Local Government, Housing and Planning Committee

Pre-Budget Scrutiny 2025-26

COSLA, Solace and Directors of Finance Section Response

Executive Summary of Key messages of COSLA's Submission

Align spending decisions to the Verity House Agreement (VHA)

1. VHA has been jointly developed and agreed by the Scottish Government and Local Government with the intention that it will enable the achievement of better outcomes for people in our communities. Making greater progress on the development of the Fiscal Framework, which is core to the VHA, would provide Local Government with sustainable, long-term funding as well as greater fiscal empowerment and fiscal flexibilities which would allow councils to tailor spend to best meet local needs. Scottish Government spending decisions that run counter to the VHA agreement, such as the council tax freeze and maintaining arbitrary teacher numbers, will prevent councils from achieving better outcomes for their communities.

2. Such policy and spending decisions put further pressure on councils who are legally required to set a balanced budget. This means councils are forced to make even tougher decisions and, as reflected within this response, will only lead to further service cuts and job losses. To protect essential frontline services and allow councils to deliver the best possible services for their communities, Scottish Government needs to recognise fully the VHA and provide adequate, sustainable and flexible funding for Local Government.

3. In advance of the 2025/26 Scottish Budget, Local Government has sought earlier budget engagement, greater transparency in the makeup of the Local Government Settlement, progression towards multi-year funding and clearer links between budget decisions and outcomes. Council Tax should also be a decision for local authorities and there should be no freeze or national cap applied in 2025/26 and beyond.

Local Government cannot deliver the same level of services with current funding

4. Scottish Government and Local Government are both facing unprecedented financial pressures where it has become necessary to prioritise finite resource. Over the past decade, Local Government has experienced substantial pressure to core budgets and the consequences of this are now becoming apparent. As reported by the Accounts Commission, Scotland's 32 Councils are facing a £585 million funding gap in 2024/25 , with Councils facing an estimated cumulative budget gap of £780 million by 2026/27, which represents five per cent of councils' revenue budget. Given the legislative requirement to set a balanced budget, Councils are taking action to manage the

funding gap which is leading to tough decisions and reducing the number of services they deliver.

5. The pressure on councils continued this year, as the 2024/25 Local Government Settlement did not provide sufficient funding to address the increased demand for services, increased operational costs due to inflation, nor any funding to support pay awards in 2024/25. The 2024/25 Settlement was effectively a ‘flat cash’ revenue settlement as all additional funding was either for new policy commitments, the agreed contribution to the 2023/24 pay deal or funding for a council tax freeze. Lack of funding for pay deals has exacerbated workforce pressures for Local Government and means funding is taken out of other key council budgets such as roads, leisure and planning services. This has been compounded by an increased trend in ringfenced and directed funding for policy commitments and baselined funding for additional commitments being eroded by inflation.

6. To alleviate pressure across wider public sector services, the Scottish Government should review its policy programme in partnership with Local Government and the wider public sector, to identify commitments that are not yet costed and no longer feasible to take forward, given current financial constraints. Following this, Scottish and Local Government should work in partnership, as per the VHA, to identify how best to achieve joint priorities and to develop a shared public narrative which articulates the reality of what is, and what is not, possible with available resources.

Local Government requires sustainable capital investment to tackle the national housing emergency

7. This year’s budget has seen the Local Government Capital Settlement cut by £54 million, alongside significant cuts to specific capital grants including the affordable housing grant (£205 million), discontinuation of the regeneration capital grant (£25 million) and majority of place-based investment programme (£24 million). All four of the FM’s priorities are intrinsically linked to capital budgets therefore without adequate housing, poverty cannot be addressed (let alone eradicated); increased poverty is linked to unemployment and worsening health outcomes which impacts on the ability to grow the economy; and a reduction in the number of homes being built will hinder progress towards a just transition to net zero as less homes will be retrofitted to mitigate against carbon emissions.

8. These capital cuts come at a time when half of Scotland’s 32 local authorities are struggling to meet their statutory duties to address homelessness which has been further compounded by pressures from humanitarian programmes, asylum seekers, removal of requirements of local connections and the cost-of-living crisis. At the time of writing, 10 local authorities had declared a housing emergency. Demand pressures have surpassed current resource, so local authorities are seeking urgent investment in the housing sector. To mitigate against the impacts of poverty, improve health outcomes and support a just transition to net zero Local Government need sustainable investment in affordable housing.

Empower Local Government to raise local levies

9. Local Government should be empowered to raise revenue locally for reinvestment in local services which benefit individuals, communities and visitors. Progress has been made in this area with the passing of the Visitor Levy Act in the Scottish Parliament

with local authorities looking to introduce these powers in 2026/27. However, it is important to recognise that delays between legislative change and when it can be enacted can lead to gaps in funding and additional pressures being placed upon local authorities. Further avenues are being explored in relation to an infrastructure levy and cruise ship levy which are welcome.

Empower Local Government to invest in tackling climate change

10. To achieve climate goals, we must work in partnership. This must incorporate funding to allow Local Government investment in areas such as decarbonisation, as well as better long-term planning.

11. The Scottish Government announced in April 2024 that it was changing the way it accounts for carbon, removing the interim climate goals in 2030 and 2040. While the 2045 net zero target remains, the delivery of this goal will only be achievable if we, as a country, become more effective at delivery. The key issues on net zero delivery highlighted by the Net Zero, Energy and Transport Committee in early 2023 in its report "The role of local government and its cross-sectoral partners in financing and delivering a net-zero Scotland | Scottish Parliament" remain relevant and need to be addressed if the 2045 target is to be credible. The resourcing of Local Government to make the right investments is central to the just transition to a net zero transition.

Sustained investment in prevention and early intervention

12. To make progress against our shared priorities we must take a 'whole-system' approach to funding public services, with a refocus on prevention and early intervention spend, given that the Christie Commission made its recommendations 13 years ago. Now more than ever, there needs to be investment in 'upstream' services that help to prevent problems rather than focusing spend on responding to them. Local Government is the key local partner in addressing each of the Scottish Government's four priorities and has a lead role in prevention as councils provide numerous services which support people out of poverty, improve people's overall wellbeing and support people into work. As many of these are non-statutory services, they are the first to get cut when councils face financial challenges. Councils have the knowledge, expertise and ability to scale up preventative approaches, however this can only be achieved if councils are supported and enabled to take forward place-based approaches.

13. Our key messages above demonstrate why it is essential to provide Local Government with fair, sustainable and flexible funding to enable councils to continue to invest in these services.

Introduction

14. COSLA, Solace and Directors of Finance Section are pleased to present a joint response to the Local Government, Housing and Planning Committee's call for views as part of its pre-budget scrutiny for 2025/26. We note that the committee is interested in the sustainability of Local Government finances with a particular focus on the **funding of council infrastructure through debt, reserves and capital investment.**

15. We aimed to address some of these issues in previous submissions to the committee, particularly in our 2024/25 pre-budget scrutiny. Key themes identified within these submissions are still relevant to this year's pre-budget scrutiny and include:

    - the crucial role of Local Government in delivering on the Scottish Government's four strategic policy priorities including eradicating child poverty, growing the economy, tackling climate change and delivering better public services (as set out by First Minister Swinney in May 2024);
    - the need for fair and sustainable funding for Local Government and greater flexibility and empowerment, contrary to the trend of increasing directed funding from the Scottish Government, often focused on inputs and outputs rather than outcomes;
    - the importance of whole-system thinking across the public sector and of investing 'upstream' in preventative services - many of them delivered by Local Government - to help reduce demand in health and social security;
    - the value of multi-year budgets, enabling Councils and other public bodies to plan and invest for the longer-term to support the focus on prevention.

16. On 30 June 2023, the Scottish Government and COSLA signed the “Verity House Agreement (VHA)” which is a high-level framework outlining the intention to develop improved partnership working between Scottish and Local Government on shared priorities including tackling poverty (particularly child poverty), transforming our economy through a just transition to next zero and sustainable person-centred services. These priorities align closely to the First Minister’s four priorities.

17. The VHA commits both parties to:

    - a default position of no ring-fencing or direction of funding from this point onwards, unless there is a jointly understood rationale for such arrangements;
    - consulting and collaborating as early as possible in all policy areas where Local Government has a key interest, as well as early budget engagement with an underlying principle of "no surprises";
    - through a new Fiscal Framework, establishment of clear routes to explore local revenue raising and sources of funding, and wherever possible the provision of multi-year certainty to support strategic planning and investment.

18. Our expectation last year was that through the development of the VHA, many of the structural barriers that prevent Local Government from achieving its full potential would be removed. Progress has been made in relation to the VHA which we have outlined in more detail in question 3; however, we have also highlighted where spending decisions have not aligned with the VHA commitments and what impact this has had on our communities. As this is the first year of the agreement, it provides an opportunity for early reflection, where both Governments can consider learning from the previous year and aim to take these forward into the 2025/26 Scottish Budget. It is only by Scottish and Local Government working together to tackle shared priorities will better outcomes be achieved for the people of Scotland.

19. As the Committee will be aware, these aspirations are set against an extremely challenging position for Scotland's public finances, which has been further exacerbated through the cost-of-living crisis and other pressures relating to pay, inflation and rising demand for services.

Questions:

Financial sustainability of Scotland's local authorities

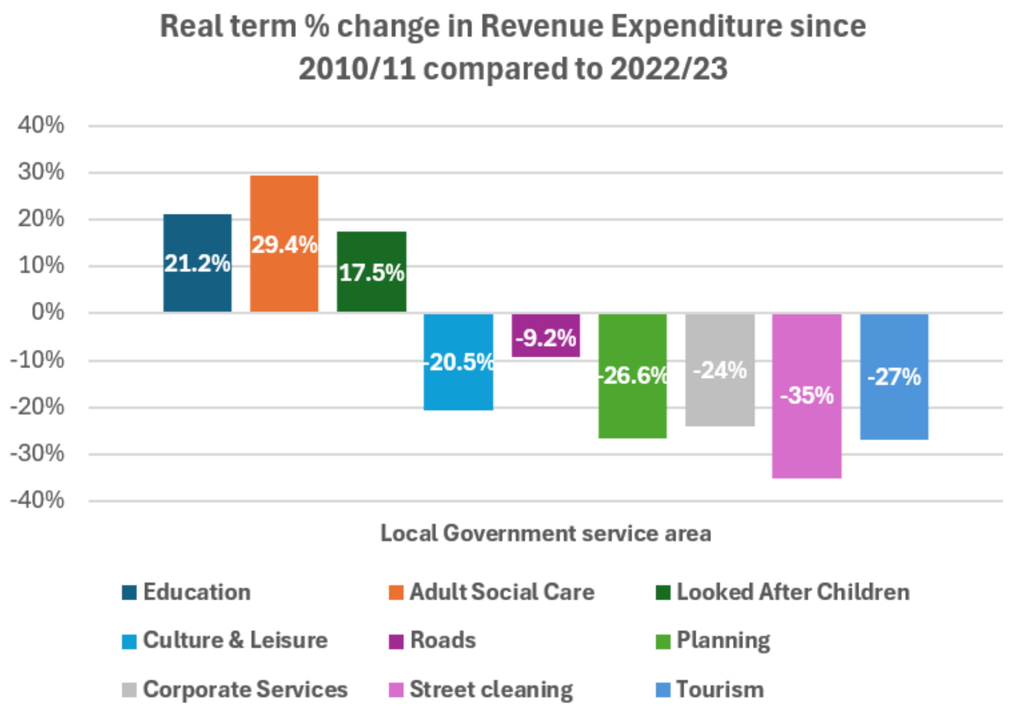
Q1. What are the main challenges facing local government finance over the next five years?

20. Local Governments' core budgets have seen real terms cuts over the last decade and have therefore not kept pace with growing need, rising demand, unprecedented levels of inflation and cost pressures. This has been compounded by an increased trend in ringfenced and directed funding for policy commitments and baselined funding for additional commitments being eroded by inflation. While inflation is expected to ease over the medium term the underlying costs of delivery have increased significantly. As a result, councils' core budgets are under more and more pressure.

21. Overall, councils still have limited flexibility on the spending decisions they can make as a large proportion of council budgets are directed to specific policy commitments, including maintaining teacher numbers and protected spend in social care. It is COSLA's view that less than 30% of funding has been entirely subject to local flexibility over the past few years, with 70% being directed spend. These protections and directions mean that cuts are then disproportionally focused on the limited areas where councils have discretion, often those services that are most critical to early intervention and prevention. Greater flexibility will empower Local Government to make spending decisions that are focused on outcomes, and both reflect the needs of local communities and progress against shared priorities.

22. The Accounts Commission (2024) has recently stated the stark reality of council finances, identifying that Scotland's 32 Councils are facing a £585 million funding gap in 2024/25 which is expected to increase to £780 million by 2026/27. This report provides clear evidence for the funding concerns consistently raised by COSLA and reinforces the simple message that councils cannot kept delivering the same number of services with the current funding they are receiving from Scottish Government. Professional associations also believe this figure could be underrepresented due to future workforce pay pressures and associated expectations.

23. The long-term underfunding of Local Government is now becoming evident. The latest Local Government Benchmarking Framework (LGBF) report, produced by the Improvement Service (2024), highlights that in 2022/23 overall council service performance and service user satisfaction declined compared to 2010/11 (for example there has been a 15.3% decline in satisfaction with street collection and 9.6% decline in satisfaction with libraries). Since 2022/23, Local Government has continued to experience real terms cuts to the budget which likely had a further impact on satisfaction levels. Councils have had to prioritise spend in statutory services such as social care, education, and support for care experienced children which has continued to see sustained and enhanced real terms spending since 2010/11. However, this has meant councils have not been able to invest in preventative non-statutory services such as employability, leisure and culture which play a key role in supporting economic growth and mitigating against the impact of poverty.



(Source: Improvement Service, 2024 – "Local Government benchmarking framework")

24. Against this fiscal context, councils have faced increased pressure on resourcing service delivery, resulting from deepening workforce recruitment and retention issues at a time where demands on services are growing due to demographic pressures. An ageing population means more people in our communities are experiencing increasingly complex needs alongside multiple conditions and are even more reliant on essential council services – right at the time when there is a reduction in the labour available to deliver them.

25. The cumulative effect of all these pressures is now starting to show, although it should not be a surprise to the Scottish Government, as COSLA warned of these inevitable outcomes. In our joint submission last year, we clearly outlined what the consequences would be if services were not adequately funded. The Scottish Government has continued to make cuts to the settlement, yet the expectation is for Local Government to continue to deliver the same services. If the current trend continues, the improvements and progress that has been achieved thus far, could potentially be lost and council service performance may start to decline over the longer-term impacting on our communities.

Q2. Have councils assessed how much revenue funding they need from the Scottish Government in 2025-26 to deliver their statutory and discretionary services to an adequate standard?

26. The Accounts Commission (2024) has recently stated the stark reality of council finances, identifying that Scotland's 32 Councils are facing a £585 million funding gap in 2024/25 which is expected to increase to £780 million by 2026/27. This is in the context of multiple years of continued pressure on council budgets which have eroded discretionary services in particular, prior to considering whether standards are adequate.

27. For context, the 2024/25 Local Government Settlement was presented at the time by the Cabinet Secretary as a 6% cash increase in revenue funding when compared against the 2023/24 settlement. However, the reality of this increase is that it does not take into account in-year commitments from 2023/24, such as for pay awards nor incoming policies such as the council tax freeze. When these are taken into account it is a ‘flat cash’ settlement and therefore a real terms cut. It is also not reflective of the growing need and rising demand pressures impacting on service delivery, nor does it take into consideration the added burden of additional policy commitments or the impact of inflation. The Institute for Fiscal Studies (IFS) formed a similar conclusion. They found the Scottish Government budget to be “misleading” about spending increases as there was no recognition of in-year top ups within their budget calculations. IFS states that “*the actual situation facing... councils is likely to be even tougher than these figures suggest*”.

28. In COSLA’s 2024/25 budget lobbying document, ‘Councils are Key’, we outlined that Local Government needed £14,377m revenue just to ‘stand still’ and £838m capital funding to achieve the buying power of 2021. The initial 2024/25 Settlement in fact represented a £67.2m cut to revenue and a £54.9m cut to the capital budget compared to 2023/24, as set out in our Budget Reality document. Whilst the £62.7m revenue was reinstated by the Scottish Government, this still only brought the Settlement back to ‘flat cash’ and didn’t meet the minimum amount required to keep delivering current service provision.

29. Flat cash budgets impact on councils’ ability to continue current service provision as well as hindering councils' ability to invest in long term prevention or early intervention initiatives, which are key to improving health outcomes and overall wellbeing as well as meeting shared priorities.

30. This means non-statutory services have faced disproportionate and substantial cuts due to pressures on council budgets, ringfenced and directed funding and protections in areas such as social care and education. Statutory services also come significant pressure with councils having to increase eligibility criteria, for instance in social care. Directed spend comes at a real cost, preventing much needed resources being used in areas with greater need of funding, and with the potential to deliver positive upstream impacts which could help meet desired outcomes across Local and Scottish Government.

31. To ensure long term sustainability of councils and ensure deliverability of essential services, Scottish Government must focus spend on the shared priority areas, adequately fund Local Government and provide sufficient local flexibility.

Q3. Has the Verity House Agreement impacted on the financial sustainability of local government since it was signed last June and if so, how?

32. One of the intended outcomes of the VHA is that it is to provide sustainable, long-term funding for Local Government alongside greater fiscal empowerment and fiscal flexibilities. Throughout the last year progress has been made as Scottish and Local Government have agreed core principles that underpin the Fiscal Framework, an early budget engagement process, and constructive discussions are taking place to develop routes to explore local revenue raising. These positive steps will enable Scottish and Local Government to achieve better outcomes for people in our

communities and we intend to continue working together to tackle our shared priorities and ensure financial sustainability for Local Government.

33. Some progress towards financial sustainability was demonstrated through £951m of funding being baselined in the 2024/25 Local Government Settlement. However, it is important to note that this did not provide any additional flexibility as the related policies (notably 1140 hours Early Learning and Childcare and Real Living Wage for Adult Social Care workers in commissioned services) must still be delivered, therefore all this funding remains directed spend.

34. There is still progress to be made in relation to implementing the VHA and having a greater focus on the financial sustainability of councils. The Scottish Government announcement of a council tax freeze was not in line with the VHA. The lack of engagement with councils on this does not reflect the commitment to early budgetary discussions nor does it provide councils with greater flexibility in discretionary spending decisions. The £147m provided by the Scottish Government only provided an income equivalent to a 5% rise, which does not cover the full cost of some councils who were considering increasing their council tax up to 10%. The Fraser of Allander Institute also estimated the shortfall to be between £229 million and £417 million in local revenue raising.

35. Freezing council tax removed local discretion to raise income and the opportunity to invest in services, and added complexity to the budget setting process, at a time when councils were having to make challenging decisions about the level of savings to make. Additional funding raised through council tax increases could have been reinvested back into local services or support pay deals, however, what this now means is that further cuts were likely required to enable councils to set a balanced budget. This decision will have longer-term financial consequences as future rises will provide less income for councils, further exacerbating current funding gaps. Council Tax is a decision for local authorities and there should be no council tax freeze or national cap applied in 2025/26 and beyond.

36. As outlined in question one, Scottish and Local Government are both facing unprecedented financial pressures, and there is now an imperative to prioritise finite resource. The shared priorities need to be at the forefront of all spending decisions. Resources need to be targeted at the people that are most in need, at policies and services that are truly outcomes focused, those which will make the biggest difference to people, and achieve best value for money. The Scottish Government needs to consider, in partnership with the whole public sector, the relative cost-effectiveness of universal provision.

Q4. What would you like to see in the forthcoming fiscal framework to help improve financial sustainability?

There has been considerable progress in delivering a Fiscal Framework for Local and Scottish Government and this joint work needs to continue.

<u>Fiscal Framework Principles</u>

37. It is important, when describing the Fiscal Framework between Local Government and Scottish Government as forthcoming, to note that there are already key elements of

the Framework in place. Fundamentally a set of core principles have been jointly agreed that underpin the Fiscal Framework. These being:

- **The fiscal framework should promote stability, certainty, transparency, affordability and sustainability**
- **The fiscal framework should promote effective use of fiscal flexibilities and levers to address local priorities and improve outcomes**
- **The fiscal framework should enable discussion of fiscal empowerment of Local Government**

Early Budget Engagement

38. Just as importantly, an early budget engagement process has been agreed, whereby COSLA can meet with Ministers at key points leading up to the Scottish Budget, including initial discussions as early as May of each year, leading up to the Programme for Government and in advance of the Scottish Budget being announced.

Increasing fiscal flexibility for Local Government

39. Constructive discussions are also taking place to develop routes to explore local revenue raising as a key element of the Fiscal Framework and greater fiscal empowerment of Local Government. Designing and adapting a range of local levies and other fiscal measures, based on local needs and circumstances, could provide Councils greater power to raise revenue locally, in turn providing economic, social, and democratic benefits. Importantly this would be for Councils' local discretion to bring in levies and other fiscal measures without national direction.

40. Following the passing of the Visitor Levy Act, several councils are planning to consult on introducing a Visitor Levy with the potential to generate significant additional income, though spend is restricted to things which support the visitor economy. This can be seen as a key first step under the Fiscal Framework, toward increased local revenue raising. However, whilst this has the potential to benefit local communities, delays between legislative change and when it can be enacted can lead to gaps in funding and additional pressures in the meantime. In the case of the Visitor Levy there is a need to consult local communities, develop plans, and an 18 month notice period after consultations are concluded, which is a considerable time lag. While this legislative change is providing a medium-term solution, in the short term the funding that can be provided to councils is limited. It should also be noted that this is not the solution to mitigate against current deficits or a sustainable solution to long-term underfunding of Local Government.

41. There is also a commitment from Scottish Government to consult on a cruise ship levy, which would meet similar objectives to the Visitor Levy, and for legislation to be brought in as early as possible, should this be deemed beneficial to go ahead. In welcoming this commitment and seeking to work jointly with Scottish Government on bringing this levy in, it needs to be recognised that this continues to be a nationally determined approach to local revenue raising, rather than Councils having the powers to determine fiscal measures locally.

Develop a mechanism to provide multi-year certainty to Local Government funding

42. In parallel work is underway to explore mechanisms which can provide multi-year certainty to Councils, regardless of whether the Scottish Budget is one year or multi-year. This is complex work involving exploring the relationship between Scottish Government and Local Government funding year on year and what linking that relationship, both benefits and risks, could mean to each party. As a key instrument of the Fiscal Framework this work should be progressed to ensure that there is both transparency over the funding which Local Government receives and how it relates to overall Scottish Government discretionary funding, and a mechanism in place to provide increased multi-year certainty.

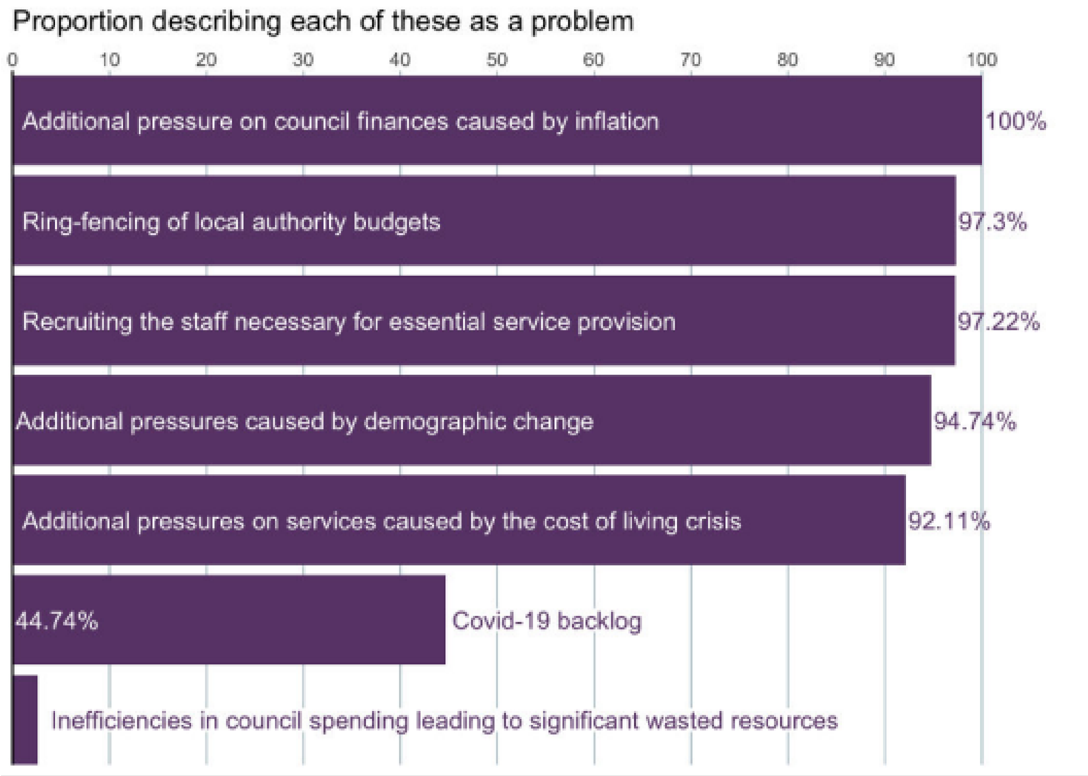
43. Productive discussions continue in relation to the other potential elements of a fiscal framework which is part of the wider attempt to deliver sustainable, long-term funding for Local Government alongside greater fiscal empowerment and fiscal flexibilities. These positive steps will enable Scottish and Local Government to achieve better outcomes for people in our communities and we intend to continue working together to tackle our shared priorities

Q5. Is there a risk that Scottish local authorities might face similar financial difficulties to those faced by some English councils such as Nottingham, Croydon, Thurrock and Slough? If so, how can this risk best be mitigated?

44. There is a risk that Scottish local authorities will face similar difficulties to those faced by some English councils. While some of the factors affecting English councils do not apply in Scotland (namely risks relating to commercial investments), many of them do (equal pay claims) and Scottish councils face constraints and pressures that do not exist in England, for example requirements to maintain teacher numbers.

45. Councils have been cutting discretionary spend for years as they seek to manage successive flat cash settlements and are increasingly having to consider how, and to whom, statutory services are delivered, for instance through the tightening of eligibility criteria.

46. A survey by the LGIU from last year, found that there was only one respondent, out of forty-two senior council figures, that were “quite confident” in the sustainability of council finances. As can be seen in the graph below, there was very high consensus as to the drivers behind the financial pressure within the responses.



(Source: LGIU, 2023 – "The state of local government finance in Scotland")

47. Mitigation is required in the form of long-term sustainable funding for Scottish local authorities, removal of directed spending, alongside open and honest conversations about what local authorities can and should be delivering on a statutory and non-statutory basis, in the context of whole public sector reform.

Capital funding

Q6. Do councils have enough capital funding to provide and maintain the infrastructure communities expect?

48. Local Government maintains a large proportion of infrastructure which is crucial to communities and the economy. This includes road networks (56,000km), the school estate (2,468 schools), community building and social housing (councils own 52% of social houses in Scotland). **The value of Local Government assets was £55.2bn in 2022/23, the total capital grant provided by Scottish Government that year (including specific grants) was £0.8bn – this is only 1.46% of value of the assets.**

49. Scotland's entire public sector continues to face significant pressures related to capital budgets and capital spend, with reduced capital funding, increased demand for services due to demographic changes, healthcare needs and economic inequalities, higher costs for goods and services, substantial public sector pay increases and wider economic circumstances such as inflation and interest rates. There are few signs of challenges easing, with forecasting by the Scottish Fiscal Commission indicating that Scotland's capital budget is expected to fall by 20%, in real terms, between 2023/24 and 2028/29. 15% of this decrease is expected by 2025/26 alone.

50. For Local Government, this presents a real risk to the viability of current and future capital programmes which help Scotland meet its ambitious targets, drive economic growth and improve the overall quality of life. Reduced capital funding weakens the ability of Councils to take forward capital projects which modernise and deliver key services, such as quality housing, create local jobs and support supply chains. Communities are further impacted by the effect that a declining capital budget has on the quality of local infrastructure including roads and community assets, as means to make impactful investment are diminished. It also makes it more challenging to maintain current infrastructure including addressing issues such as reinforced autoclaved aerated concrete.

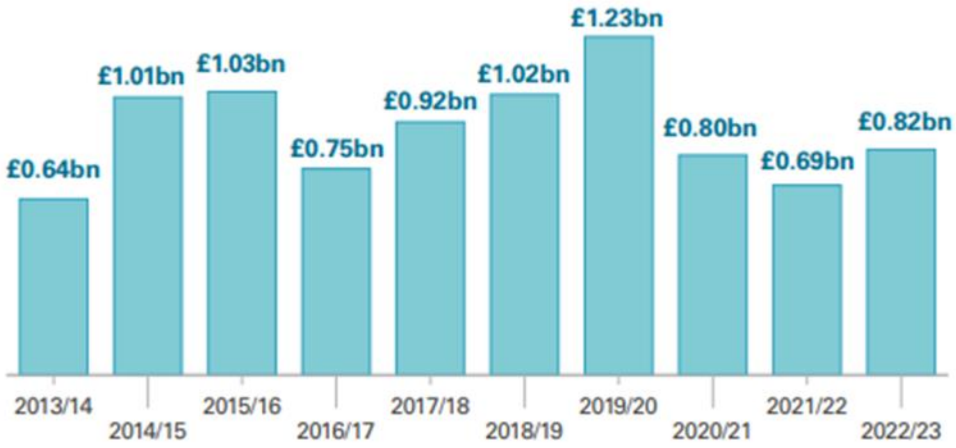
51. Likewise, efforts to drive economic growth and achieve net zero targets will be constrained as councils are unable to procure for capital construction and invest in infrastructure at the necessary pace or scale. Revenue spending will also be impacted, as difficulties in replacing or improving existing assets lead to higher maintenance costs to keep them working.

52. This demonstrates the need for the Scottish Government to actively and, going forward, proactively review its planned capital investments and take decisions to direct capital budgets to prioritise those that secure the best value for money, have the greatest potential impact for Scotland's economy and contribute to our shared priorities. In particular, the Scottish Government should prioritise capital investment that:
    - enables investment in affordable housing; and
    - supports efforts to achieve net zero.

Volatile capital budgets reduce Councils' ability to support economic growth

53. The Accounts Commission highlight, in its 'Briefing: Local Government budgets 2024/25,' that Local Government was allocated capital funding of £638 million in the 2024/25 Scottish Budget compared to £827 million in 2023/24. This £189 million reduction represents a 22.8% decrease in cash terms and 23.6% decrease in real terms. Much of the reduction is accounted for by the movement of £121 million from the general capital grant to the general revenue grant to fund prior years Local Government pay awards and a £40 million lower investment in the expansion of free school meals compared to 2023/24 as highlighted by SPICe in their briefing 'Scottish Budget 2024-25.' However, even accounting for this, core capital grant funding for Local Government has reduced by £54.9m or 4%. Moreover, it remains significantly lower compared to many of the years leading up to the Covid-19 pandemic, and remains similar to levels seen in 2013/14. Additionally, there have been significant cuts in the affordable housing supply programme, place-based investment programme and regeneration capital funding which directly impact on local government and communities.

Real-terms Scottish Government Capital Funding Between 2013/14 and 2022/23



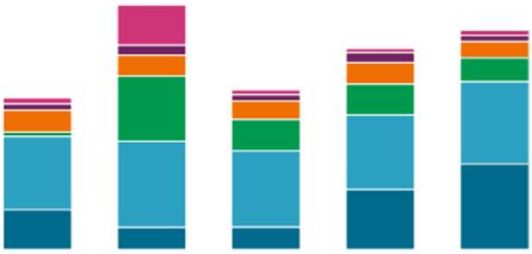
(Source: Accounts Commission, 2024 – "Local Government in Scotland: Financial bulletin 2022/23")

54. The Accounts Commission financial bulletin 2022/23 report also notes the year-on-year volatility of capital funding from the Scottish Government over the last decade, as shown by the graph above. This uncertainty feeds through to the ability of Councils to plan for both the medium- and long-term, therefore also affecting their ability to invest more strategically into services and provide support for local businesses. Being able to confidently plan for longer-term capital expenditure is essential for local communities and for the key role that Local Government has in boosting economic growth, attracting investment and creating job opportunities.

55. Whilst overall, Local Government capital expenditure increased by 16% in 2022/23 compared to 2021/22, this must be looked at in the context of the financial pressures which have squeezed capital spending power and impacted the returns gained by enhanced capital spending. As the table below demonstrates, this increase was driven by a 52% increase in borrowing. With a decline in government grant funding, Councils have found themselves in a position of having to place greater reliance on borrowing as a source of capital funding to sustain and invest in their infrastructure to meet the needs and priorities of communities and boost local economies. This includes a requirement to borrow for investment under the Learning Estate Improvement Programme, should councils wish to be part of this programme, meaning that councils borrow the funding required upfront on the basis that Scottish Government make revenue payments in future covering part of the cost. As it stood in 2022/23, this meant that borrowing outstripped government grants in terms of capital expenditure. This is not sustainable, nor does it tackle the underlying challenges to financial sustainability.

56. The Accounts Commission has underlined that this places lasting pressure on the budgets Councils have year-to-year for in-year revenue costs, as a higher portion of the revenue budget is essentially ringfenced in order to pay debt over the long term. This must also be considered in relation to the fact that Councils are increasingly relying on the unsustainable use of savings and reserves to balance their budgets, with the Accounts Commission report showing that the use of reserves to bridge the budget gap doubled from 17% in 2021/22 to 34% in 2022/23.

Capital Expenditure Analysed by Sources of Finance 2018/19 to 2022/23 (£ billion)



2018/19	2019/20	2020/21	2021/22	2022/23	
0.09	0.60	0.07	0.06	0.09	Capital receipts
0.09	0.15	0.09	0.15	0.10	Other contributions and Public Private Partnership (PPP)
0.32	0.31	0.28	0.33	0.27	Capital Funded from Current Revenue (CFCR)
0.06	0.96	0.47	0.48	0.39	Internal loans fund repayments available to reinvest
1.06	1.27	1.15	1.15	1.35	Government grants
0.57	0.32	0.33	0.92	1.41	An increase in borrowing
2.18	**3.61**	**2.41**	**3.10**	**3.61**	**Total expenditure (£ billion)**

(Source: Accounts Commission, 2024 - 'Local Government in Scotland: Financial bulletin 2022/23')

57. It should be noted that Councils must equally ensure that borrowing is sustainable and conforms to the Prudential Code of Practice for Capital Finance in Local Government (Source CIPFA). This requires Councils to ensure that their capital plans and the related borrowing requirement are affordable, prudent and sustainable. Therefore, there cannot be a presumption that Councils can simply continue to borrow their way out of financial challenges, either for Councils themselves or for Scottish Government.

Provide sustainable capital funding to enable councils to invest in affordable housing

58. The Scottish Government has committed to working with partners to deliver 110,000 affordable homes by 2032, including 70% being available for social rent and 10% in remote, rural and island communities. Most will be newly built by Councils and registered social landlords (RSLs). To secure the target by 2032 an average of 11,500 homes per year need to be delivered over the next several years. However, the latest Scottish Government housing statistics show that current levels of approvals and starts for affordable housing have declined to around 6-7000 over the last two years, comparable to figures last seen in 2014/15 (Scottish Government, 2024). This is simply not enough to meet need, with a recent report estimating that there are around 250,000 people throughout Scotland waiting for a social home.

59. Two years of significant reductions in the AHSP budget, increased costs of construction and supply chain delays have weakened the prospects of revitalising the affordable housebuilding programme and achieving the levels seen in the years leading up to Covid-19 (SPICe, 2024). The Scottish Housing Regulator has highlighted that RSLs face ongoing economic uncertainty and volatility, including higher inflation and borrowing costs, labour scarcity and below inflation rent rises. Councils, who also operate within a similarly challenging financial environment, are forced to balance increased development costs with their other capital commitments to ensure that they continue to deliver the best for their communities. In short, achieving the 2032 target and meeting demand does not look promising without

providing sustainable capital funding to Councils to enable impactful investment in housing, and further risks losing the many benefits that house building delivers for Scotland's productivity, innovation and growth.

Q7. What level of capital grants do local authorities need in 2025-26 to ensure their capital priorities and pre-existing commitments are met?

60. In COSLA's 2024/25 budget lobbying document, 'Councils are Key', we outlined that Local Government needed £838m capital funding just to achieve the buying power of 2021.

Q8. How have local authority debt and reserves levels changed over the past ten years?

61. The level of debt held by local authorities has increased over the last 10 years, as set out in Q6 a key driver is the financing of capital programmes.

62. Reserves are covered in detail in the answer to Q10.

Q9. Why are councils borrowing more now and how will this impact resource budgets in future years?

63. As set out in Q6, the proportion of capital expenditure financed by borrowing has increased. This impacts on the budget available year to year for in year revenue costs for service delivery as part of the revenue budget is committed to repaying the principal debt. Given the significant increases in interest rates this is a much higher pressure than previously with commensurate increases in the interest associated with new debt to meet future shared plans. Taken together the principal and interest elements of debt will increase.

64. The Local Government Benchmarking Framework financial sustainability data for 2022/23 shows that the proportion of councils' general fund revenue budget being used to service debt has fallen from 8.4% in 2013/14 to 5.4% in 2022/23. A key contributory factor to this has been the decision by councils to re-profile principal repayments over a longer period, in line with 2016 Loans Fund regulations. Some councils also used the financial flexibility afforded by the Scottish Government that permitted a reduction in the statutory repayment of debt in 2020/21, 2021/22 and 2022/23 which will have contributed to this. Without these sensible and prudent changes, financial position would be considerably more challenging that it is at present.

65. As already mentioned, Councils must equally ensure that borrowing is sustainable and conforms to the Prudential Code of Practice for Capital Finance in Local Government (Source CIPFA). This requires Councils to ensure that their capital plans and the related borrowing requirement are affordable, prudent and sustainable.

Q10. Why have reserve levels changed over recent years?

66. Significant care is required to ensure that discussion on reserves differentiates between "usable" and "unusable" reserves. By definition, unusable reserves cannot

be applied to support revenue pressures and are as a result of accounting adjustments, movements in asset valuations and pension funds.

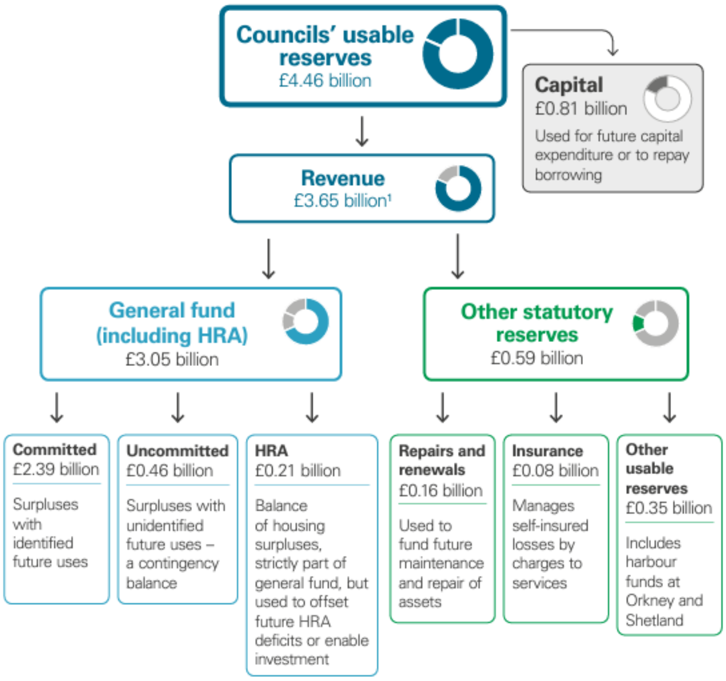
67. Usable reserves therefore constitute to those applied by Councils for a variety of purposes including ‘earmarking’, or setting aside, specific elements of usable reserves to offset risk and manage timing differences between the receipt of income and incurring of related expenditure. Reserves can be earmarked to cover a period of time which may span across 3-5 years to account for future pressures.

68. Councils also hold ‘unallocated reserves’ which are held against the risk of unanticipated expenditure and/or reduced income arising in any particular year. Local authorities will not plan to use these reserves as they represent the backstop provision for unanticipated expenditure in year.

69. Councils are having to rely on the use of reserves to bridge funding gaps. Local Government professional associations have consistently expressed that this is not a sustainable solution to manage underfunded policy areas. This is also emphasised in the Accounts Commission (2024) report, which states that “*the use of reserves and other non-recurring measures is unsustainable and is only a temporary plug for a budget gap in that one year*”. Councils are legally required to set a balanced budget alongside ensuring long term sustainability of statutory services, therefore reserves must be managed effectively. Reserves are held for a variety of purposes with unearmarked reserves being held as a general cushion against uneven cashflows as well as being a contingency against unexpected expenditure. The Cost of Living crisis over recent years is an excellent example where unearmarked reserves have been used to cushion the impact of extremely high inflation which had not been budgeted for with Councils restoring these balances over the medium term. Earmarked reserves are used for specific policy purposes and are often carry forwards of funding which has not been spent in previous years, in recent years this would include funding for Education (such as PEF) where funding is provided in financial years but spent in academic years resulting in summer term funding being carried forward as earmarked reserves.

70. In 2022/23, Audit Scotland recorded council useable reserves to be around £4.46 billion. This figure will also include reserves where costs to Councils do not fall evenly over years (such as Insurance or Winter Maintenance) where Councils hold reserves to smooth peaks from high spend years. The position in 2022/23 is also likely to have been inflated by Glasgow’s funding programme for the settlement of Equal Pay. The key figure to note is the level of unearmarked reserves which for the General Fund was only £0.46bn – only 3.4% of General Fund net revenue expenditure.

The nature and value of councils combined usable reserves, 2022/23

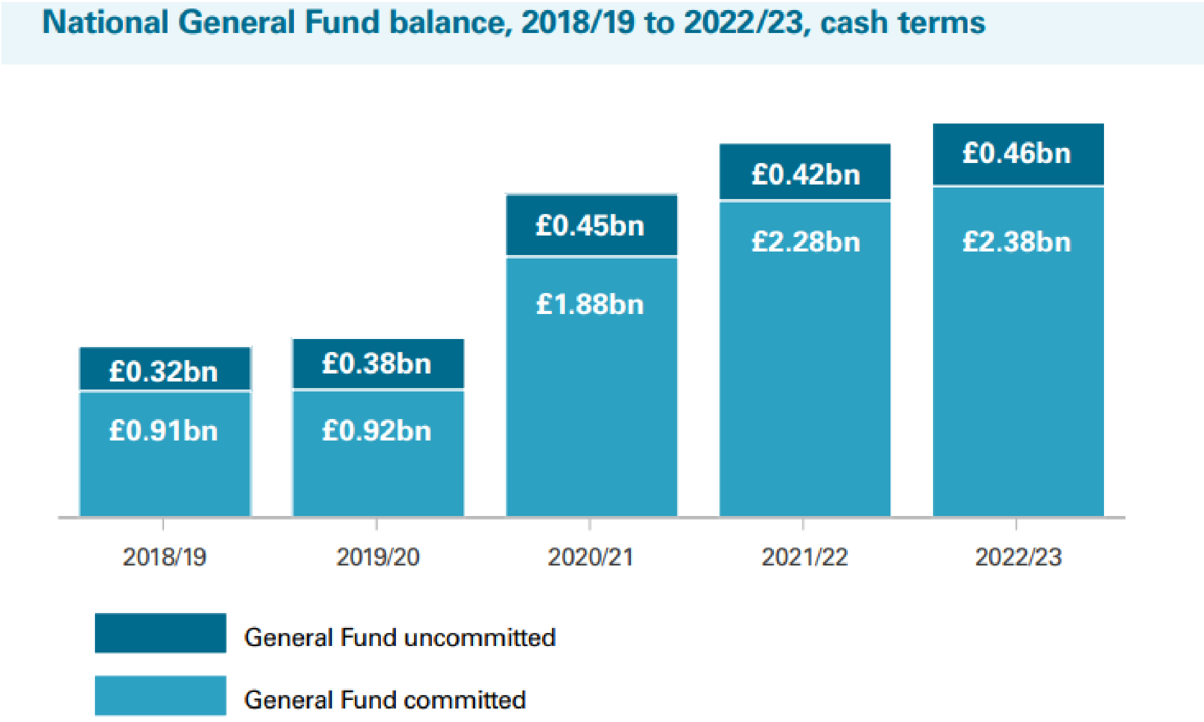


(Source: Accounts Commission, 2024 - "Local Government in Scotland: Financial bulletin 2022/23")

71. Reserves can only be used once. If councils are being forced to use reserves for day-to-day service delivery, there will be no means to respond to a crisis. To put this in perspective, **a reserve of 2% of annual revenue resource only equates to one week of council running costs**. Fundamentally, reserves are used to ensure the sustainability of councils and are a vital and necessary part of councils' financial management.

72. Care is also needed to understand how reserves are used to support the delivery of the Capital programme. Reserves are not generally held in cash or investments, they are applied as part of the Councils Treasury Management Strategy to deliver capital programmes until there is a time that they are needed – for example when interest rates fall or cash flow requires. This strategy ensures economy and efficiency within Council capital programmes and ensures that decisions on debt, at high interest rates, can be deferred until such a time as rates reduce. Irrespective of whether reserves are earmark or unallocated they will generally not be cash backed or available to unwind without other costs within Capital Programmes being incurred.

73. In terms of changes in the level of reserves, unearmarked reserves in the General Fund have increased slightly over the past 5 years. Earmarked reserves increased substantially between 2019/20 and 2020/21. These increases were largely attributable to accounting adjustments related to the permitted use of financial flexibilities for the repayment of longer-term debt or the timing of funding received immediately before the financial year end. Some councils are also earmarking reserves to contingency or financial sustainability funds to cushion the impact of known financial challenges in the years ahead or to help fund transformation, potential workforce reconfiguration or equal pay settlements.



Note: This chart excludes HRA.
(Source: Accounts Commission, 2024 - "Local Government in Scotland: Financial bulletin 2022/23")

Q11. What criteria and definitions are used to determine whether reserves are "committed" of "uncommitted"?

74. See answer to Q10 for more detail. In short, earmarked reserves will be carried forwards or policy led, while unearmarked are to deal with fluctuations.

Impacts of capital spending decisions on communities

Q12. In a time of restricted capital resources, how do councils prioritise their capital spending?

75. Local Government regularly invests in capital programmes which help Scotland meet its ambitious targets, drive economic growth and improve the overall quality of life, unlocking the best for our communities. However, as we have outlined above, councils' capital budgets have been continually restricted and reduced, paired with considerable year-on-year volatility of capital funding from the Scottish Government over the last decade. In fact, capital funding in the 2024/25 Scottish Budget is significantly lower compared to many of the years leading up to the Covid-19 pandemic and is comparable to levels seen in 2013/14.

76. Despite severely restricted and reduced budgets, Local Government recognises the importance of prioritising capital spending in a way that maximises impact through a structured approach that balances immediate needs with long-term strategic objectives. As such, councils aim to use capital spend to protect essential frontline

services and invest in infrastructure and projects which support economic growth and achieve net zero, aligning with broader national ambitions.

77. However, the uncertainty that has become inherent in capital budgets, and the increasing requirement of using other sources of finance to meet capital expenditure, has affected councils' ability to meet these aims and confidently plan for medium- and long-term capital expenditure. Councils are increasingly forced to use their capital budgets to maintain service standards at their current level, or direct spend to meet legal requirements such as maintaining minimum health and safety standards in public buildings, roads and other infrastructure.

78. Whilst appreciating the undeniable importance of meeting these requirements, the reduced capital funding means that providing and maintaining the infrastructure that communities expect is also at risk. It also means that opportunities are being lost as there is less capital investment in projects which help to modernise services, create jobs and enhance local economies.

Q.13 What impacts have recent capital spending decisions had on various service users and communities?

79. The most evident impacts of recent capital spending decisions are seen in the consequences resulting from the significant year-on-year cuts to the AHSP, which impacts on the ability to meet national housebuilding ambitions. Recent Scottish Government statistics illustrate that meeting the target of building 110,000 affordable homes by 2032 (with 70% for social rent and 10% in remote, rural and island communities) will require an additional 5-6000 homes to be built each year on top of current levels. However, without providing councils with additional and sustainable capital funding this will not be possible. Not only does this risk not meeting the needs of the roughly 250,000 people throughout Scotland currently waiting for a social home, it also means losing the many benefits that house building delivers for Scotland's communities and the services our councils offer.

80. As recognised in the Scottish Government's Housing to 2024, housing has a vital role to play in meeting national ambitions, including eradicating child poverty and homelessness (as discussed above in our response to question 6). Homes for Scotland highlights there are also many further interlinked benefits that house building can unlock for our communities, including regeneration and place making objectives, stimulating economic activity through the direct and indirect creation of jobs and apprenticeships and supporting local growth through increased consumer spend – which also benefits local businesses - and via developer contributions towards affordable housing and infrastructure to support schools, healthcare, open spaces, transport and sport and leisure facilities.

81. House building also unlocks significant benefits for Scotland's national and local economies through expanding the tax base, with Homes for Scotland also indicating that the 22,000 new homes (all-sector) built in 2019 raised £521 million nationally (though Land and Building Transaction Tax (LBTT), Corporation Tax, National Insurance and PAYE contributions) and £28 million locally through Council Tax receipts. These benefits help to mitigate against some of the financial challenges discussed above, allowing, for example, increased investment in local services which have the most impact for our communities.

82. Affordable housing is also a key part of providing access to housing for those whose needs are not met by the wider market, improving social mobility and inclusivity through creating mixed and balanced communities. This, in turn, promotes labour mobility as the type, price and quality of housing can have a significant impact on the attractiveness of new locations to different types of workers. The result, in tandem with job creation, is improved attraction and retention of a skilled workforce for key sectors and regions, therefore boosting productivity and economic output (CaCHE and HACT, 2020; Homes for Scotland, 2022). These benefits are particularly important for our remote, rural and island communities, with a 2017 report commissioned by the Highlands and Islands Enterprise emphasising that the availability of, and access to, housing is part of the complex problem relating to "a long-standing concern associated with a population decline and... the sustainability of local services," as well as the recruitment and retention of staff for local businesses.

83. Further, it is essential to ensure that homes that are being built are of a high quality, with the direct and indirect impact of housing standards being far reaching and well documented. For example, a 2018 report by Shelter outlined the detriment poor quality housing can have on children, including on their education attainment, attendance at school, ability to learn, social interactions, mental and physical health and confidence and motivation. Quality housing also has the potential to reduce or reinforce health inequalities, with poor quality housing leading to or exacerbating conditions including cardiorespiratory disease, digestive health, allergies and skin conditions. However, the cut to the capital budget makes it difficult for Councils to deliver new, quality and fit-for purpose homes as well as invest in improvements to the current housing stock. This is compounded by the fact that Local Government have received no additional funding in the 2024/25 Budget to address the costs of managing and mitigating buildings affected by reinforced autoclaved aerated concrete (RAAC), which has affected homes provided by several Councils and RSLs across Scotland. This only serves to deny people the ability to thrive as members of society and the economy.

84. Recent capital spending decisions also present risks for the place-based investment programme (PBIB). The PBIP, when it was first developed, aimed to link and align place-based funding initiatives and ensure that all place-based investments were shaped by the needs and aspirations of local communities. This included a commitment to provide multi-year funding to local authorities.

85. Since its inception, evaluation by the Improvement Service proves that the resources distributed to local authorities through the PBIP have allowed Local Government to deliver shared priorities, attract additional funding and enhance and improve new and existing projects and places. Jobs have been created and contributions have been made to our climate change targets through improved energy efficiency and increased active travel availability and accessibility.

86. However, there is currently a lack of clarity over the future of the previously agreed funding of £23m for 2024/25 and £23m for 2025/26, which now threatens the future of projects that had already been allocated funding by Councils across Scotland. Failure to deliver projects allocated funding under the PBIP will have a devastating effect not just for our communities, but also for our efforts to tackle inequalities and deliver a just transition to a net zero carbon economy.

Q14. How do councils involve service users in their capital spending decisions?

87. Local Government strongly believes that every individual in Scotland should be empowered in a way that lets them have their voice heard by decision-makers, particularly when it comes to decisions being taken that affect them and their community and councils seek to implement this through a variety of methods.

88. Whilst appreciating that there is always room for improvement, councils have and continue to use a variety of methods designed to ensure that they involve residents in the capital spending decisions they take. Through doing so, councils ensure that they are making informed decisions that are more responsive to and reflective of the needs and priorities of the residents they seek to benefit. These methods include:

    - Engagement with elected representatives – regular surgeries provide a space for service users to meet with their local councillors to discuss their concerns and priorities, which are then fed back into council discussions and decision. Councils also regularly engage with community councils, who often play a key role in gathering input from service users.
    - Engagement and partnerships with community groups – councils often form groups, panels or advisory boards that include representatives from various community organisations and service users, whose input feeds into the design and implementation of capital projects or use of capital spend.
    - Public consultations and feedback mechanisms – service users are regularly invited to engage in consultations which can take place in-person or respond via surveys and questionnaires online or sent through email and/or post. Councils also utilise comment and suggestion boxes placed in public buildings, such as libraries, community centres and service centres.
    - Participatory budgeting – where possible, councils host workshops and events where service users and residents can discuss and debate potential projects before voting, helping to shape and select projects that reflect their priorities.
    - Pilot projects – councils use small-scale versions of projects which allow them to gather feedback from service users. They use this feedback to assess the viability of launching a larger project, its potential impact and to make any adjustments,

Q15. How do councils communicate the likely impacts of capital spending decisions to their communities?

89. Local Government recognises that it is crucial for there to be transparency and accountability in relation to the decisions they make, particularly where this means spending public money and where there can be a real impact on the lives of those living in their communities. They realise that doing so can help build trust, manage expectations, reduce uncertainty, avoid misinformation and empower residents through encouraging democratic participation. As such, councils employ a range of mechanisms to help them effectively communicate the likely impacts of ongoing or upcoming capital projects to their communities. These include:

    - Public consultations and engagement events – councils often hold meetings in their communities where residents can learn about capital projects, ask questions and express their views in dialogue with council officials. These can be held voluntarily or in respect of statutory obligations, such as where there are proposed changes to a council’s school estate.

- Official publications and reports – councils publish annual reports, such as performance reports, corporate plans and delivery plans, and other strategic documents that outline planned capital spending, expected outcomes, and the rationale behind decision-making. These are often readily accessible on council websites or in public libraries.
- Digital communication – councils regularly use their own websites, social media and digital newsletters and email updates to inform their communities about ongoing and upcoming projects. These communications can include things such as timelines, budgets and key impacts, such as traffic disruptions, benefits to the community or improvements to services. Social media also allows councils a broader engagement reach, particularly with younger residents.
- Public information campaigns – councils also utilise traditional methods of communication such as leaflets, posters and public displays, which can be distributed or displayed in public spaces such as libraries, community centres and schools. These methods can help raise awareness of ongoing or upcoming capital projects, and also display website links, social media handles or QR codes which allow residents to access more detailed information or find out where to have their voice heard on the project.

***COSLA** is a Councillor-led, cross-party organisation, representing all 32 Councils in Scotland, which champions Councils' vital work to secure the resources and powers they need. COSLA works on Councils' behalf to focus on the challenges and opportunities they face, and to engage positively with Governments and others on policy, funding and legislation. We're here to help Councils build better and more equal local communities. To do that we want to empower local decision making and enable Councils to do what works locally.*

***CIPFA Directors of Finance Section** works closely with COSLA in leading strategic discussions with Scottish Government around funding and distribution for the essential services and policy areas that Councils deliver on. Members of the Section are those who have responsibility for the overall financial functions across all 32 local authorities.*

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