East Lothian Council

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| **REPORT TO:** | East Lothian Council |
| **MEETING DATE:** | 19 December 2017 |
| **BY:** | Depute Chief Executive (Resources & People Services) |
| **SUBJECT:** | Financial Strategy 2018-2023 |

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## 1 PURPOSE

1.1 This report proposes an updated Financial Strategy for the Council, covering a five year period from 2018-2023.

## 2 RECOMMENDATIONS

2.1 The Council is recommended to:

- approve the Financial Strategy set out in Appendix 1 of this report;
- approve the further refinements to the new budget development process set out in paragraph 3.4 of this report.

## 3 BACKGROUND

3.1 In recent years the financial strategy has been considered at the annual budget meeting. The current approved Financial Strategy covers the period until March 2020; however, each year the Strategy is refreshed to reflect any changes in the financial planning landscape. As set out in the recent Financial Prospects report considered by Council in October, the proposed Financial Strategy (attached as Appendix 1) has been prepared earlier to better assist with development of financial plans, and has been extended to cover a five-year financial planning period, from 2018 to 2023. The Strategy itself covers both the General Services and also Housing Revenue Account, contains the Reserves Strategy, and sets a clear direction on how the Council will manage its financial resources across the next five years.

3.2 It is important that in developing future budget proposals and related amendments, all councillors have due regard to the direction set within this strategy.

**Budget Process**

3.3 As already approved by Council in October, the budget development process has been reviewed with the key variables set out below.

- An initial set of DRAFT budget proposals (covering both General Services and HRA) is developed by the Administration and considered by Cabinet on 16 January 2018 covering both revenue and capital budgets.

- Other political groups will have the option to develop any amendments to the Administration budget, with formal proposals to be considered by Council on 13 February 2018, where the Council budget for both General Services, HRA and Council Tax setting will be approved.

3.4 Within this, the framework to support any budget amendments which may arise between the Administration draft budget and the Council budget-setting meeting on 13 February is proposed below:

- Any amendment to be made against the Administration's Draft Budget Proposal approved by Cabinet in January can only be made through Party Group Leaders.

- All amendments must be presented to Council in the form of an alternative budget proposal based around the Administration draft. The amendment must be deemed competent, both in its ability to be delivered as well as ensuring that it can still deliver a balanced budget.

- Political Group Leaders may, during this period, work with the Finance Team on any potential budget changes which may be reflected within proposed amendments. Any final amendments to be considered by Council at the February Special Meeting must be submitted through Group Leaders to the Chief Financial Officer (delegated to the Service Manager, Business Finance) **no later than Tuesday 30 January 2018**.

3.5 Should Council wish to approve this framework for amendments in respect of the budget development process, this will require a specific departure from existing Standing Orders as regards submission of amendments, particularly Standing Order 9.3(ii), and therefore would require the support of two-thirds of those who are present at the meeting.

## 4 POLICY IMPLICATIONS

4.1 There are no direct policy implications associated with this report, although clearly, the report provides a strategic context and direction within which future financial plans should be considered. Ongoing monitoring and reporting of the Council's financial performance is a key part of the approved Financial Strategy.

## 5 INTEGRATED IMPACT ASSESSMENT

5.1 The subject of this report does not directly affect the wellbeing of the community or have a significant impact on equality, the environment or the economy.

## 6 RESOURCE IMPLICATIONS

6.1 Financial – as set out within the strategy

6.2 Personnel - none

6.3 Other – none

## 7 BACKGROUND PAPERS

7.1 Council 21 February 2017 – Item 1 – Council Financial Strategy 2017/18 – 2019/20

7.2 Council 31 October 2017 – Item 5 – Financial Prospects 2018/19 and Beyond.



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| **DATE** | 7 December 2017 |

Appendix 1

East Lothian Council

# Financial Strategy

# 2018-19 to 2022-23

**Financial Strategy 2018-19 to 2022-23**

## 1 Introduction

1.1 The Council is currently facing significant financial challenges in the years ahead resulting from an expected reduction in the level of grant funding which we receive from the Scottish Government at the same time we are seeing a rapidly expanding population.

1.2 The purpose of the financial strategy is to provide clear direction on how the Council will manage its financial resources in the medium to long term to ensure they are deployed effectively to achieve corporate objectives. It plays a vital part of decision-making and forms the basis of the Council's stewardship over tax payers funds.

1.3 Given the extent of financial challenges ahead, the value of such a Strategy is that it enables the Council to develop a better understanding of the wider policy and financial environment within which it operates, and ensure that the Council can identify and respond flexibly to opportunities and threats, and manage and mitigate risks and ensure that financial resources are contributing to achieving Council objectives and outcomes. The principal objectives of the financial strategy are:

- Outline the Council's high level financial position over the years 2018-2023 based on a range of assumptions.
- Highlight the key influential issues that have been considered in developing the strategy.
- Ensure that limited available resources are focused on delivery of the Council's key priorities.
- Provide a financial planning platform for a sustainable revenue budget and capital investment programme which will support the Council's key priorities.
- Ensure that the Council is fully aware of the financial challenges and uncertainties that it faces and is in the strongest possible position to deliver the best possible quality and range of services within available resources.
- Increase both organisational awareness and wider community understanding of the Council's financial position and the challenges it is facing over the medium term in balancing its budget.

1.4 The Strategy also sets out the policy for the utilisation of reserves, including a clear rationale between holding fund balances for specified purposes and making decisions on how much reserves can be utilised when setting the budget.

1.5 The Strategy covers the five year planning period from 2018-19 to 2022-23 and includes both the General Services and Housing Revenue Account (HRA) revenue and capital budgets.

## 2 Current Economic Context

2.1 The Financial Prospects report which was considered and approved by Council in October 2017 set out the financial context within which we are currently operating and many of the key pressures that may impact on the way in which the Council spends its limited resources.

2.2 With so many external influences currently impacting on the wider economy, forecasting remains very difficult. Progress with Brexit negotiations are ongoing but uncertainty still remains as to what the economic implications will be. If there is either a downturn or further slowdown in economic activity within the UK this could lead to further public sector expenditure restraint beyond that signalled within the UK Chancellor's most recent budget. Furthermore, inflation currently remains at a record high at over 3%, and experts are currently forecasting that inflation will range between 2% and 3% in 2018/19 reducing marginally over the following few years. The cost of inflation places increased pressure on the cost of delivering existing levels of local service.

2.3 In Scotland, as well as any limitations imposed through the UK Budget, the spending available to Scottish Local Government is dependent on the Scottish Government's budget priorities. The Scottish Government have already signalled through their programme of government, continued levels of current investment in health and other public service portfolios such as Policing. Within the context of tight UK budgets, the outcome of this means a continued squeeze on local government services remains most likely.

2.4 The Scottish Government does however have at its discretion a new range of fiscal powers over taxation and welfare, which mean in practice that around 40% of devolved expenditure will now be funded by tax revenues collected in Scotland – a figure that will rise to 50% once VAT revenues are assigned. This makes the determinations of the Scottish Budget significantly more complex than it has been in the past, where in addition to the block grant received from Westminster, the resources available to the Scottish Government will depend on a complex interaction between the revenues from taxes transferred to the Scottish Government and the revenues from the equivalent taxes in the rest of the UK.

2.5 A number of independent commentators from across a wide range of sources including: Fraser of Allander Institute, Government Expenditure and Revenue Scotland (GERS), Office of Budget Responsibility (OBR) and the Improvement Service (IS); are all suggesting a prolonged period of austerity will continue for the public sector and indeed Scottish Local Government at least for the medium term and through until 2021-22.

## 3 Local Context

3.1 The local environment within which the Council operates has changed significantly in recent years and will alter further in future years due to the impact of national legislation and policy, further economic turbulence, societal changes and developing customer expectations.

## Council Plan

3.2 The recently approved Council Plan for 2017-2022, sets the strategic policy direction for the Council, and continues the journey towards realising our vision for an even more prosperous, safe and sustainable East Lothian, with a dynamic and thriving economy that enables our people and communities to flourish. The overarching aim is 'reducing inequalities within and across our communities' with four themes each designed to make the biggest impact in our communities. These are: Growing our Economy, Growing our People, Growing our Communities and Growing our Capacity. The alignment of financial resources to enable the delivery of the Council Plan is a key requirement, working across all Community Planning partners to deliver this shared agenda for the benefit of local people.

## Demographics

3.3 The Council is currently experiencing a rapidly expanding population with the number of school age children expected to increase by just under 28% between 2012 and 2037, and the projected number of pensioners expected to increase by over 37%. This will create both opportunities for the Council but also significant financial challenges for providing services to meet these growing demographic changes to ensure that the Council and wider public sector has the appropriate infrastructure to support these growing demands.

## Changing Public Sector Landscape

3.4 The public sector landscape continues to evolve as public bodies continue to explore ways to work together to achieve shared outcomes. Some of these changes are driven from legislative requirements, others are driven by local community planning and other collaborative arrangements. The development of new public sector provision presents new opportunities and challenges for the Council as it seeks to ensure that shared outcomes are achieved and that resources are deployed efficiently and effectively.

3.5 The East Lothian Integrated Joint Board (IJB) was formally established in July 2015, and forms a partnership between the Council and NHS Lothian, following the requirements set out in the Public Bodies (Joint Working) Act 2014. The IJB has been designed to integrate how health and social care services are: planned, commissioned and delivered from 1 April 2016. It is a separate legal entity receiving resources from both the Council and NHS partners, and in turn instructs these partner bodies to carry out specific delegated functions and associated resources. It is hoped this partnership will provide both challenge and opportunity in future years, requiring the Council to identify and manage any risks identified through the joint working arrangements with its Health partners. The Council will play an active role within this partnership to help secure the key objectives and outcomes associated with Shifting the Balance of Care and must do what it can to ensure that adequate resourcing follows this mutually accepted policy direction.

3.6 The Community Empowerment (Scotland) Bill received royal assent on 24 July 2015. The Act places new duties on the Council and its partners to provide new rights for community bodies. The Act came into effect in July 2016 and will have a significant impact on the way the Council interacts with the Community.

3.7 The Scottish Government review on Education Governance and proposed Next Steps, places focus on an Education system that is; centred on children and young people, is school and teacher led, focus on the quality of learning and teaching, supports leadership and has a relentless focus on improvement. Part of the Governance review has resulted in the proposed establishment of Regional Improvement Collaboratives, with East Lothian forming part of the South East Regional Improvement Collaborative alongside Edinburgh, Fife, Midlothian and Scottish Borders. The main focus of the South East Collaborative is on Quality Improvement and Raising Attainment, and will place new and changed duties on Local Authorities to work within the Collaborative arrangement to drive forward increased improvement.

## 4 General Services Revenue Budget – Medium Term Outlook

4.1 The October 2017 Financial Prospects report set out scenario based financial modelling across a 5 year planning horizon. The starting point for these scenarios was the existing approved 3-year revenue budget used as a baseline.

4.2 A summary of the Spending Plans for 2017-18 approved by Council in February 2017 are set out in the table below.

| **General Fund – Revenue** | **2017-18** | **2018-19** | **2019-20** |
|---|---|---|---|
| | **£'000** | **£'000** | **£'000** |
| Approved Expenditure | 232,967 | 232,589 | 231,922 |
| Financed by: | | | |
| RSG (including NDR) | 166,108 | 164,533 | 163,320 |
| Other Government Grants | 8,945 | 8,945 | 8,945 |
| Council Tax | 54,318 | 56,900 | 59,586 |
| Other | 1,066 | 71 | 71 |
| Transfer from Reserves | 2,530 | 2,140 | 0 |
| **TOTAL** | **232,967** | **232,589** | 231,922 |
| **Delivery of Planned Efficiencies (contained in above)** | **2,124** | **3,447** | **3,492** |

4.3 The current spending plans remain crucially dependent on services being able to both manage existing spending commitments within available budgets as well as the delivery of planned efficiency savings. In total the current approved spending plans require that over £9 million of additional efficiencies are delivered between 2017-18 and 2019-20. Within the current financial year, whilst substantial progress has been made, the scale of further savings required over the next few years does not come without significant challenge. Any delays regarding the implementation and delivery of these recurring savings will create further problems, and ensuring that the Council has resilient plans in place to minimise any potential delays, or accelerate any new efficiency programmes remains critical.

4.4 Effective monitoring of the in-year financial position id also critical and recently has highlighted that some service areas are at risk of overspending and consequently have been asked to develop and implement cost recovery plans with enhanced financial controls and additional monitoring checks are now in place. The ability to address the in-year and crucially the recurring nature of these overspends remains critical in assessing the future financial landscape for the Council.

**Scottish Government Grant Funding**

4.5 Key to identifying the future financial outlook as well as the Financial Strategy is the level of grant funding which we currently receive from the Scottish Government. The level of general Revenue Support Grant (RSG) currently makes up around 71% of the Council's total available funding, and is therefore an integral part of the overall resources that are used to support the delivery of Council services.

4.6 The Council also receives additional specific revenue grant funding of around £8.9 million from the Scottish Government; including investment in Health and Social Care through the Social Care Fund, Pupil Equity Fund devolved directly to Head Teachers, Criminal Justice Funding as well as additional funding provided to support the delivery of Early Learning and Childcare – 1140 hours expansion. Over the past few years, there has been an increasing level of national policy commitments being funded by grant which can only be used for these specific purposes at the same time as we are facing reductions in the core grant for the provision of other services. The earmarking of these resources, reduces the scope for flexibility in how the Council allocates resources in a way which best meets local priority outcomes.

4.7 In recent years including 2017-18, we have only received one year grant settlement from the Scottish Government and the lack of certainty around future grant awards, significantly weakens longer term planning and continues to place a high degree of volatility around future spending plans.

**Council Tax**

4.8 Following years of relative stability as a result of the nationally imposed Council Tax Freeze from 2007-08, the projected Council Tax income within the 3 year approved budget includes: anticipated income relating to the change in Council Tax multipliers introduced in 2017-18, increased yield from additional household properties expected to be built in the next 3 years, and an assumed annual Council Tax increase of 3% per annum in line with the cap which was imposed in 2017-18.

4.9 The housebuilding growth across the East Lothian area generates significant opportunities for the Council, but these opportunities must be managed alongside a backdrop of reducing resources and the related growing demand for our services. The future growth in the Council Tax yield as a result of a growing number of properties, does not match the associated costs of servicing this increased population both in terms of capital infrastructure costs and associated revenue costs across a wide number of Council services including increasing school roll, care for the elderly and more waste collection. The reliance upon shrinking government grants together with the previous Council Tax freeze, and the existing cap on Council tax increases imposed by the Scottish Government means that this additional cost must be met within the existing, limited resources available to fund core council services.

**Workforce**

4.10 The workforce is the Council's most valuable asset and with this comes significant financial contractual commitments in terms of pay and pensions. The Council is in the process of updating its Workforce Development Plan which will assist in planning the workforce going forward particularly given the future challenges, both around availability of resources as well as changing policy commitments. In recent years, any public sector pay annual increase has been approved broadly in line with public sector pay policy which has been around 1%. The Scottish Government has now set out within its Programme for Government the intention to remove the public sector pay cap, and we have already started to see an increase in pay award above this level from the 2017-18 award which has now been approved for most staff groups (excluding Teachers which is still to be agreed).

4.11 This will inevitably place increased pressure on wider public sector pay claims. Even if future pay awards are contained within 2017-18 levels going forward, this will place an increased recurring pressure on the wider Council budget. As a broad indication every 0.5% increase amounts to around £0.650 million on our annual pay bill, and therefore the potential implications of rising pay awards will be significant.

4.12 All employees working for the Council have access to defined benefit pensions, which means that the Council as employer has substantial unknown future financial liabilities that only materialise when the pensions are actually paid. For teachers, this liability is not established specifically for East Lothian as these costs are part of a national scheme administered by the Scottish Government. For non-teaching staff, there is a statutory requirement that these costs are independently assessed as part of an actuarial valuation of each local pension fund every three years.

4.13 All public sector pension schemes are subject to on-going scheme valuations to establish the financial sustainability of the schemes to ensure that they meet their future liabilities, and set any future employers contribution rates for the scheme for the next few years based on these results. The most recent Local Government Pension (LGPS) actuarial valuation will be affect employers contribution rates from April 2018, with a further valuation ongoing relating to the Teachers Pension Scheme which may impact on contribution rates from April 2019. In relation to the LGPS, the Council previously agreed to participate in a formal Contribution Stability Mechanism which provided a degree of stability in the employers pension contribution rates for future years. This stability mechanism continues to remain in place, but now requires an increase of 0.5% per annum to current employer contribution rates from 2018-19 onwards. This will place an additional burden in successive financial years of around £260k per annum.

**Scenario Planning / Funding Gap**

4.14 Despite the many uncertainties facing Scottish local authorities, in particular those arising from reduction in Government funding, the need for medium to longer term financial planning is becoming increasingly important. Councils must ensure that they have robust financial plans in place to mitigate any potential impact arising from a wide range of variables.

4.15 The scenario based financial modelling which was highlighted in the recent Financial Prospects report highlighted three scenarios based on a limited number of key variables (RSG, Pay and non-pay inflation) and different assumptions within these variables based on potential outcomes. These scenarios were modelled on the assumption that the current approved spending plans, including the planned efficiencies, can be delivered. The total estimated level of revenue savings which will be required to be delivered over the next 5 years is therefore over and above the current planned savings, and is summarised in the Table below.

**Estimated Funding gap 2018-19 to 2022-23**

| Scenario | 18-19 £'000 | 19-20 £'000 | 20-21 £'000 | 21-22 £'000 | 22-23 £'000 | TOTAL |
|---|---|---|---|---|---|---|
| Existing Planned Efficiencies | 3,447 | 3,492 | - | - | - | **6,939** |
| 1 | 2,200 | 1,710 | 2,920 | 2,830 | 2,740 | **12,400** |
| 2 | 4,961 | 4,439 | 5,530 | 5,514 | 5,498 | **25,942** |
| 3 | 9,708 | 8,671 | 6,936 | 6,875 | 6,814 | **39,004** |

4.16 All of the scenarios indicate a clear requirement that the Council will require to make large cost savings unless there is a significant improvement in the level of funding provided to Local Government through the next financial settlement and beyond. While the level of savings identified will undoubtedly change as work progresses on developing the Revenue Budget, this provides an indication of the scale of financial challenge potentially facing the Council over the next five years. Reductions on this scale would have a potentially significant adverse impact upon service delivery and it is imperative that early consideration is given to how best this might be minimised. What remains clear however is that if these reductions materialise, the Council will be required to make some difficult choices in order to balance the budget through reducing its cost base and/or increase income streams.

## 5 General Services Capital Budget – Medium Term Outlook

5.1 The 2017-20 General Service capital spending plans which were approved in February 2017 is summarised in the table below. These spending plans in-year have been subject to re-profiling and updating following the 2016-17 outturn, but in broad terms indicate a continuing growth in the capital plans.

| **General Fund – Capital** | **2017-18 £'000** | **2018-19 £'000** | **2019-20 £'000** |
|---|---|---|---|
| Approved Spend (gross) | 47,933 | 51,582 | 69,090 |

### Capital Funding

5.2 Funding for the capital plan comes from a range of sources including; Scottish Government (General Capital Grant and Specific Ring-Fenced Capital Grants), Developers contributions, capital receipts from asset disposals, other income such as grant funding from other bodies, and borrowing funded by the loan charges provision in the revenue budget.

5.3 The General Services capital grant funding for Scottish local authorities received from the Scottish Government during 2016-17 had been reduced by £150m with the promise that this would be returned to local authorities over the next spending review period. This was not included within the 2017-18 settlement although there remains a commitment this will be returned to Councils during the period 2018-20.

5.4 Furthermore the uncertain economic conditions places further risk on the funding and delivery of the current and any future capital programme due to the future level of interest rates and associated cost of borrowing as well as realisation of any anticipated capital receipts.

### Future Capital Commitments

5.5 The Council has invested significantly in its infrastructure over recent years and this growth is likely to continue with the current plans designed to support the future infrastructure requirements across the Council area. Linked to the growth agenda, the Council now has an approved Local Development Plan (LDP) that is currently undergoing a formal period of representation. When adopted during 2018, this will require the building of an additional 10,050 homes in East Lothian by 2024. The Council's financial plans have now been modified to better reflect the additional enabling infrastructure costs that will fall due to the council. These modifications reflect a new Developer Contributions Framework that has been approved by the Council and is currently subject to a statutory consultation process.

5.6 The Edinburgh and South East City Region Heads of Terms Agreement was signed by all regional partners and UK and Scottish Governments on the 20 July 2017. The Heads of Terms agreement confirmed all partners' joint commitment to achieve full implementation of the deal. Outline business cases now require to be updated and developed to bring them up to 'Green Book' standard before being approved by partners and then by Government, enabling funding to be released.

5.7 Subject to affordability, the detailed structure of any deal will need to be more fully incorporated within our existing financial plans and a further report to Council can be anticipated. Whilst the majority of these costs are likely to fall outwith the current 3-year approved budget, the financial implications of supporting both any future adopted LDP and emerging City Deal commitments are significant and the Council budgets will need to be updated to reflect the related capital and revenue implications.

5.8 Alongside this, the Council aims to provide a modern, efficient and sustainable operational asset portfolio that meets the needs of its existing and future service users and employees. Key to this is the Corporate Asset Strategy which provides the framework for the efficient management of the Council's core assets. This strategy supports the delivery of the operating model for services, promoting collaborative working with our Community Planning partners, other public bodies and sectors to achieve more effective use of combined assets.

5.9 All of these investment plans are underpinned by financial models that determine their affordability both in terms of capital and revenue budgets. What remains clear is that the affordability plans of future capital investment remains critical in order to ensure that we can continue to maintain appropriate level of investment for the future benefit of the East Lothian area.

## 6 Reserves

6.1 Holding an adequate level of reserves to meet unexpected costs is a key management tool for delivering the Financial Strategy. It remains the responsibility of the Head of Council Resources in his capacity of the Chief Financial Officer (Section 95 Officer) to advise the Council on the level of reserves which it should hold and ensure that there are clear protocols for their establishment and use.

6.2 In determining medium term financial plans and preparing budgets, the Council needs to consider the establishment and maintenance of reserves in accordance with its statutory powers. Reserves can be held for three main purposes:

- Working balances to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing – this forms part of General Reserves.
- A contingency to cushion the impact of unexpected events or emergencies – this also forms part of General Reserves.
- A means of building up funds often referred to as Earmarked Reserves, to meet known or predicted liabilities.

6.3 The General Services reserves (excluding HRA reserves) available as at 31 March 2017 as per the audited accounts was £20.534 million with more detail around the breakdown of this reserves set out below. It should be noted that the actual available reserves going into 2018-19 will differ as many of these reserves already have commitments against them and will be spent during this year.

| General Services Reserves | Current Position 1 April 2017 £'000 |
|---|---|
| Required to support future budgets | 4,670 |
| Civil Emergency | 2,000 |
| Cost Reduction Fund | 2,767 |
| Earmarked Reserves | |
| • DSM (Devolved School Management) | 258 |
| • MELDAP | 303 |
| • Other reserves | 431 |
| Insurance Fund | 1,723 |
| General Services Capital Receipts Reserves | 4,600 |
| Gen Services Capital Fund | 3,782 |
| **Sub-total General Services Reserves** | **20,534** |

6.4 Each of these reserves is set out for a specific purpose with the detail of their intended use explained below.

6.4.1 **Requirement to support future budgets**: This balance has already been committed to support the budget in 2018-19 as per approved budget plans in February 2017. If decisions are taken which can deliver a balanced budget without the reliance on this reserve it is recommended that this is transferred to the Capital Fund to support future capital infrastructure requirements and minimise on-going revenue payments.

6.4.2 **Civil Emergency**: This fund should act as a cushion against the costs of any emergency or other unforeseen event should it arise. This is currently retained at a level of £2 million, however the level of this remains under constant review as to the adequacy of this.

6.4.3 **Cost Reduction Fund**: Meeting future financial challenges is likely to mean significant changes in the way in which the Council delivers services. To help make these changes the Council previously established a Cost Reduction Fund. The balance on this Fund currently stands at £2.767 million and is expected to reduce to under £2 million at March 2019 based on current commitments. This fund has largely been used to meet the costs of employee contract severance payments as well as supporting some costs associated with delivering Transformational Change.

6.4.4 **Earmarked Reserves**: These funds are earmarked for specific purposes and include: Midlothian Drug and Alcohol Partnership (MELDAP), balances established from both Primary and Secondary Devolved School Management (DSM) schemes as well as specific carry forward balances for a range of projects including Area Partnership and also balance of funds to support the feasibility plans around the future of Cockenzie.

6.4.5 **Insurance Fund**: The level retained within the Insurance Fund is subject to ongoing fund valuations, and whilst the current level remains in line with current assumptions, there are emerging pressures arising within the fund and the level should be kept under review.

6.4.6 **General Services Capital Receipts Reserve**: This fund has been established from Capital Receipt income which has not yet been applied in year. This Fund can be used to either support capital investment or repay the Principal element of debt repayments. This fund cannot be used to support General Revenue budgets.

6.4.7 **General Services Capital Fund**: The Fund was established in recent years from flexibility from year end underspends, in order to mitigate the impact of the growing capital infrastructure commitments. Unlike the Capital Receipts reserve this Fund does have the flexibility to be transferred to other General Reserves.

**Reserves Strategy**

6.5 Given the scale of the changes facing the Council and the costs associated with delivering the enhanced transformational programme, it is suggested that the Cost Reduction Fund should be increased by a further £1.5 million to support the delivery of the change agenda and establish a reduced cost base for the Council. Despite continued pressure on future capital infrastructure commitments, the need to support up-front investment to drive forward Transformational change and deliver significant reductions to the Council's cost base remains essential and therefore it is recommended that £1.5 million is transferred to the Cost Reduction Fund from the General Services Capital Fund to support this programme of change, the balances of which had been established in recent years broadly from service underspends.

6.6 In line with the current Financial Strategy, the reliance on the use of reserves to support future revenue budgets is not sustainable and therefore the preferred and more sustainable direction is by having the final year of the three year budget showing balanced income and expenditure without the use of reserves. Borrowing is usually repaid over a longer period than three years, and the best indicator of whether the future repayments are sustainable is a longer term budget that does not rely on temporary sources of funding such as reserves. In other words, to sustain the capital investment plan the Council needs to demonstrate that there is no structural deficit in its budget by 2020-21.

6.7 Taking into account in year financial performance, it is unlikely that the Council will deliver a surplus contribution to reserves in 2017-18. Furthermore, it is clear that the Council faces significant challenges over the medium term, with continued reductions in funding and increasing demand for many of its services. It will therefore be necessary to maintain balances at an appropriate level to support any future commitments and mitigate future financial risks, and it is recommended that there is now a need to establish a minimum level of uncommitted General Reserve balances which can be used to support any unforeseen / unquantifiable event. This level should equate to a minimum of 2% of the Council's annual running cost (£4.1 million). Taking into account the Civil Emergency Fund (£2 million) and the revised balance following the transfer of £1.5 million to the Cost Reduction Fund of the General Services Capital Fund (£2.282 million) the Council currently meets this minimal required level of balance at just over £4.282 million. In the event that the Reserves are projected to fall below this level then Members must have a clear route for bringing Reserves back up to the level over the subsequent three financial years.

## 7 General Services Financial Strategy

7.1 Given the potential challenges which lie ahead, over the next three years, the Council's financial strategy will continue to focus upon;

- Delivering an enhanced Transformational Change Programme that will change the way it does things to be more efficient and deliver services more effectively to meet the new demands and pressures in line with the Council's aims and support the realisation of existing planned savings;

- Maximising the income generation available to the Council. This will include ensuring that where the Council has decided to charge, these are where possible based on the principle of full cost recovery, whilst ensuring existing charges are benchmarked against other similar authorities. This will also include the exploration of new opportunities for income generation where it is deemed possible;

- Continue to explore options for the Council to become more entrepreneurial including developing new ways of ensuring service are provided in the most effective way possible. This could include developing new services that can make a 'profit' for the Council.

- Continue to progress opportunities for partnership and collaborative working where there are proven efficiency and or service gains;

- Continuing to constrain cost growth – through effective demand management, good financial control by managers and by effective negotiation with suppliers;

- Continue to focus spend on prevention and early intervention, which is designed to reduce future demand for council services by stopping problems arising or by addressing problems early on;

- Maximising the use of the Council's assets, reviewing our existing asset base to ensure that it meets the new ways of working, and work in partnership with other public agencies to make best use of our assets and provide a more joined up service.

- Continuing to invest where appropriate in the Capital investment programme, ensuring the plans will support the Council's key priorities, and remain affordable based on a clear understanding of both capital and future revenue costs.

- Continuing to manage the General Services Loans Fund balance, maximising the use and application of capital receipts, capital grant, and any flexibility arising from revenue balances, in order to minimise the future impact of debt charges.

7.2 Taking this into consideration, alongside the Reserves Strategy outlined above, it is also recommended that the budgets are developed annually on the following approach:

- Develop a sustainable three year General Services budget avoiding the use of reserves in Year three (2020-21).

- Develop a five year General Services Capital Plan, which seeks to minimise net borrowing requirements and is considered affordable both in terms of prudential limits and within the constraints of the three year revenue budget.

## 8 Housing Revenue Account

8.1 It has been more than ten years since the achievement of a zero net HRA debt position in 2004-05 – mostly as a result of council house sale receipts in the property boom. Since then, there has been a significant increase in HRA capital spend as both the modernisation and affordable house building programmes have been expanded – and as a consequence, the share of spending on debt charges has also increased.

8.2 The Local Housing Strategy sets out the strategic approach of the local authority and its partners to delivering high quality housing and housing related services across all tenures, to meet identified need. The Strategy has been prepared within the context of a highly pressured housing market. Against this backdrop, increasing the supply of affordable housing was and continues to be, a corporate priority for East Lothian Council. House prices remain among the most expensive in Scotland and there is significant demand for social rented housing. A high level of homelessness applications persist and the economic climate continues to impact on the ability of households to meet their housing needs.

8.3 A new and updated Local Housing Strategy is currently being prepared for the period 2018-23, with the housing need and demand assessment a key part of the evidence base for the Strategy. The current SESplan housing need and demand assessment was approved by the Scottish Government in March 2015. Within this, the plan indicated the requirement for circa 553 new additional units of housing per annum in East Lothian over the period 2012-30, comprising 370 affordable housing units and 183 units of market housing. The ability to deliver will be dependent upon a combination of affordable housing providers, which includes Registered Social Landlords (RSLs), East Lothian Council and the private sector. It will also be dependent on complex funding models delivering different tenures.

8.4 For the Council, the timing around the delivery of many of the affordable housing sites remains key, coupled against the affordability to deliver the plans. The overall HRA budget is a balancing act between the income raised through rent, the revenue expenditure such as staffing & repairs and the capital spending which is undertaken on modernisation and provision of affordable homes.

8.5 For the HRA, the financial strategy will continue to focus upon the following;

- Ensuring rental income and any future rental increase remains affordable for tenants, whilst benchmarked against national average;
- Continuing to constrain cost growth – through effective demand management and good financial control by managers, focusing spend in line with agreed priorities whilst maintaining high quality service delivery for Council House tenants.
- Ensuring that the HRA can sustainably support the required housing capital programme associated with building new Council Houses and modernising existing homes. This will be delivered working alongside wider RSL partners to deliver the affordable housing needs across East Lothian in line with the objectives of the Council's Local Housing Strategy and LDP requirements and the Scottish Government's aim to deliver an additional new affordable housing;
- Moving towards a position whereby the HRA is self-financing a larger proportion of its capital expenditure – typically by direct funding rather than borrowing;
- Continuing to meet on-going statutory requirements, including; Scottish Housing Quality Standards and EESSH (Energy Efficiency Standard in Social Housing);
- Responding to the challenges arising from recent and proposed UK benefit reforms;
- Reducing rent arrears; an area which has been particularly challenging following the roll out of Universal Credit;
- Delivering the efficiencies required across the housing management and repairs service;
- Ensuring that the Council stays within the recommended upper limit for the ratio of debt charges to income of 40%, maximising the use and application of capital

receipts, capital grant, and any flexibility arising from revenue balances, in order to minimise the future impact of debt charges. This limit maintains an appropriate long term balance between the various elements of the HRA budget;

- Ensuring that the reserve or balance left on the HRA should not fall below £1.0million. This will allow the Council to maintain a cushion against any unexpected increase in costs or loss of income, and to protect against the risks inherent in the UK welfare reform proposals. Given the uncertainty that exists over the timing and scale of capital investment in new affordable housing, there is no upper limit on reserves.

## 9 Financial Management

9.1 The Council's external operating environment is subject to constant change and therefore budget review and development cannot simply be a once-a-year process. In-year performance monitored against approved financial plans will be kept under constant review with regular quarterly reports made to Cabinet and a year-end report presented to the full Council following submission of the draft accounts for audit.

9.2 As part of our normal financial management support service, monthly and quarterly performance reports are issued to managers with budget responsibility and in addition to that, the overall finances of the Council are subject to detailed annual independent audit review.

9.3 It is vitally important that through the Council Management Team (CMT), the Council maintains a disciplined approach to the implementation of its change programme and does everything possible to deliver the financial efficiencies planned in accordance with that programme and the supporting budgets. Heads of Service will be required to manage within the budgets approved and if at any time spending pressures are not containable within the Business Group, the relevant Service Manager should report this to their Head of Service and Depute Chief Executive. In consultation with their Cabinet Spokesperson, the relevant Depute Chief Executive has the flexibility to move budgets between business groups. Should this not resolve the spending issue, it is the Depute Chief Executives' responsibility to formally report this to the Head of Council Resources. In this situation, the matter may be reported to Cabinet and the Council may be asked to reconsider the policies applying within that Group with a view to reducing services and costs or increasing charges and income. If this cannot be achieved, then the Council may be asked to approve policy changes elsewhere that will yield the necessary savings through service reductions or increased charges.

9.4 Despite the Financial Strategy covering the period until 2022-23, given the uncertainty around the financial planning landscape which the Council operates within, the Strategy will be subject to an annual refresh to ensure that it remains appropriate to respond to the future financial challenges.

## 10 Summary

10.1 The Council continues to face much uncertainty, a wide range of risks and an increasingly difficult financial environment. For General Services, in the short and medium term expenditure continues to be outstripping income against an increasing demand for services with East Lothian projected to be one of the fastest growing Council areas in Scotland. With growth comes both expenditure commitments as well as increased opportunities.

10.2 The Council is ambitious in its vision to become the best place to live in Scotland, and if to remain sustainable, the way in which we deliver services to the community must change. The Council will continue to work with the community and wider planning partners to do all that it can to maximise and enhance service delivery within the resources which are available, however reductions on this scale would have a potentially significant adverse impact upon service delivery and it is imperative that we seek to adopt a strategy seeks to address how best this might be minimised. What remains clear however is that if these reductions materialise, the Council will be required to make some difficult choices in order to balance the budget.