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Financial Sustainability Assessment – **Newport City Council**

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Summary report

Summary

What we reviewed and why

- 1 The project sought to assess the sustainability of councils' short to medium-term financial position.
- 2 This included a focus on the financial strategy of each council as well as reviewing financial 'indicators' of each council's financial position in relation to:
 - Performance against budget
 - Delivery of savings plans
 - Use of reserves
 - Council tax
 - Borrowing

Exhibit 1: about the Council

This exhibit sets out some background information on the Council's net revenue budget, the number of staff it employs and the value of its fixed assets.



The Council's net revenue budget for 2019-20 was £280.6m¹



The Council employs around 5,750 people, including around 1,350 teachers²



The Council's fixed assets as at 31 March 2019 were £503m³

- 3 We undertook this assessment because we identified financial sustainability as a risk to councils putting in place proper arrangements to secure value for money in the use of resources. In part, this was informed by the recent experiences of some councils in England, our knowledge of the financial situation in councils in Wales, and the general trend of decreasing resources for local government combined with rising demand for some services.

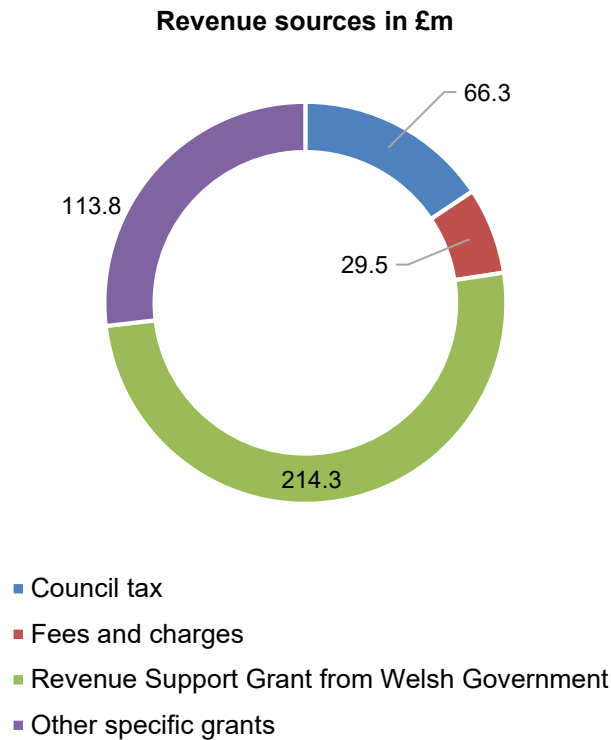
¹ Newport City Council Budget Dashboard 2019-20

² Council Officers

³ Newport City Council 2018-19 Statement of Accounts

Exhibit 2: the Council's sources of revenue

The pie chart below shows how much money the Council received from different funding sources during 2018-19.



Source – Council self-assessment

4 We undertook the review during the period October 2019 to December 2019.

What we found

- 5 Overall we found that: **The Council has a relatively strong financial position, but has recently recognised the need to develop a more strategic and sustainable approach to consolidate its position.** We reached this conclusion because:
- the Council does not yet have a sustainable strategy to support financial resilience and sustainability over the medium term;
 - while the Council has continued to underspend against its budget in recent years, its plans highlight that maintaining financial balance over the coming years will be more difficult;
 - while the Council's delivery of planned savings has been strong in recent years, its ability to continue to deliver savings within demand-led services is becoming more challenging;

- the Council has a high level of useable reserves, although most are currently earmarked for specific use;
- while council tax represents a growing proportion of the Council's income, its level of arrears is increasing; and
- in implementing its commercialisation strategy, the Council will need to manage risks associated with any increased borrowing.

Detailed report

The Council has a relatively strong financial position, but has recently recognised the need to develop a more strategic and sustainable approach to consolidate its position

The Council does not yet have a sustainable strategy to support financial resilience and sustainability over the medium term

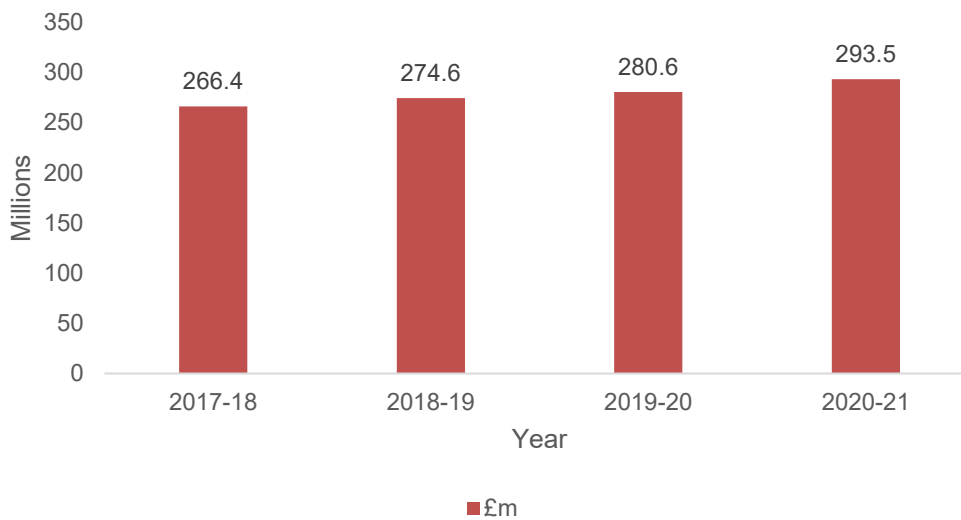
Why strategic financial planning is important

- 6 A clear and robust financial strategy is important to identify the likely level of funding available to a council, as well as the anticipated level of demand for, and cost of, providing services. Given the recent and anticipated funding pressures facing all councils it is also important to identify how it intends to respond to those pressures, and particularly how they will meet projected funding gaps.

What we found

- 7 We found that although the Council has a high-level medium-term financial projection that sets out its key financial challenges, its focus has primarily been on annual budgeting. The Council has recognised that it has not yet developed a strategic change programme to deliver a balanced and sustainable medium-term financial position.
- 8 We reached this conclusion because:
 - The Council's net revenue budget has increased between 2017-18 and 2020-21. However, in real terms the Council has seen a reduction in its net revenue expenditure on services during the same period.
 - **Exhibit 3** below sets out the Council's total net budget between 2017-18 and 2020-21:

Exhibit 3: total net budget between 2017-18 and 2020-21⁴

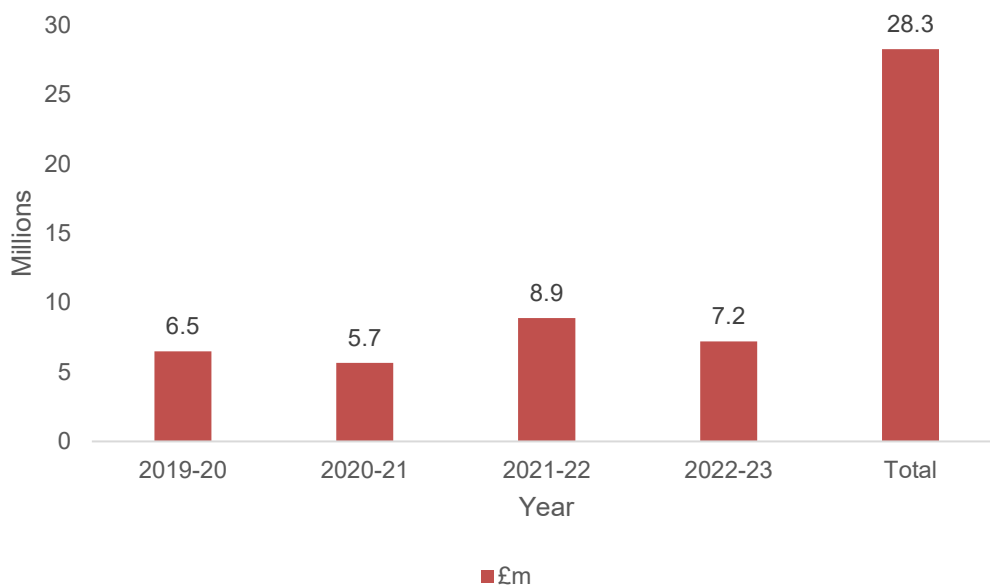


- The Council's medium term financial projection presented to elected members is a high-level summary of the financial challenge facing the Council between 2020-21 and 2022-23. In December 2019, prior to the announcement of the Welsh Government's revenue support grant settlement, the Council projected an overall deficit of £21.8 million between 2020 and 2023, of which £5.6 million arises in 2020-21. Exhibit 4 below sets out the Council's projected funding gap between 2019 and 2023.

⁴ Newport City Council Statement of Accounts

Exhibit 4: projected funding gap⁵

The following graph shows the funding gap that the Council has identified for this year, and the following three years.



- The Council's projection for 2020-21 was based on a 1% increase in revenue support grant (RSG) from the Welsh Government. In December 2019, the Council's final RSG settlement from the Welsh Government for 2020-21 was 5.4%, which equates to a £14 million cash increase. However, some of this increase includes amounts previously provided by the Welsh Government as specific grants for teachers' pensions and social services. Taking this into account, the Council estimates that it will receive £7 million more than it originally anticipated from the Welsh Government in 2020-21.
- The Council's projection contains a summary of the key assumptions used to model the size of the financial challenge, including forecasts of capital and revenue expenditure, and pay and demand pressures. Brief details of the pressures and their impact are also presented to Council Members.
- The Council does not explicitly consider sustainable development in its medium-term projection and it does not have a medium-term approach to close its forecast deficit. The Council has not set out a strategic vision for the future direction of council services in light of the financial deficit. The Council recognises that further work is required to ensure the budget is balanced

⁵ Source – 2019-20 figure taken from Newport City Council 12 December 2018 Cabinet meeting – Agenda Item; 2019-20 Budget and Medium Term Financial Projections. 2020-21 onwards figures taken from Newport City Council 20 December 2019 Cabinet meeting – Agenda Item; Revenue Budget and MTFP Draft Proposals.

over the medium term whilst meeting its Corporate Plan and wellbeing objectives.

- Although the Council has identified a range of planned savings to meet its financial deficit to 2022-23, those planned savings of £5.7 million in 2020-21, £759,000 in 2021-22 and £585,000 in 2022-23 do not completely close the anticipated deficit of £21.8 million, and the Council recognises that delivering savings will become more difficult.
- The Council has previously used alternative delivery models for its leisure and property services as well as working collaboratively to deliver school improvement services regionally with other councils through the Education Achievement Service. During the course of our review, the Council has indicated that in future it may consider a wide range of options to deliver services sustainably, but has not yet agreed on a strategy to do so.
- The Council has not undertaken a Council-wide review of statutory and discretionary services to inform its current financial projections. We have found evidence of such a review of statutory and discretionary services in our recent Environmental Health Follow Up review⁶.

While the Council has continued to underspend against its budget in recent years, its plans highlight that maintaining financial balance over the coming years will be more difficult

Why accurately forecasting expenditure is important

- 9 It is important that overspending and underspending are kept under control and that actual expenditure is as close to the levels planned as possible. A council that is unable to accurately forecast and plan expenditure runs the risk of creating unforeseen financial pressures that may compromise the ability to set a balanced budget. Significant patterns of underspending may be reducing the ability of a council to deliver its key objectives or meet its statutory responsibilities.

What we found

- 10 In recent years, overall the Council has underspent against its annual budget. However, within this overall underspend position, the financial outturn position has consistently reported continued overspends in a number of key service areas including social care and education. The Council recognises that in light of the forecast demand led pressures, it will be more challenging to deliver against its budget.

⁶ Wales Audit Office, [Newport City Council – Environmental Health follow-up review, 2020](#)

11 We reached this conclusion because:

- in the past two years the Council delivered against its budget and **Exhibit 5** below sets out this performance.

Exhibit 5: amount of overspend/underspend relative to total net revenue budget

The following exhibit shows the amount of overspend or underspend for the Council’s overall net revenue budget for the last two years and also its forecast end of year position for 2019-20 as at October 2019.

	Original Budget net revenue budget	Actual Outturn net revenue budget	Amount of overall surplus/overspend	Percentage difference from net revenue budget
2017-18 ⁷¹	£266.4m	£265.1m	£1.3m underspend	0.5% underspend
2018-19 ⁸²	£274.6m	£272.2m	£2.4m underspend	0.9% underspend
2019-20 as of end of October 2019 ⁹	£280.6m	£281.3m	£0.7m overspend	0.2% overspend

- Year on year the Council has seen significant overspends within service areas (excluding schools), in areas such as looked after children’s out of county placements, adult community care, additional learning needs and independent fostering. These areas of budgetary pressure present an ongoing risk to the Council’s financial position.
- The overall underspends in the table above have been supported by factors such as Council Tax surpluses, underspends against the Council Tax Reduction Scheme and revenue contingency budgets, and corporate services underspends, which have outweighed the pressures above. However, many of these underspends are uncertain in nature and there is no guarantee that they will continue in the future.
- Delegated school budgets are also under significant pressure with a forecast overspend of £3.1 million in 2019-20. This would see overall school reserves

⁷ 2017-18 data taken from Revenue Budget Out-Turn Reports presented to Cabinet June 2018.

⁸ 2018-19 data taken from Revenue Budget Out-Turn Reports presented to Cabinet June 2019.

⁹ 2019-20 data taken from Newport City Council 20 December 2019 Cabinet meeting – Agenda Item; Revenue Budget and MTFP Draft Proposals Appendix 8 Financial Resilience.

falling below zero at the end of the year. Such overspends by schools could add further pressure to the Council's financial position.

- Whilst the Council has identified its current major budget pressures, it has not set out how it intends to strategically manage these budget pressures in a sustainable way.
- In the past 18 months, the Council has sought to address its looked after children's out of county residential placements budget pressure. In 2019, we reviewed the Council's actions in addressing that budget pressure and found that although it has taken some effective measures to address its budget pressures for out of county placements, significant ongoing pressures remain and more work is required to develop a sustainable long-term approach.

While the Council's delivery of planned savings has been strong in recent years, its ability to continue to deliver savings within demand-led services is becoming more challenging

Why the ability to identify and deliver savings plans is important

- 12 The ability to identify areas where specific financial savings can be made, and to subsequently make those savings, is a key aspect of ensuring ongoing financial sustainability against a backdrop of increasing financial pressures. Where savings plans are not delivered this can result in overspends that require the use of limited reserves whilst increasing the level of savings required in future years to compensate for this. Where savings plans are not delivered and service areas are required to make unplanned savings, this increases the risk either of savings not being aligned to the Council's priorities, or of 'short-term' solutions that are not sustainable over the medium term.

What we found

- 13 In recent years the Council has delivered a high level of its planned savings. However, demand led services such as social care and education are now finding it more challenging to deliver planned savings.
- 14 We reached this conclusion because:
- the Council achieved 92% of its planned savings in 2018-19, as illustrated in **Exhibit 6** below.

Exhibit 6: savings delivered during 2018-19 as a percentage of planned savings¹⁰

The following exhibit sets how much money the Council intended to save through planned savings during 2018-19 and how much of this it actually saved.

£8.6m	£7.9m	£0.7m	92%
Total planned savings	Planned savings delivered	Planned savings not delivered	Percentage savings achieved

- Education and social care accounted for the majority of the underachievement and those service areas contain some of the Council's major budget pressure areas.
- The Council has identified a range of planned savings to close its financial shortfall of £21.8 million until 2022-23. However, the level of those savings beyond 2020-21 is £1.3 million which is considerably lower than the level required and this demonstrates that its approach to meeting its financial deficit is generally short term. The Council recognises that delivering savings will become much more difficult going forward.
- Of the £7.0 million savings planned for 2019-20, £1.5 million will be delivered through a technical accounting adjustment (Minimum Revenue Provision) and £879,000 is a reduction in its Council tax reduction scheme. The Council's monitoring reports showed that at the end of October 2019, it was on target to make 93% of its planned savings in 2019-20 with the majority of that underachievement in social care.
- The Council has recognised that in order to achieve the necessary savings between 2020-21 and 2022-23 it will need to take a different approach to that which it has used to date. The Council has indicated that it plans to undertake a root and branch review of its eight service areas to help increase its financial resilience.
- Savings plans for 2019-20 that we reviewed generally had robust underpinning data and assumptions. However, in a small number of cases the Council is not forecasting that it will fully achieve the planned savings initially. In response, the Council would therefore need to either defer those savings to subsequent years or recognise them as future budgetary pressures, either of which adds further pressure to the Council's financial position.

¹⁰ Source – Newport City Council, 2019

- Draft savings proposals for 2020-21 that we reviewed varied in the level of detailed assumptions and underpinning data and many of the proposals set out limited anticipated impact of the reduced funding.
- Although draft savings proposals refer to the Well-Being of Future Generations Act 2015, it is unclear how the Council has consistently used the principles of the Act to inform decision making around those savings. The Council also carries out fairness and equality impact assessments on savings proposals.

The Council has a high level of usable reserves, although most are currently earmarked for specific use

Why sustainable management of reserves is important

- 15 Healthy levels of usable reserves are an important safety net to support financial sustainability. As well as being available to fund unexpected funding pressures, useable reserves can also be an important funding source to support 'invest to save' initiatives designed to reduce the ongoing cost of providing services. Councils that show a pattern of unplanned use of reserves to plug gaps in their revenue budget that result in reductions of reserve balances reduce their resilience to fund unforeseen budget pressures in future years.

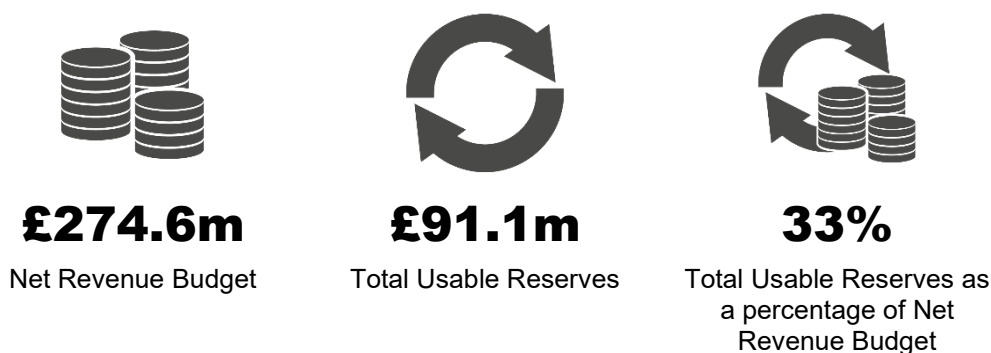
What we found

- 16 We found that the Council has not previously made any unplanned use of reserves to fund revenue budget pressures and in recent years has increased its overall level of reserves. The Council has only started to use reserves from 2018-19 to balance its budget.
- 17 We reached this conclusion because:
- The Council has a strong track record of protecting its reserves. Between 2012-13 and 2017-18, the Council added to its reserve balances.
 - According to its 2018-19 Statement of Accounts the Council held a total of £103.0 million in usable reserves, consisting of:
 - £47.9 million of 'smoothing reserves', set aside by the Council to smooth funding variations over periods of time (£45.5 million of this relates to two PFI schemes which will be wound down over the next 18 years);
 - £28.5 million of 'enabling reserves', retained for potential future investment including an Invest to Save reserve of £11.1 million and usable capital receipts of £8.3 million;
 - £11.5 million of 'risk reserves', held to mitigate against specific risks previously identified by the Council;
 - £6.5 million of Council Fund, available for any purpose;

- £5.5 million of 'other reserves', held for specific projects/issues; and
- £3.1 million of reserve balances relating to individual schools.
- While many of the above reserve balances could be applied by the Council for alternative use if needed, they are to some extent already earmarked for a specific future purpose (other than the £6.5 million Council Fund reserve). Therefore, using such earmarked reserves could lead to planned future activity being curtailed or delayed, or risks being inappropriately managed, unless they were later replenished.
- Furthermore, the Council identifies that the following reserves from the above list are not readily available for alternative use: school reserves of £3.1 million (for the specific use of individual schools only), and capital receipts reserves of £8.3 million (largely limited to use on capital projects). This leads to a total of £91.1 million of 'usable reserves' which the Council could access, but would consequently have to manage the impact of such use. **Exhibit 7** below sets out the Council's level of usable reserves against its annual budget in 2018-19.

Exhibit 7: amount of reserves vs annual budget, 2018-19¹¹

This exhibit shows the amount of usable reserves the Council had during 2018-19 compared with its net revenue budget for the same year.



- 2018-19 was the first time in recent years that the Council used its reserves to balance its budget. It used £1.2 million in 2018-19, and plans to only use £900,000 in 2019-20 and £459,000 in 2020-21. The Council forecasts that its usable reserves will fall to £71.5 million in 2019-20 and £66.0 million in 2020-21.
- The Council has a published reserves strategy and elected members are informed of the Council's position in relation to all reserves when agreeing the Council's budgets annually. In 2019-20, elected members agreed to

¹¹ Source – Newport City Council, 2019

maintain the Council Fund at £6.5 million, supported by a revenue contingency of £1.5 million in the budget. The Council assessed that the risks in the budget were low enough to allow for this level of general reserve, although it is below the 5% of net revenue expenditure excluding schools (£9.2 million) that the Council uses as a guiding principle in establishing the minimum Council Fund level.

While council tax represents a growing proportion of the Council's income, its level of arrears is increasing

Why council tax collection rates are important

- 18 Failure to collect the amount of council tax due to the Council will result in less income. This in turn may increase the financial pressures on the Council and require it to make additional savings. Whilst council tax is not the biggest source of funding for councils in Wales, it remains a key income source.

What we found

- 19 We found that although the proportion of the Council's budget funded by council tax is increasing, council tax arrears have increased over time.
- 20 We reached this conclusion because:
- The Council set its tax-base for 2019-20 based on an increase of 1.2% (£58.5 million in 2018-19 to £59.2 million in 2019-20), significantly higher than the all-Wales average of 0.5% to 0.8% over the last few years. This resulted in a £634,000 increase in council tax income but consequently reduced the Revenue Support Grant increase from the Welsh Government by £391,000.
 - In real terms, the percentage of gross budget funded by council tax has risen from 9.2% in 2008-09 to 13.3% in 2018-19. Although the proportion of gross expenditure funded by council tax has increased, it remains the second lowest across all councils in Wales. The Council estimates that if it were to increase council tax to the average level across Wales, this would equate to around £7 million in additional funding. However, this would require a council tax increase of around 18%.
 - Between 2008-09 and 2018-19, the Council has improved the amount of council tax it collects annually from 95.8% to 96.6%. Despite this improvement, council tax arrears have increased from £2.2 million in 2008-09 to £4.6 million in 2018-19, an increase of 109%. This compares to an increase in annual council tax debit of 69% over the same period. Over this period, in real terms the Council's arrears balance has fallen from the 4th lowest in Wales to the 12th lowest.
 - The Council's medium-term financial projection (setting out an overall deficit of £21.8 million between 2020 and 2023) is modelled on the basis of a 4%

council tax increase annually until 2022-23 but full Council considers and sets the level of council tax on an annual basis. Those projections are below the council tax increases agreed in the past two financial years (5.95% in 2019-20 and 4.8% in 2018-19). In December 2019, Cabinet agreed to consult on a council tax increase of 7.95%.

Exhibit 8: council tax collection rates¹²

This exhibit shows the percentage of council tax due that the Council collected during 2018-19.



Cash collected from Council Tax at 31 March 2019 was **£64.4m** (96.6%) against a collectable debit of **£66.7m**

In implementing its commercialisation strategy, the Council will need to manage risks associated with any increased borrowing

Why maintaining sustainable levels of borrowing is important

- 21 Borrowing can be a valuable source of funding, for example to fund large scale capital projects such as new schools or leisure centres. However, the cost of repaying borrowing including interest costs can have a long-term impact on ongoing revenue budgets. Councils that fail to properly balance the benefits and costs of borrowing with their current and predicted revenue budgets risk reducing the amount of funding available for service delivery. Borrowing to fund commercial activity has the potential to generate additional income to fund council services, however, it can also bring significant risks that would be associated with any commercial activity.

¹² Source: Stats Wales Council Tax Collection Rates in Wales: 2018-19

What we found

- 22 We found that in implementing a new emerging commercialisation strategy, the Council will need to manage the associated risks in terms of borrowing.
- 23 We reached this conclusion because:
- The Council has limited income from commercial properties, 0.4% of its overall net expenditure budget. In 2018-19, the Council disclosed rental income of £1.3 million from investment properties valued at £7.8 million.
 - In 2018-19, the Council had total outstanding borrowings of £192.8 million from a mixture of sources including the Public Works Loan Board (PWLB), Lender Option Borrower Option (LOBO) loans, and other long-term loans. On top of this amount, the Council has further obligations to meet under Public Finance Initiative (PFI) and lease arrangements.
 - The Council's overall cost of borrowing in 2018-19 was 9.1% of its total net revenue budget, which was high in comparison with other Welsh councils. A large driver of this cost of borrowing is the Council's PFI obligations, which contribute over £5 million of annual interest costs for the Council alone (out of total annual interest costs of £13.6 million).
 - The Council has made previous efforts to limit its borrowing as far as possible by using 'internal borrowing' (that is, using available internal resources first before borrowing from other entities). Over time, the Council will need to borrow from third parties to cover for previous internal borrowing, in order to fund its planned activity. Doing so will attract further interest costs in the medium to long term. The Council will therefore need to carefully consider the affordability of further interest costs when deciding whether to take on any further external borrowing above that already planned.
 - In April 2019, the Council's Cabinet agreed a commercialisation strategy which aims to contribute to addressing the financial deficit that the Council faces. The strategy includes three main approaches:
 - current services provided on a more commercial basis;
 - new services being provided by the Council; and
 - property investment, both commercial and residential.
 - The Cabinet agreed to examine each of these areas and to examine business cases before taking any decisions. It agreed in its Capital Strategy to establish a £50 million property investment fund to be funded via additional borrowing, but no such investments have yet been undertaken. The Cabinet recognised that such an approach creates additional financial risks with the significant increase in the Council's long-term debt and potential uncertainty around the return on any investments. Given these risks, Cabinet agreed a framework in which it will review and assess opportunities to assess the level of risk and benefit within agreed parameters.

Exhibit 9: Council borrowing¹³

The exhibit below shows the total amount of money that the Council has borrowed to fund commercial investments, as well as the cost of all the borrowing that the Council has as a proportion of its net revenue budget.



£0m

Amount of borrowing to fund commercial investments



9.1%

Cost of total borrowing as a proportion of net revenue budget 2018-19¹⁴

¹³ Source – Newport City Council, 2019

¹⁴ This figure includes the interest costs of PFI and MRP

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