.25
Low	2.55	3.40	3.40	3.40	3.40

Non-Pay Increases

The approach taken to estimating the annual increases associated with non-pay spending is very high level rather than based on a detailed review recognising specific issues and pressures. Funding required to address specific issues and pressures varies significantly year on year based on the nature and significance of the issues that arise. The approach taken at this stage has been to make an overall allowance for non-pay cost increases which is intended to provide some scope to address specific pressures as they are identified. **This approach is also intended to provide some allowance for the impact on increased demands on specific services**. However, it is important to recognise that arrangements for dealing with demand pressures in relation to Adult Social Care Services are now dealt with through the Integrated Joint Board and Scottish Government direction has significantly influenced the budget setting arrangements for these services in recent years.

The need for non-pay cost increases will continue to be monitored on an ongoing basis.

The table below provides details of potential non-pay cost increases over each of the upcoming 5 financial years, again providing high, mid-range and low scenarios.

Table 5: Projected Non-Pay Increases

	2018/19	2019/20	2020/21	2021/22	2022/23
Percentages					
High	3.00%	3.00%	3.00%	3.00%	3.00%
Mid-Range	2.50%	2.50%	2.50%	2.50%	2.50%
Low	2.00%	2.00%	2.00%	2.00%	2.00%
Values (£M)					
High	4.38	4.38	4.38	4.38	4.38
Mid-Range	3.65	3.65	3.65	3.65	3.65
Low	2.92	2.92	2.92	2.92	2.92

Capital Investment Levels/Borrowing Costs

The Council has an agreed 10 Year Capital Investment Strategy which reflects agreed levels of affordable borrowing over that 10 year period. Members agreed to a restricted level of capital spending in the latter years of the investment strategy period in order to accommodate increased borrowing over the next 3 financial years to support investment in the Dumfries Learning Town Development (Phase 1).

While projected increases in interest rates will impact on the Council's borrowing costs over the upcoming period, the timing of borrowing will seek to minimise this impact and it will be the level of borrowing undertaken, and any changes to investment levels reflected in the agreed investment strategy, that will have a much more significant influence on borrowing costs.

The mid-range estimate reflected in the table below assume borrowing levels in line with those reflected in the current agreed Capital Investment Strategy. While the pessimistic (high) scenario makes a relatively modest allowance for increased borrowing costs above that level, any significant increase in currently agreed capital investment levels would result in greater increases in borrowing costs beyond those reflected in this Financial Strategy.

Table 6: Projected Loan Charges Increases

	2018/19	2019/20	2020/21	2021/22	2022/23
Percentages					
High	3.00%	3.50%	3.50%	3.50%	3.50%
Mid-Range	2.50%	3.00%	3.00%	3.00%	3.00%
Low	2.00%	2.50%	2.50%	2.50%	2.50%
Values (£M)					
High	0.66	0.77	0.77	0.77	0.77
Mid-Range	0.55	0.66	0.66	0.66	0.66
Low	0.44	0.55	0.55	0.55	0.55

Note

Additional capital expenditure of £10 Million (one off) would increase the above projections, and therefore the annual savings requirement, by approximately £650k per annum for 20 to 25 years.

One approach that could seek to offset the impact of increased borrowing costs would be to seek to increase the extent to which capital investment plans reflect projects of a 'spend to save' nature with decisions on capital spending priorities more closely linked to the generation of reductions in annual running costs. This approach will be further progressed as part of the development of the financial and service planning processes.

Summary of Overall Financial Projections

The high level projections included within this Financial Strategy have been based on an approach of identifying the key variables that will have an impact on assessing the Councils projected funding gap over each of the upcoming 5 financial years, based on 3 specific scenarios; High, Mid-Range and Low.

In summary, these projections indicate a potential 5 year funding gap of between £64 Million and £98 Million, with a mid-range estimate of £81 Million.

Also, if annual Council Tax increases are factored in (although it is important to recognise that this will be subject to annual consideration by Members) the 5 year funding gap is reduced to between £49 Million and £89 Million, with a mid-range estimate of £71 Million.

These amounts represent required annual savings of between 19% - 29% of the current annual level of revenue spending (or 15% - 26% if council tax increases are factored in). The mid-range scenario can be summarised as follows:-

Table 7: Summary of Mid-Range Financial Projections

	2018/19	2019/20	2020/21	2021/22	2022/23
	£M	£M	£M	£M	£M
Funding Reduction (AEF)	9.77	8.37	6.98	6.98	6.98
Budget Uprating*	7.6	8.56	8.56	8.56	8.56
Funding Gap	17.37	16.93	15.54	15.54	15.54
Cumulative Funding Gap		34.30	49.84	65.38	80.92
Including Council Tax Increases					
3% Council Tax Increase	2.07	2.07	2.07	2.07	2.07
Funding Gap	15.3	14.86	13.47	13.47	13.47
Cumulative Funding Gap		30.16	43.63	57.10	70.57

* Includes the combined impact of projected pay increases, non-pay increases and borrowing costs.

It is important to recognise that each of the figures reflected within this Financial Strategy represent early estimates and will be subject to potentially significant change. Each of the variables informing these figures will be subject to continual monitoring and updating as appropriate.