Financial Sustainability Assessment – Newport City Council

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Contents

What we looked at and why

1 We undertook this assessment as financial sustainability continues to be 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 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. We undertook a similar project in 2019-20, before the COVID-19 pandemic.

2 Our 2020-21 assessment on councils' financial sustainability was in two phases. Phase 1 was a baseline assessment of the initial impact of COVID-19 on local councils' financial position. Phase 1 drew on: the year-end position for 2019-20; the position at the end of quarter 1 for 2020-21; and projections for quarter 2 for 2020-21. Following Phase 1, in October 2020 we published a national summary report – **Financial Sustainability of Local Government as a result of the COVID-19 Pandemic**[1]. We found that councils and the Welsh Government have worked well together to mitigate the impact of the pandemic to date, but the future sustainability of the sector is an ongoing challenge.

3 The pandemic has had an immediate and profound effect on public sector finances as a whole and, as a consequence, on councils' financial position. The summary report set a high-level baseline position, including the reserves position of local councils before the pandemic. It also set out the initial financial implications of the pandemic for local councils and the scale of the anticipated challenge going forward.

4 This report concludes phase 2 of our financial sustainability assessment work during 2020-21. As part of this we are producing a local report for each of the 22 principal councils in Wales.

5 We undertook this assessment during February 2021 to March 2021.

[1] Audit Wales, Financial Sustainability of Local Government as a Result of the COVID-19 Pandemic, October 2020.

The Council has a good understanding of its financial position and recognises the need to transform its service delivery for future sustainability, although further work is required to design and implement these changes

The immediate impact of COVID-19 on the Council's financial sustainability has been funded by the Welsh Government

6 This section sets out the impact that COVID-19 has had to date on the Council's financial position and the extent to which this has been mitigated by additional funding from the Welsh Government.

7 We found that:

- the Council quickly set Strategic Recovery Aims in response to the COVID-19 pandemic that make explicit its priorities. The Council has used its existing governance framework to manage the delivery of these additional Strategic Recovery Aims.
- when preparing its financial plans, the Council has maintained a general contingency of £1.5 million within its revenue budget as a safeguard for unknown costs (in line with the approach taken in previous years). On top of this, it has forecasted the potential impact of the COVID-19 pandemic through reduced revenue and additional costs. The Council has taken this approach in previous years and has achieved small underspends in recent years.

Exhibit 1: the cost to the Council of COVID-19 over 2020-21

The table below shows the Council's estimated additional expenditure and lost income over 2020-21 as a result of COVID-19 and how much of this was covered by extra funding received from the Welsh Government.

The additional amount the Council estimates it will have spent as a result of COVID-19 over 2020-21.	£18.1 million
The amount of income the Council estimates it will have lost as a result of COVID-19 over 2020-21.	£5 million
The amount of additional funding the Council estimates it will receive from the Welsh Government over 2020-21 to mitigate the impact of COVID-19.	£23.1 million
The cost to the Council of COVID-19 over 2020-21 after extra funding from the Welsh Government is taken into account.	£0

Source: Newport City Council, March 2021

The Council has a financial strategy that quantifies the gap in funding for future years and continues to recognise the need for transformational changes in service delivery, although details of these changes are yet to be confirmed

Why strategic financial planning is important

8 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.

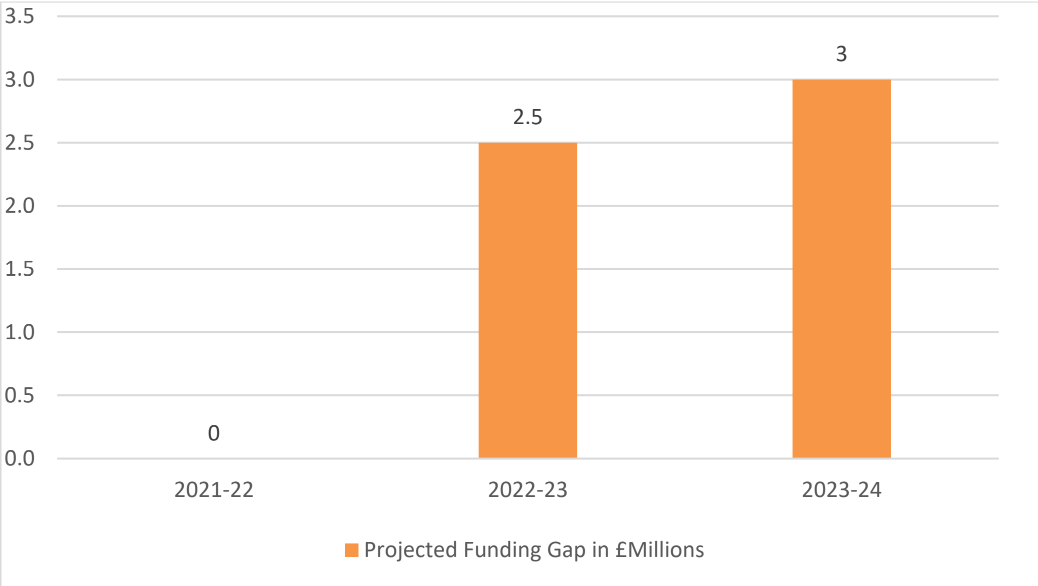
9 We found that:

- in August 2020 we reported[2] that 'the Council did not have a sustainable strategy to support financial resilience and sustainability over the medium term'. Also, that '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'.
- the Council had an 'Invest to Save'[3] usable reserve of £9.9 million at March 2020 set aside for additional costs to finance a transformational programme to move towards a more financially sustainable delivery of services model. Understandably, the Council's focus on responding to the COVID-19 crisis has prevented further progress being made in the last year.
- to inform financial planning and identify their projected funding gaps, all councils make assumptions about factors that will impact on the amount of funding they will have available in future years. The Council sets out financial assumptions within its Medium Term Financial Plan (MTFP) produced in January 2021, including:
  - an increase in the Welsh Government's Revenue Support Grant of 5.58% in 2021-22 (which has since been confirmed by the Welsh Government) and with assumed smaller increases of 1.85%, 1.15% and 1.0% in the following three years.
  - increases in Council Tax of 5% in 2021-22 (which was reduced to 3.7% in response to a public consultation), then a consistent 4% each year in 2022-23 to 2025-26.
- the Council's MTFP also sets out the key assumptions and financial pressures over and above general pay and pricing inflation in 2021-22. At January 2021 the Council planned to respond to these pressures by adding around £8.1 million in 2021-22 into its revenue budget.
- the Council's MTFP includes a sensitivity analysis which states the key financial assumptions used when calculating its budgetary projections and also includes consequences of any differences in these assumptions.
- in August 2020 we reported[2] that: the Council receives over half of its total revenue from the Welsh Government's revenue support grant (RSG). At the time of our fieldwork for that report, the Council projected a funding gap of £21.8 million for the three years 2020-2023. Since then, the actual increases in RSG have been significantly higher than the Council's projections. Consequently, the Council now projects a significantly smaller funding gap of £5.5 million for the next three years, being 2021-2024. The spread of the funding gap is depicted in **Exhibit 2**.

[2] Audit Wales, Financial Sustainability Assessment of Newport City Council, August 2020
[3] Newport City Council, Statement of Accounts 2019-20

Exhibit 2: Newport City Council has a total projected funding gap for the three years 2021-22 to 2023-24 of £5.5 million

This graph illustrates the funding gap that the Council has identified for the following three years. The Council is projecting a balanced spend in 2021-22 after taking into account planned savings. The gaps in funding in the following years are:



Source: Newport City Council, Medium Term Financial Plan, March 2021

- the Council's MTFP and budget include some details about amounts of money being 'invested' to deliver against Corporate Plan promises, such as a new Household Waste Recycling Centre, digital transformation and delivery of the capital programme.

Whilst the Council has reduced its usable reserves in the last year, they remain comparatively high, although most are earmarked for specific use and a significant proportion relates to future Private Finance Initiatiative obligations

Why sustainable management of reserves is important

10 Healthy levels of usable reserves are an important safety net to support financial sustainability. As well as being available to fund unexpected funding pressures, usable 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.

11 We found that:

- when considering the usable reserves held by the Council at the end of 2018-19, in August 2020 we reported[2] that the Council had a high level of usable reserves, although most were earmarked for specific use.
- at the end of 2019-20 the Council's usable reserves were reduced from £94.7 million in 2018-19 to £78.8 million, mainly with transfers to the General Fund from Usable Reserves for: Bad debt provision; Insurance; Schools; Capital Expenditure; and Invest to Save.
- according to its 2019-20 Statement of Accounts the Council held a total of £78.8 million in usable reserves, consisting of:
  - £44.2 million of 'smoothing reserves', set aside by the Council to smooth funding variations over time (£42.3 million of this relates to two PFI schemes to be unwound over the next 17 years);
  - £17.1 million of 'enabling reserves', retained for potential future investment including an Invest to Save reserve of £9.9 million;
  - £4.8 million of 'risk reserves', held to mitigate against specific risks identified by the Council;
  - £6.5 million of Council Fund, available for any purpose;
  - £5.0 million of 'other reserves' for specific projects/issues; and
  - £1.1 million of reserve balances relating to individual schools.
- while many of the above reserve balances could be applied by the Council for alternative use, they are to some extent already earmarked for specific future purposes (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 risk being inappropriately managed. Some reserves (such as the PFI smoothing reserve) are also being currently used and so would need to be replenished urgently if drawn upon.

- the Council's MTFP proposed to further reduce usable reserves to £75.2 million by the end of 2020-21, with this reduction being across its range of individual earmarked reserves. The Council is forecasting a relatively large revenue underspend in 2020-21 and so will not need to further reduce its usable reserves to supplement revenue budgets.

Exhibit 3: the amount of reserves versus annual budget

This exhibit shows the amount of usable reserves the Council had at the end of 2019-20 and the previous four years as a proportion of the net cost of the services the Council delivers.

	2015-16	2016-17	2017-18	2018-19	2019-20
Net Cost of Services in £ millions [4]	278.0	277.5	284.5	294.0	299.8
Total Usable Reserves in £ millions [5]	93.3	95.4	94.0	94.7	78.8
Total Usable Reserves as a percentage of the net cost of services [6]	33.5%	34.5%	33.0%	32.2%	26.3%
Comparison with the other councils of Wales*	1/22	1/22	2/22	2/22	5/22

Source: Newport City Council Statement of Accounts and

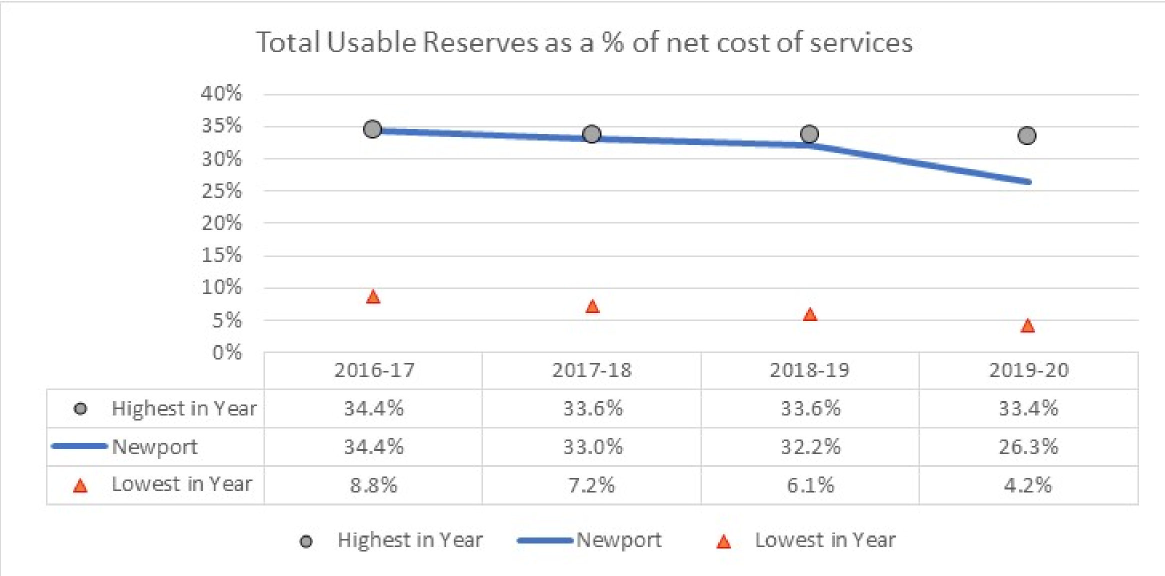
* Audit Wales analysis of the Statement of Accounts of Welsh councils

[4] Value used is the net cost of services charged to the general fund from the Expenditure Funding Analysis, less any Housing Revenue Account cost of services, plus precepts, levies and debt interest. Source: Statement of Accounts

[5] By usable reserves, we mean the total general fund balance, together with earmarked reserves that councils are not legally prevented from redirecting to use for another purpose. We therefore include PFI smoothing reserves (£42.3 million at March 2020) and do not include usable capital receipts (£8.3 million at March 2020). Source: Statement of Accounts

[6] Audit Wales calculation.

Exhibit 4: usable reserves as a percentage of Net Cost of Services are comparatively high, although they have been in decline for the last three years



	2016-17	2017-18	2018-19	2019-20
Highest in Year	34.4%	33.6%	33.6%	33.4%
Newport	34.4%	33.0%	32.2%	26.3%
Lowest in Year	8.8%	7.2%	6.1%	4.2%

Source: Audit Wales analysis of the Statement of Accounts of Welsh councils

The Council has consistently spent within its revenue budget over recent years

Why accurately forecasting expenditure is important

12 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

13 In August 2020, we reported[2] that while the Council had continued to underspend against its budget in recent years, its plans highlight that maintaining financial balance over the coming years will be more difficult.

14 In January 2021[7], the Council forecast an underspend of £2.7 million on its revenue budget for 2020-21, largely as a result of the COVID-19 pandemic, to: temporary school closures; lower demand for its adults' social care services; and

[7] Newport City Council, report to Cabinet on 8 January 2021, November 2020 – Revenue Budget Monitoring

not needing to draw upon the £1.5 million contingency. Despite this underspend, the report details service areas where financial pressures remain and emphasises the need for continued remedial action and potential for this position to worsen. The Council's arrangements enable it to closely manage the financial performance of service areas and therefore to respond within year to notable under and over spends.

15 The Council has recently added further commitments to its capital programme. Whilst these decisions are well understood and arrangements are in place to closely monitor progress, these capital investments increase the borrowing costs for the Council. These costs have been budgeted for but place increased strain on the Council's revenue budget, which could inhibit the Council's ability to respond effectively to potential future funding cuts or expenditure pressures.

Exhibit 5: the amount of overspend/underspend relative to the net revenue budget set at the beginning of each year

The following exhibit shows the amount of overspend or underspend for the Council's overall net revenue budget for the last four years and also the year to date as at November 2020.

	2016-17	2017-18	2018-19	2019-20	2020-21
Original net revenue budget £ millions [8]	263.9	266.4	274.6	280.6	300.3
Actual Net Revenue Outturn	263.6	265.1	272.2	278.8	297.5*
Amount of overall surplus (-) /overspend (+) [9]	-0.3	-1.3	-2.4	-1.8	-2.8*
Percentage difference from net revenue budget	-0.1%	-0.5%	-0.9%	-0.6%	-0.9%*

* Projected figure by Newport City Council at the end of November 2020.

[8] The Original Net Revenue budget agreed by Newport City Council for the start of the financial year.

[9] Audit Wales calculation.

The Council has a good record of achieving savings but is finding it more difficult to identify future savings to balance its budget

Why the ability to identify and deliver savings plans is important

16 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

17 In August 2020, we reported[2] that 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.

18 Whilst the Council's MTFP does set out some savings plans over the four-year period, these do not fully bridge the funding gap after 2020-21.

19 The Council reported to its Cabinet in January 2021 that implementation of its planned savings had been delayed due to the COVID-19 crisis. The delays are both detailed and quantified.

Exhibit 6: the savings delivered during 2019-20 as a percentage of planned savings

The following exhibit sets how much money the Council intended to save from its savings plans during 2018-19 and 2019-20 and how much of this it actually saved as well as estimated figures for 2020-21 and 2021-22.

	2018-19	2019-20	2020-21	2021-22
Total planned savings in £ millions	8.6	6.553	5.417	3.391
Planned savings achieved in £ millions	7.9	5.961	4.517	N/A
Planned savings not achieved in £ millions	0.7	0.6	0.9	N/A
Percentage of savings achieved	92%	91%	83.4%	N/A

The Council has a reasonable liquidity position to cover its immediate liabilities

Why the Council's liquidity position is important

20 Gauging current assets to current liabilities (liquidity) is important because:

- it serves as an indicator of how a council manages its short-term finances.
- while it is commonly used to examine whether organisations are able to pay their debts in the short term, this is unlikely to be a risk for councils given their ability to take short-term borrowing. It does also, however, act as an indicator of how a council manages its short-term finances.
- councils with low liquidity ratios should ensure they have arrangements in place to meet their liabilities.
- there may be additional costs for councils that rely on short-term borrowing to pay debts.
- councils with very high liquidity ratios should consider whether they are managing their current assets in the most effective way.

21 We found:

- in one of the last five years spanning 2015-2020, the value of the Council's current assets was less than its current liabilities as is shown in **Exhibit 7**; and
- the notable fluctuation in the value of Current Assets and Liabilities in 2015-2018 was due to the funding and completion of Friars Walk.

Exhibit 7: the Council’s liquidity ratio has generally been higher than or approximately the median of Welsh councils

	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21*
Current Assets in £ Millions	134.8	127.7	31.8	101.7	69.3	69.3
Current Liabilities in £ Millions	73.9	108.9	56.5	94.1	67.5	66.9
Liquidity Ratio	1.8	1.2	0.6	1.1	1.0	1.0

*Projected by Newport City Council

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