East Lothian Council

REPORT TO:	East Lothian Council
MEETING DATE:	23 October 2012
BY:	Executive Director (Support Services)
SUBJECT:	Financial Strategy 2012-15 – Mid-year Review

1 PURPOSE

To provide information on the current financial position of the Council and recommend essential adjustments to the current financial strategy.

2 RECOMMENDATIONS

The Council is recommended to:

2.1 Note that the Financial Strategy adopted in February 2012 remains largely appropriate but that certain important changes need to be made to reflect growing cost pressures in the current and future financial years.

2.2 Note the update on recent changes to the external financial environment including the initial assessment of the impact of the draft 2013/14 Scottish Government Budget for East Lothian and the implications this will have for future budgets.

2.3 Approve the various additional control measures outlined in Section 3.21 of this report.

2.4 Approve the revised Capital Expenditure Limits detailed in Section 3.24.

2.5 Approve the adjustment to the HRA Capital Budget establishing a new line for Extensions/Conversions with a budget for 2012-13 of £230,000 with a compensating reduction in the budget line for Open Market Acquisitions.

2.6 Taking into account existing powers already delegated under Standing Order 35, delegate to the Head of Council Resources in conjunction with the Chief Executive and Council Leader authority to conclude the most appropriate support arrangements to the community organisations as detailed in Sections 3.32 – 3.35 of this report.

3 BACKGROUND

3.1 The Council will recall that, as part of agreeing its 2012/15 budget it agreed a Council Financial Strategy for the 2012-2015 financial years.

3.2 For General Services the Financial Strategy was constructed around the objective of maintaining and, where possible, improving services. The longer term aim was that by 2014/15 the Council would have a fully balanced annual budget - where it was no longer reliant upon the use of reserves. This approach was underpinned by;

- Using available reserves to manage the transition to a balanced budget;
- The targeting of significant efficiency savings across all Business Groups – with all managers expected to achieve the required savings targets;
- The targeting of further 'corporate savings' through themes such as shared services, procurement and the generation of additional sources of income – in particular renewable energy;
- A core expectation of cost containment and where possible cost avoidance for all Business Groups. That is, services are expected to absorb general inflationary pressures and other cost increases through their efficient management of existing resources;

3.3 For the Housing Revenue Account (HRA) the strategy was also constructed around the objective of maintaining existing services. However, the financial circumstances of the HRA are significantly different from that of other Council services and the general approach adopted was to ensure that the increased costs of new council houses and modernisation work are 'self financed' from proposed increases in rent charges to tenants.

3.4 This paper reviews progress with the strategy and consists of six elements;

- An update on the financial position at the end of 2011/12;
- An outline of changes in the financial operating environment since February 2012, in particular an initial early assessment of the likely impact of the draft Scottish Government Budget announced on 20th September and other changes within the wider economic/financial context;
- An update on the progress made in delivering services within budget during the current financial year 2012/13 alongside an early assessment of the progress made in delivering planned efficiency savings for the 2013/14 and 2014/15 financial years;
- An update on the work carried out to date on reviewing the capital programme; and

- A review of the position of the Housing Revenue Account;

- A summary of control measures where the Council's financial strategy needs to be adjusted.

Financial Position at 31 March 2012

3.5 The audit of the 2011/12 accounts has now been completed, with the accounts receiving an unqualified audit opinion and certificate. This means that the figures within the fully audited accounts match with those reported previously to Council at its 28 August meeting.

3.6 At the end of the 2011/12 financial year the Council had the following Usable Reserves;

Table 1: Reserves Analysis at 01 April 2012

Reserve	(£m)
General Services Reserves	
Required to Support Future Budgets	6.357
Civil Emergency	2.000
Property Renewals	0.932
Cost Reduction Fund	3.733
Roads Renewals	0.000
Earmarked Reserves	
• DSM (Devolved School Management)	0.573
• MELDAP/DAAT	0.082
Insurance Fund	0.973
Capital Receipts Reserve	0.095
Sub-total General Services Reserves	**14.745**
HRA Reserves	
Capital Fund	3.985
General Reserve	2.748
Sub-total HRA Reserves	**6.733**
Total Reserves	**21.478**

3.7 Within the August report, I commented that;

- The 2011/12 financial year is a significant watershed since the Council has for the first time in many years, used reserves to bridge the gap between income received and spending on services;

- The Council enters the 2012/13 financial year with the reserves it expected and required as part of setting the 2012-2015 budgets in February 2012. However, all available reserves are now fully committed; and

- Although remaining largely on track as at 31st March 2012, the Council's existing financial strategy is exposed to the emergence of significant financial risks – not least the inability of certain services to constrain and reduce costs, to achieve planned efficiency savings and to manage certain capital projects within approved budget – and that this would therefore require close monitoring and review as part of my reporting on 2012/13 financial performance

Changes in the Financial Operating Environment

3.8 Since approval of the Financial Strategy in February and the closure of the 2011-12 account, there have been some significant changes in the overall financial environment within which the Council operates.

3.9 At a national level the UK Chancellor has acknowledged that the progress made in improving the national finances has been more patchy and extended than originally anticipated. He has also announced that fiscal plans have been adjusted so that planned reductions in spending across most items of expenditure are now likely to extend beyond the lifetime of this parliament. More details should be available as part of the Chancellor's 2012 Autumn Statement on the 5th December although the overall impact of this will mean that funding restrictions for public sector organisations will continue to be applied.

3.10 Central to the successful delivery of the Financial Strategy is the level of grant funding received from the Scottish Government. Within the General Services budget, around 80% of the Council's funding is received as grant from the Scottish Government.

3.11 On 20 September, the Cabinet Secretary for Finance announced the draft Scottish Budget for 2013/14. The following points are of note;

- Government grant figures were provided for the financial years up to 2014/15. This confirmed the previous expectation that the core grant settlements would be basically 'flat cash' i.e. no cash increase - with councils expected to bear the costs of prevailing inflationary pressures and pay awards;

- Capital allocations have been re-profiled again – with a previously indicated capital grant boost now postponed until 2015/16;

- As in previous years the Scottish Government will provide £70 million of funds nationally to encourage local authorities to freeze their council tax levels at the 2007/08 levels;

- A decision will be taken with regard to the 2013/14 poundage rate for non domestic properties when the September Retail Prices Index (RPI) becomes available. The current (August) rate is 2.9% and if fully applied this would mean that ELC costs would increase by approximately £120,000;

- The Scottish Government draft budget included a commitment, in partnership with Local Government, to provide resources for the replacement to the Council Tax Benefit scheme. Initial figures suggest that local government will be expected to fund 43% of the shortfall and in the case of East Lothian this could mean a 'top slice' of approximately £340,000 being applied to the grant income we had expected for the 2013/14 budget round.

- The Cabinet Minister announced a 1% increase for those employees covered by the Scottish Government Pay Policy. Although not directly of relevance to local government – since the pay and conditions of local government employees are the responsibility of individual local authorities and COSLA acting as employers – this may well influence negotiations on other public sector pay awards. In the case of East Lothian this level of award would amount to an increase of around £1.3 million in costs.

3.12 This wide range of issues arising from the draft Scottish Budget still requires clarification and further analysis before the Council can decide how best to deal with them. Greater clarity is likely to emerge between now and early December when formal announcement of the grant settlement is expected. However, as described above, the early indications are that East Lothian Council can expect less Government grant for longer period and will have to bear some additional costs as a result of their draft budget. Consequently, the Council will need to plan for a further year where it will need to deliver substantial efficiency savings just to afford the services it currently provides.

Progress with Current and Future Year Budgets

3.13 The finance team continues to review the progress of all Council services on implementing the 2012/13 budget and Financial Strategy. In overall terms, some limited progress is being made across the Council.

3.14 In my Q1 review of financial performance reported to Cabinet in September, I advised of an increase in Business Groups classified as “high risk” reflecting the emergence of a number of cost and other financial pressures in certain service areas.

3.15 Early analysis of the preliminary Q2 financial performance data reflects a mixed picture with most services operating within approved budget levels but the previously identified high risk areas still giving cause for significant concern. Most worrying is the likelihood that without further remedial action, the Services for People directorate is forecast to overspend its approved budget by almost £0.75M. This forecast is despite the directorate carrying a substantial over provision and therefore likely underspend in the budget for Primary Schools of around £1.0M. Much of the overspending is due to demand pressures currently evident in both Children’s Wellbeing and Adult Wellbeing but also reflects lack of progress in meeting planned efficiency savings.

3.16 The directorates for both Services for Communities and Support Services are currently forecast to spend within approved departmental budget levels although this favourable net position masks some areas of continuing concern and high risk. Most notable in this respect are Facility Support and Policy and Partnerships where lack of progress on planned efficiency savings will almost certainly lead to overspends in these services.

3.17 Provided that further disciplined budgetary control is applied and that no other risks materialise to any significant extent (e.g. severe weather), the consolidated forecast for overall Council financial performance for 2012-13 is pretty much in accordance with the approved budget.

3.18 The Council will recollect that as part of the three-year strategy to bring Council income and expenditure into sustainable balance the Council decided to use £6.357 million of reserves to balance an excess of expenditure over income. This was to be used as follows;

- £4.073 million use in 2012/13; and
- £2.284 million use in 2014/15.

The forecast 2012-13 year end position outlined above suggests that in respect of planned use of reserves, the Council remains very much in accordance with that planned within the 2012/13 budget. However, considered alongside my earlier statement about no spare reserves, this also confirms that the Council will enter the development of the 2013/14 budget with the relatively modest amount of £2.2 million available to help balance future budgets.

3.19 Despite the forecasts of net Council performance and use of reserves being in line with our existing plans it continues to be my view – as expressed in the Quarter 1 report to Cabinet - that there has been deterioration in the Council's overall medium term financial prospects since March 2012. This is based upon the following;

- Slower progress towards delivery of certain Group and Corporate efficiency savings that have been built into the 3 year budget, particularly those in 2013-14 and 2014-15;
- Lack of progress made in developing new forms of income generation – particularly in relation to renewable energy;
- The continuing evidence of cost and demand pressures within certain Business Groups; and
- The changes in the overall financial operating environment reported above.
- The limited future availability of reserves.

Within existing financial plans the Council must make efficiency savings of £8.3 million across 2013/14 and 2014/15. Taking into account my concerns about the realisation of some of these savings, the demand/cost pressures within the current financial year, likely grant reductions for 2013/14 and the likely need to make savings for the new third year 2015/16, this figure will almost certainly need to increase. The extent of the increase will be dependent upon the ability of services to avoid and constrain costs and the speed with which the Council faces various demographic pressures. However, given past experience it is my view that the Council will need to make at least £13 million of savings over the next three years in order to achieve a balanced budget.

3.20 Although not the specific purpose of this report, it is obvious that the Council will need to approach budget development work in respect of the 2013-16 budget with much vigour and discipline. It is sufficiently clear from the Scottish Government's Draft Budget figures that there will be very little scope for anything other than unavoidable statutory service developments and even those will require further compensating savings or service reductions to be made. In accordance with normal practice, it will be my intention to develop appropriate budget rules to guide the work of both officers and elected members over the coming months.

Mid-year Actions

3.21 Given the scale of the challenges faced in both the current future years, I am proposing that the following steps be taken with the aim of reducing expenditure, securing greater efficiencies and increasing the reserves available for future budgets;

- In an effort to reduce the planned call to be made upon reserves over the remainder of this financial year;
    - All budget holders must ensure every effort is made to contain spending within approved budget levels. Where demand pressures are evident, this will require appropriate management actions and/or compensating cost reduction measures to be identified.
    - I am advising all budget holders that additional purchasing commitments should be avoided where possible.
    - Expenditure on staffing should be minimised through continued application of stringent workforce management measures including careful monitoring of vacancies and minimising the use of overtime and temporary and agency working
    - The targeted deferral of planned spending. In conjunction with Council Management Team, we will be reviewing the current 2012/13 budget plans across all services and will be identifying any areas where spending can be deferred or postponed to deliver under-spends in the 2012/13 financial year.
- Recognising the patchy delivery of planned efficiency savings to date, I am proposing some changes to the way in which the Council plans for and monitors the achievement of efficiency savings. Through the Chief Executive, the Council Management Team will receive regular reports on the planned programme of efficiencies and a full validation assessment will be carried out as part of the 2013-14 budget development process. The CMT will continue to oversee and manage

use of the Cost Reduction Fund as a means of assisting in the delivery of planned efficiency savings.

- With the intention of reducing future borrowing and therefore loans charges liabilities, the ongoing review of the capital programmes should be completed. Further update is provided in sections 3.22-3.26 below;

- Renewed efforts should be made to explore new ways of generating additional income. This should include a review and refresh of potential income through renewable energy as well as identification of any new schemes such as the introduction of car parking charges. Efforts should also be made to maximise our returns from all possible asset sales with thinking extended beyond land and buildings.

Review of the Capital Program

3.22 As part of the Quarter 1 report to Cabinet I signalled my intention to report back to Council with regard to a review of the Capital Plan.

3.23 This review has been carried out for a number of reasons

- The normal requirement each year to adjust the Capital Plan in respect of completion of the previous year end – this would include projects that did not start when anticipated and also those subject to variations on planned spending.

- The need to include a capital budget allocation for 'Property Renewals – priority repairs'. During the 2010/11 financial year the Council approved the setting up of a Repairs & Renewals Fund with an initial sum of £2m. Over the past two years, over £1m of repairs have been charged directly against the fund, with significantly more charged against the capital account as part of final accounts. Based upon this trend, the fund will be extinguished by 2013/14.

- Concerns over the affordability of the current Capital Plan - in terms of increasing debt charges on the revenue account and the likelihood of achieving the planned efficiency targets set within the revenue budget for 2012 – 2015;

- The potential benefits of extending the planning horizon beyond the 2014/15 financial year for the purposes of more effective asset management and better managing affordability as re-determined within the latest financial context;

3.24 Detailed work is ongoing in relation to this review. However, given;

- The current status of revenue budgets and the future outlook for planned efficiency savings; alongside

- The wider economic situation and the likely grant funding from the Scottish Government;

I am recommending two significant changes to the Council's financial strategy in respect of capital investment plans;

- With immediate effect the Capital Expenditure Limits approved within the Financial Strategy in February are reduced. My initial calculation of this adjustment is detailed below in Table 3. These totals will be reassessed as part of the 2013/14 – 2015/16 budget preparation.

- Taking into account the latest information on financial prospects, the Council should in future set Capital Expenditure Limits for General Services that seek to minimise the requirement for additional borrowing – in effect this would amount to the total of capital grants from the Scottish Government, income from asset sales, other capital contributions plus the amount of debt which will be repaid in that year. This would have the consequential impact of significantly limiting the Council's level of indebtedness and therefore alleviating some of the pressure upon the revenue account.

Table 3: Revised Capital Expenditure Limits		
Year	**Original Capital Expenditure Limit (as per Financial Strategy) (£m)**	**Revised Capital Expenditure Limit (£m)**
2012/13	37.525	33.000
2013/14	36.526	28.000
2014/15	31.999	20.000
Totals	**106.050**	**81.000**

3.25 On behalf of the Council's Corporate Asset Group, relevant officers are carrying out more detailed project review work to ensure that the Capital Plan is amended to fit within the proposed capital limits stated above. This will involve re-phasing the timing of projects, reassessing projects more strictly against Council priorities and business need and applying a savings target to a number of others. It is expected that following agreement through the Corporate Asset Group and through discussion and meetings with the Administration, I will bring forward a report on the detailed implications to a future meeting of the Cabinet.

3.26 One of the more immediate effects of reducing the capital programme in line with the figures outlined above is that the Council will see a reduction in the debt charges incurred in the years covered by the current financial strategy. Initial indications suggest that by operating within the revised spending limits, the savings to the revenue budget will approximate £900,000 by the 2014/15 financial year.

Housing Revenue Account (HRA)

3.27 The financial position of the HRA at the start of this year is as reported to Council on 28 August this year. Moving into 2012/13 it has reserves of £6.7 million – above the £5.7 million figure anticipated at the time of setting the 2012/13 budget.

3.28 The HRA differs in some regards from the other services run by the Council. As a single service, funded almost entirely from charges to users, the risks are generally better understood and relatively more controllable. Regular updates are made to the budget detail reflecting the progress made with the various affordable housing projects and to ensure that the overall plan remains self-financing. The updated figure in terms of reserves has been factored into this process alongside other recent changes such as the re-commencement of open market acquisitions. This means that the current level of reserves has been fully accounted for within current HRA plans.

3.29 The current HRA plan is based upon significant investment in new affordable homes and the modernisation of the existing stock to meet East Lothian and Scottish Housing Quality standards. The investment strategy rests on two significant financial assumptions. These are as follows;

- Non debt expenditure i.e. Staff Costs/Repairs Costs and Other Operating Expenditure will either stay broadly fixed over the next five years or increase very slowly. In effect, this means that the service will have to absorb the costs of any inflationary increases and any service enhancements and in this respect, the HRA, as with other parts of the Council, will be required to identify how they will make the required efficiency savings over the coming years

- Assuming the non-debt costs detailed above are able to be controlled then in accordance with the 5 year budget approved in February, rents are planned to increase by approximately 4.3% every year – by which point they are likely to be more in line with the Scottish average.

3.30 The Council continues to place considerable importance upon increasing the supply of new affordable homes and is currently making good progress with a number of developments throughout the county with the objective of bringing forward as many new units as possible. Successful realisation of the larger strategic sites continues to be a major challenge, particularly in light of the continuing difficult economic circumstances faced by the construction and banking sectors. Subject to securing best value, every effort will continue to be made to secure progress in respect of these major sites.

3.31 As mentioned earlier, the Housing service is continually fine tuning the balance of investment between new build, acquisition and modernisation of existing stock. In his report to Cabinet on 9 October, the Head of Housing and Environment advised of his intention to set aside a sum within the HRA capital investment plan of £230,000 to support a new programme of Extensions and Conversions that will be brought to Cabinet in November. With this in mind, I am proposing to introduce a new budget line for this purpose in 2012/13 that can be enabled through a compensating reduction in the funds available for Open Market Acquisitions.

Other mid-year Financial Matters

3.32 The Council appreciates the many challenges imposed by the prevailing economic climate for many organisations across all sectors. Recognising the particular difficulties that many third sector organisations increasingly face in securing either working capital or loan finance, the Council has had to respond to a growing number of enquiries for financial advice and assistance. In response to approaches made in 2011 by two specific community organisations, the Council has already pledged/provided support arrangements that have only been partly implemented. The Council has continued to work in varying degrees with both organisations in an effort to help stabilise their financial position and secure their continued operation. It is now suggested that in both cases, more immediate action is required to complete the proposed support arrangements.

3.33 Musselburgh Old Course Golf Club - In April 2011, the Council provided a short term interest bearing loan facility to ease the clubs immediate cash flow difficulties. This has been successful with the club managing to stay out of overdraft since that time. The club own the existing clubhouse. Further assistance was approved in principle at that time in the shape of a further longer term refinancing loan that would allow the club to extinguish all other loan debt which would lead to the Council's loan becoming secured on a first ranking basis. It would now be my intention to finalise this follow up loan facility on terms that are considered acceptable to both parties and are also in accordance with state aid rules.

3.34 Prestongrange Bowling Club - Towards the end of 2011, club officials approached the Council as the club faced increasing financial difficulties with mounting liabilities and a dwindling membership/patronage. Although the club have managed to stabilise membership numbers, they continue to accumulate increasing levels of debt. Although the 2012 bowling season has now come to an end, there is a genuine concern that without a new, robust business plan in place the club may not be able to re-open next season. The club own the bowling green and other ancillary buildings and club officials have now suggested they wish to sell the entire site to the Council but retain use of the green and pavilion for bowling purposes. Although some consideration is being given to possible loan finance based solution, in this instance there may be advantages to securing Council ownership of the site.

3.35 For both of the above, it is suggested that up to date, robust diligence checks are made in respect of business plans and property valuations and that the most advantageous arrangements be developed that aim to secure continued club operations at minimum cost/risk to the Council. In this respect I would seek to work closely with the Council's Property, Finance and Legal Teams as well as Internal Audit. It is anticipated that both support packages could be completed before the end of the calendar year and that more detailed reports will be brought to Councillors via the Members Library Service.

4 POLICY IMPLICATIONS

4.1 The report confirms the relevance and applicability of the approved Financial Strategy although it does make recommendations for some important adjustments and some additional control measures. Bringing expenditure and income into balance may mean changes to Council policy on a range of matters depending on how that balance is to be found.

5 EQUALITIES IMPACT ASSESSMENT

5.1 This report is not applicable to the wellbeing of equalities groups and an Equalities Impact Assessment is not required.

6 RESOURCE IMPLICATIONS

6.1 Financial – as set out in the report above.

6.2 Personnel – it is very unlikely that reductions in staffing cost can be avoided as part of our efforts to balance income and expenditure. Efforts in support of existing workforce management plans will be intensified to ensure that resources are better focused on the priorities set out in the SOA and the Council Plan.

6.3 Other – bringing expenditure and income into balance may impact on any of the wide range of resources used by the Council.

7 BACKGROUND PAPERS

7.1 Council 14 February 2012 – "Council Financial Strategy 2012/13 to 2014/15"

7.2 Member's Library May 2012 (116/12) – "Capital Investment & Treasury Management Strategy 2012/13 to 2014/14"

7.3 Council 28 August 2012 – Item 6 "2011/12 Year-End Financial Review"

7.4 Cabinet 11 September 2012 – “Financial Review 2012/13 – Quarter 1”

7.5 Audit & Governance Committee 18 September 2012 – Item 1 “ELC ISA 260 Report to those charged with governance”

7.6 Audit & Governance Committee 18 September 2012 – Item 2 “ELC Draft Annual Audit Report to Members”

7.7 Cabinet 09 October 2012 – Item 2 “Update on the Open Market Acquisitions Strategy”

7.8 Members Library Service 30 March 2011 – Short-term Loan to Musselburgh Old Course Golf Club.

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