East Lothian Council

REPORT TO:	East Lothian Council
MEETING DATE:	15 December 2020
BY:	Depute Chief Executive (Resources & People Services)
SUBJECT:	Financial Update including Financial & Capital Strategy 2021-2026

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1 PURPOSE

1.1 This report provides an update on progress of mitigation actions currently being pursued to manage the funding deficit of the Council in this current financial year. In addition, this report sets out an updated Financial and Capital Strategy for the Council, covering a five year period from 2021-26.

2 RECOMMENDATIONS

2.1 The Council is recommended to:

- note the current progress of mitigation actions being taken to manage the 2020-21 General Services funding deficit;
- approve the overarching Financial Strategy set out in **Appendix 1** of this report, together with the Capital Strategy included at **Appendix 2**.

3 BACKGROUND

2020-21 General Services Revenue

3.1 The Council has already received a number of financial reports on the challenging in-year financial position. At the last meeting in October it was reported that current projections indicate that there remains a significant financial deficit facing the Council this year, and a number of mitigating actions designed to bring the Council back into financial balance is currently being explored.

3.2 The outcome of many of these actions still remain unclear, but a summary of the key areas being reviewed are set out below:

- Loss of Income Scheme
  - The Council has now submitted a return through COSLA to seek compensation for loss of income. In line with the agreed guidance, the scheme focuses on loss of external income, and as such does not include any loss of income experienced through any of the Council's main revenue streams such as Council Tax and Rent, nor indeed through internal trading activities. As such any potential reimbursement will not take into consideration the full cost implications being experienced by the Council through loss of income. The return does include a claim for income lost through the Council's ALEOs, including both Enjoy and Brunton Theatre. COSLA are currently collating all returns across Scotland, with a view to determining the national quantum and support the distribution of available resources but it seems likely the available national funding pot will be heavily over-subscribed.
- Education Recovery
  - As part of the wider funding to support the safe re-opening of schools, the Deputy First Minister (DFM) has made a commitment to ring-fence a further £30 million to meet any further costs experienced by local authorities based on evidence of need. COSLA is currently collating wider returns from all Council's, which will inform and support the disbursement of available resources.
- Property Maintenance Mitigation
  - Work remains ongoing to progress mitigation actions that will minimise the financial impact experienced through the delayed programme of work and continuing COVID implications.
- Fiscal Flexibilities
  - In October 2020, in response to COVID-related financial implications, the Cabinet Secretary for Finance advised of work being progressed by Scottish Government and COSLA that would potentially open up some additional financial opportunities described collectively as Fiscal Flexibilities. Although no substitute for full and proper funding, they would provide some further scope for managing the severe impacts of COVID and any consequence of full funding not being made available by national governments.
  - These flexibilities cover a range of areas including; the application of capital receipts to finance COVID revenue expenditure; flexibility to review the accounting treatment for debt relating to credit arrangement charges; and a loans fund principal

repayment holiday. Statutory guidance has still not been finalised, and as such it is not yet clear the full extent of any flexibility available to the Council. These are complex areas, and will require careful consideration to determine the extent of any financial mitigation options available to the Council. These will be considered and reported upon further by the Council's Chief Financial Officer.

3.3 Furthermore, as per a previous Council decision, an amount of £0.245 million is held in a Capital Grants and Receipts Unapplied Account which allows capital receipts to be used to transform service delivery to reduce costs and/or reduce demand. This ability is only open to councils up to 2021-22 and this will be utilised in year to support financial pressures. Projects have been identified which meet the statutory guidance.

Financial Strategy and Capital Strategy

3.4 The current approved Financial Strategy was approved by Council in December 2019 and covers a five-year financial planning period from April 2020 until March 2025. This strategy is subject to an annual refresh to ensure that it remains appropriate and relevant to any change in the financial planning landscape.

3.5 This year, more than ever, the Council is operating within a very uncertain financial and economic environment. In support of the continuing global health crisis caused by COVID, the Council has experienced unprecedented levels of need amongst the communities we serve. This in turn has created significant financial challenges in the immediate short term for the Council to manage, but will also create a degree of opportunity to change the way in which we support and deliver services going forward.

3.6 The continuing political and economic uncertainty surrounding future public sector funding alongside the UK's impending exit from the European Union will be significant influential factors and must be considered against a backdrop of increasing demand for services. This means that it is inevitable the Council will need to find ways of ensuring that it can balance these competing pressures in the most sustainable way possible.

3.7 The Strategy itself covers both the General Services and the Housing Revenue Account, and sets a clear direction on how the Council will manage its financial resources across the next five years. The Financial Strategy also includes the Council's Reserves Strategy and is set out in **Appendix 1** of this report.

3.8 The Prudential Code now requires all Local Authorities to produce an up to date capital strategy. The current capital strategy was approved in December 2019, and supports the wider Financial Strategy, with an intention to firmly place decisions around borrowing in the context of the longer-term financial position of the authority and to provide improved linkages between the revenue and capital budgets. The Capital Strategy is set out in **Appendix 2** of this report.

3.9 The overarching Financial Strategy sets a clear direction for future budget development, and it is important that in developing future budget proposals and related amendments, all councillors have due regard to the direction set within this strategy.

4 POLICY IMPLICATIONS

4.1 There are no specific policy implications associated with this report although clearly, the report provides a strategic context and direction within which all 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 has been considered and given there is no direct change in policy direction, there is no immediate requirement to undertake any further impact assessment.

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 17 December 2019 – Item 4 – Financial Strategy 2020-25

7.2 Council 27 October 2020 – Item 5 – Financial Update

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Appendix 1

Financial Strategy

2021-22 to 2025-26

Financial Strategy 2021-22 to 2025-26

1 Introduction

1.1 The Council continues to operate in a very uncertain and extremely challenging financial environment. The financial implications and consequences facing the Council from supporting the national crisis response to COVID has been on a scale which is unprecedented, and this is expected to continue well into 2021-22 with the economic impact likely to be felt for the foreseeable future. Alongside this, the continuing political and economic uncertainty surrounding future public sector funding, the UK's impending exit from the European Union, all against a backdrop of increasing demand for services means that it is inevitable the Council will need to find ways of ensuring that it can balance sustainable delivery of an increased demand for vital services to the public against a backdrop of reducing levels of like for like government grant support.

1.2 The Council continues to receive a significant proportion of its funding from the Scottish Government. The Chancellor has recently published a one year UK Government Spending Review, with the previously expected multi-year Comprehensive Spending Review now delayed indefinitely. In turn, the draft Scottish Government budget and related finance settlement for Local Government will now be delayed from early December until end of January 2021, however the final position will not be known until early March. This creates significant uncertainty both in the short and medium term. Current forecasts by independent commentators indicate that the level of core funding we receive from the Scottish Government is unlikely to increase, and this alongside the growing demand for services, suggests that more must be done to reduce our cost base or alternatively to expand our income streams such that the Council can meet its priorities within the finite resources which are available.

1.3 A key purpose of the Financial Strategy is to provide clear direction on how the Council will best manage its financial resources over the forthcoming years to ensure they are deployed effectively to achieve agreed Council plans and associated outcomes. It provides a critically important financial context for effective decision-making helping to ensure the future financial sustainability of the Council. It also provides a framework for financial management arrangements that support the proper financial stewardship of public funds as well as providing appropriate financial resilience ensuring that the Council has the ability to respond and adapt to changing operating environments and significant unforeseen events. The principal objectives of the proposed Financial Strategy are to:

- Outline the Council's high level financial position over the years 2021-2026 based on a range of assumptions.
- Highlight the key financial drivers and other relevant issues that have been considered in developing the strategy.
- Ensure that limited available resources are focused on delivery of the Council's approved key priorities and plans and their associated key outcomes.

- Provide a solid financial planning platform for the development of 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 and delivering against its budget.

1.4 The Strategy also sets out the proposed policy for the effective utilisation of reserves, including a clear rationale between holding fund balances for specified purposes and making decisions on the extent to which reserves can be applied when actually setting the formal budget.

1.5 The Strategy covers the five year planning period from 2021-22 to 2025-26 and includes revenue and capital budgets for both General Services and the Housing Revenue Account (HRA).

2 Current Economic Context

2.1 The economic outlook and financial prospects for the strategy period were considered by Council in October 2020. The report set out the financial context within which the Council is currently operating and also many of the key pressures and variables that may impact on the way in which the Council spends its financial resources, and the funding it receives.

2.2 With so many exceptional and unpredictable external influences currently impacting on the wider economy, future forecasting with any degree of credible certainty is very difficult. The recently announced UK Government Spending Review delivered a very stark warning that the 'economic emergency' caused by COVID has only just begun, with record level of public sector spending and associated levels of debt required to support the crisis, and future economic projections suggesting that by 2025 the UK economy will be 3% smaller than in March 2020. It seems inevitable that balancing the public sector books could lead to another prolonged period of public sector expenditure restraint.

2.3 In Scotland, as well as any limitations imposed through resource decisions taken within the UK Budget, the spending available to Scottish Local Government is further dependent on the Scottish Government's own budget priorities. Recent years' settlements have seen reductions in core revenue funding, with associated cash terms increases largely ring-fenced to support the delivery of new national policy commitments and other statutory burdens such as early learning and childcare.

2.4 The Scottish Government does now have at its discretion a range of new fiscal powers over taxation and welfare, and this makes determination of the Scottish Budget significantly more complex than it has been in the past.

2.5 The recently announced UK Spending Review (25 November 2020) suggested that Scotland will receive an extra £2.3bn of funding in 2021-22. Of this, £1.3bn is to support recurring COVID related funding, a further increase of £1.3bn on revenue baseline, and a reduction in capital funding by £0.3bn. As highlighted earlier, the Scottish Government will publish its draft budget plans (covering 2021-22 only) on 28 January 2021. This is considerably later than normal and even with accelerated parliamentary procedure, it is not expected this will formally complete its passage through Scottish Parliament until early March.

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 changes, further economic turbulence, societal changes and developing customer expectations.

Council Plan

3.2 The existing 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.

Local Development Plan (LDP) & City Deal

3.3 The Council has an approved Local Development Plan (ELLDP 2018). This will continue to see a rapid expansion in population across the area, with an estimated population increase to 120,000 by 2037. This will continue to impact on the wider demography within the area, with significant growth in particular in the number of school-age children and the number of pensioners.

3.4 This will create opportunities for the Council but will also provide significant financial challenges in terms of the provision of necessary services to meet these growing demographic changes such as; the increased number of school children, care packages, households requiring waste collection etc. and there will need to ensure that the Council has the appropriate infrastructure in place to support these growing demands.

3.5 The Council is also part of a wider Edinburgh and South East of Scotland City Deal. This will see significant investment across the region, including through UK and Scottish Government, and will include the development of an Innovation Hub, which working in partnership with Queen Margaret University will facilitate the expansion of a new Scottish Centre for Food Development and Innovation and will therefore support the wider food and drink sector.

3.6 The impact of growth associated with high levels of development across the County will continue to have a significant impact in future years.

Climate Change

3.7 The global implications from climate change has resulted in the Council declaring a climate emergency in August 2019. To support this, a climate change strategy has been developed which sets out the commitment, vision and overall aims for a 'net zero Council' and a 'carbon neutral East Lothian' by working in partnership with the community to deliver specific outcomes to improve sustainability, encourage a low carbon lifestyle and look after our environment.

3.8 The Council will need to consider how this ambition can be realised, and this may require a change to what we are doing, and how we are using our resources.

Changing Public Sector Landscape

3.9 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 challenges and indeed opportunities for the Council as it seeks to ensure that shared outcomes are achieved and that resources are deployed efficiently and effectively.

3.10 These include:

- The East Lothian Integrated Joint Board (IJB) which supports the wider integration of health and social care services.

- The Community Empowerment (Scotland) Act places duties on the Council and its partners to provide new rights for community bodies and on the way the Council interacts with the Community.

- The Scottish Government has established a National Participatory Budgeting Strategic Group which is supported by a framework agreement which supports a wider resource allocation to determine local decision making. This will strengthen the requirement for active community engagement in local decision making, and resource allocation.

- The Scottish Government review on Education Governance has established 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 this will place new and revised duties on Local Authorities to work within the Collaborative arrangement to drive forward increased improvements within all educational settings.

- COSLA in partnership with the Scottish Government has embarked on a review of Local Governance, which will consider how powers, responsibilities and resources are shared across national and local spheres of government, and also with communities.

4 General Services Revenue Budget – Medium Term Outlook

4.1 Notwithstanding the many uncertainties facing Scottish local authorities, the need for medium to longer term financial planning is becoming increasingly important. Councils must ensure that they have robust financial plans in place that can respond to and absorb the potential impact arising from the increasingly wide range of variables highlighted earlier in this report. Only by doing so, can they ensure long term sustainability of effective service provision.

4.2 The current General Services revenue budget extends over a 3 year planning horizon with a high level summary of the spending plans approved in March 2020 set out below.

General Fund – Revenue	**2020-21**	**2021-22**	**2022-23**
	£'000	**£'000**	**£'000**
Approved Expenditure	262,622	266,294	270,794
Financed by:			
RSG (including NDR)	(176,598)	(176,598)	(176,598)
Other Government Grants	(19,717)	(19,457)	(19,457)
Council Tax	(64,751)	(69,899)	(75,399)
Other	(90)	(90)	(90)
Transfer (from) / to Reserves	(1,466)	(250)	750
TOTAL	**(262,622)**	**(266,294)**	**(270,794)**
Delivery of Planned Efficiencies (contained in above)	**(3,213)**	**(1,487)**	**(829)**

4.3 The October financial update report considered by Council, set out the key variables which will have the most significant implications for future budgets. A summary of these key variables is set out below;

- The level of future Scottish Government grant funding;

- The level of Council Tax income, influenced both in terms of any annual increase in the rate and also any additional properties that will increase the overall yield;

- Future contractual commitments including pay and pensions;

- Ability to deliver planned efficiencies;
- Non-COVID budgetary pressures;
- COVID related pressures;
- Estimated financial outturn 2020-21.

4.4 The most significant of these relates to the level and make up of future Scottish Government grant funding, which makes up the largest proportion of the funding available to the Council. The complexity of the finance settlement, current delayed notification of anticipated settlement details for 2021-22, and uncertainty relating to future funding levels makes this very difficult to forecast with any accuracy. Relatively modest percentage variations in grant funding result in financially material consequences. For illustration; a 1% reduction in core revenue funding equates to an annual impact of £1.8m or cumulative £5.4m over a 3 years planning horizon.

4.5 The Council is a very large organisation and employs a significant number of staff, who support the delivery of services in accordance with the Council plan and associated outcomes. The Workforce Development Plan will assist in planning and shaping the workforce to ensure it can effectively meet our obligations. The contractual costs relating to pay and pensions must be contained within the overall resources available to the Council, and collectively these can have a material impact on the Council's overall cost base. By way of illustration, a 0.5% increase amounts to just under £1 million on our annual pay bill (£3m across the 3 years), and prevailing rates are subject to the outcome of both national pay settlements and actuarial pension valuations, both of which remain unknown for 2021 and beyond.

4.6 As previously highlighted to Council, current year forecasts suggest that the Council is facing a financial deficit in excess of £7 million, most of which relates to the direct implications from supporting the government's COVID response. Officers continue to explore a range of mitigation options to manage the funding deficit which includes the pursuit of full and proper funding to support all COVID implications, continued application of enhanced cost control measures, and as a last resort, exploration of any new temporary fiscal flexibilities in line with national guidance.

4.7 Whilst COVID has unquestionably created significant additional financial challenges many of which may have a long lasting economic impact both for the Council and the communities we serve, there may also be some opportunities to consider alternative ways in which we operate going forward. Reset and renewal and building back better are key concepts within the Council's Recovery and Renewal Strategy and it is likely that the way in which the Council delivers many of its services will change, with increased numbers of staff working remotely supported by digital technologies, and the way in which we provide services to our communities also under constant review.

General Services Capital Budget – Medium Term Outlook

4.8 The Capital Strategy sets out the how future capital investment plans will be determined and supported, and this is set out in more detail in Appendix B of this report. In March 2020, the Council approved an ambitious, growth driven 5 year General Services capital budget, a summary of which is set out in the table below.

	2020-21 £000 *	**2021-22 £000**	**2022-23 £000**	**2023-24 £000**	**2024-25 £'000**	**TOTAL £'000**
General Services Gross Expenditure	98,152	81,480	76,824	72,038	28,966	357,460
General Services Income	(48,433)	(30,670)	(43,411)	(49,935)	(18,131)	(190,580)
Net General Services	**49,719**	**50,810**	**33,414**	**22,103**	**10,835**	**166,881**

*Note * - 2020-21 has been updated to reflect 2019-20 outturn as reported in 2020-21 financial update reports*

4.9 Funding for the capital plan comes from a range of sources including; Scottish Government (General Capital Grant and Specific Ring-Fenced Capital Grants), developer's contributions, capital receipts from asset disposals, other income such as grant funding from other bodies, with the balance made up from borrowing funded through loan charges to the revenue budget.

4.10 The current capital investment plans recognise the growth and ambition of the Council, with current plans designed to support the future infrastructure requirements across the Council area. These plans are aligned to the delivery of the approved Local Development Plan (ELLDP 2018) and ambition relating to the commitment from the Council relating to the Edinburgh and South East of Scotland City Deal. The related investments will create significant economic long term benefits for the East Lothian economy, but will place a significant financial burden upon council finances, and affordability remains a key consideration both in terms of the short and longer term.

4.11 Whilst much of the current LDP commitment falls within the 5 year capital investment plan, there will also be significant impact on future years and the anticipated emergence of a subsequent successor LDP.

4.12 The Council has an extensive operational asset portfolio to support service delivery needs. The Corporate Asset Strategy provides the framework for the efficient management of the Council's core assets, with significant and future investment requirements, it aims to provide a modern, efficient and sustainable asset base that meets the needs of its existing and future service users and employees. Since March 2020, COVID has created many challenges but also some opportunity to review the way in which we deliver and support services, including what assets we hold, and how they are used. This may provide us with scope to rationalise assets, which would be critical to support the affordability of future capital investment plans.

4.13 The Council has agreed to undertake a Learning Estate Review to formally assess the condition and suitability of our education and early learning assets. This review is on-going and will inform the establishment of a Learning Estate Investment Plan which will help inform future capital investment plans for the Council.

4.14 As highlighted in previous Council reports, the severe COVID restrictions prevalent throughout this operating year, effectively brought most construction and maintenance activity to a halt, and with recovery still slow, this has had a major adverse impact on the planned delivery of our capital programmes in this financial year, and will also have implications for future years. Capital investment can often be used as a major stimulus to assist economic recovery and it will therefore be important to see how national governments respond in terms of their own spending plans and subsequent allocations made to Local Government.

4.15 Affordability is a key consideration within effective capital planning with the capital investment programme generating significant revenue consequences for the Council, such as staffing, rates, utility costs, cleaning etc, which must be met from within the revenue resource levels available to the Council. At a time where revenue budgets remain under significant pressure, it is essential that capital investment decisions take into consideration the full cost implications facing the Council.

4.16 In addition, the borrowing for capital infrastructure is funded through annual loans fund payments which are charged to the revenue budget and repaid over the lifetime of the asset. Despite current low interest rates, all borrowing will need to be repaid in the future and capital investment decisions which are taken now must be taken within the context of longer term projections. All capital investment decisions are supported by the Capital Strategy and Treasury Management and Investment Strategy to assess and better understand the implications for both current and future Council Tax payers and to ensure that investment plans remain affordable and sustainable.

4.17 The economic consequences of COVID will have an impact both directly on the Council and also upon its community in the years to come. It is essential that the capital investment plan is targeted to ensure it provides essential investment aligned to Council priorities and where possible, to stimulate and support economic growth. To help get this delicate balance right, this will require enhanced affordability criteria to be applied to the capital investment programme to protect both current and future Council Tax payers. Within this context, the Strategy will:

- Focus on a comprehensive review of the Council's asset base, with a view to maximising capital receipts where possible. In turn, this will help maintain ambitious levels of future capital investment and will support transformation of council services that will help minimise on-going revenue costs.

- Introduce an upper limit on net borrowing is now required to be introduced over the strategy period. This limit will ensure that over the next 5 years, net additional borrowing does not exceed £150 million. This will retain a significant capital investment programme over this period which remains vital to support the Council's plans and ambition as well as support local economic stimulus, but importantly recognises the financial challenges facing the Council, minimising future revenue costs.

4.18 Managing the consequences of Covid has introduced a further requirement for enhanced flexibility in how we best manage the capital investment plan. Much of the programme is underpinned by prevailing economic conditions, including the realisation of developer contributions dependent upon wider housebuilding that are critical to support the delivery of many of the related capital infrastructure projects. Should there be any further national or local restrictions imposed adversely affecting the construction sector, the ability to be flexible and adaptive with our capital planning will prove critical.

5 Reserves

5.1 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 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.

5.2 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.

5.3 In accordance with the now audited annual accounts, the General Services reserves (excluding HRA reserves) available as at 31 March 2020 was £19.121 million, further detail including a breakdown is set out below. It should be noted that many of these reserves already have post 31 March commitments against them and will be spent during this year.

2019-20 General Reserves

Required to support future budgets	1,716
Civil Emergency *	2,000
Cost Reduction Fund	3,445
Earmarked Reserves	
- DSM	21
- MELDAP	303
- Other	485
Insurance Fund	2,009
Capital Fund & Capital Receipts	713
General Services Capital *	2,282
Capital Grants & Receipts Unapplied	245
Council Tax 2nd Homes	1,962
Uncommitted Balance necessary to support min level *	798
Uncommitted Balance	3,142
TOTAL	**19,121**

* Specific reserves, which collectively reflect the minimum level of reserves as approved in 2020-2025 Financial Strategy.

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

- **Requirement to support future budgets**: This balance has already been committed to support the budget in 2020-21 and 2021-22 as per approved budget plans in March 2020.

- **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.

- **Cost Reduction Fund**: This fund is used to support delivery of change which will realise a financial saving and/or service efficiency going forward. The Chief Executive and Head of Council Resources have responsibility to consider projects which supports these objectives. The fund already has a number of earmarked forward commitments in place.

- **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 a reserve earmarked to support some of the wider growth development plans.

- **Insurance Fund**: The insurance fund is used to insure against a risk, or pay premiums on a policy to insure against a risk. The level of fund retained remains subject to ongoing fund valuations.

- **Capital Fund & Capital Receipts**: This fund has been established from Capital Receipt income which has not yet been applied in year. This Fund can be used meet future capital investment costs either reducing loans fund advances or providing funds to cover the principal repayments of the loans fund. This fund cannot be used to support General Revenue budgets.

- **General Services Capital**: The Fund was established in recent years from flexibility arising 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.

  Capital Grants and Receipts Unapplied: Allows capital receipts to be used to transform service delivery to reduce costs and/or reduce demand. This flexibility is only available to Councils until 2021-22.

- **Council Tax 2nd Homes:** An earmarked fund established by reducing the second home or empty property Council Tax discount for the development of affordable housing. Under Scottish Government direction within certain criteria, Local Authorities can now use this income to support the development of affordable housing, including the disbursement of funds to other organisations or individuals, as well as RSLs. This fund was previously classified as a provision on the Council's balance sheet and more appropriately transferred to an earmarked reserve in 2019-20.

- **Uncommitted Balance to support minimum level**: In line with the previous approved Financial Strategy, these specific reserves collectively support the minimum level of uncommitted reserves.

- **Uncommitted Balance**: Current level of general reserves with no specific earmarked commitments.

Reserves Strategy

5.5 The use of reserves should not be used in place of developing a sustainable budget. Given that, the final year of the three year budget must demonstrate sustainability and show a balanced income and expenditure without the use of reserves.

5.6 The Council's Chief Financial Officer should be delegated authority to approve any specific commitment of funds for both the Cost Reduction Fund and the Council Tax 2nd Homes within the policy intent described in Section 5.4 above. Any such commitments made during the year, will be reported to Members Library Service.

5.7 The Council's overall general reserve balance remains at a very low level. The financial environment is now even more challenging given the on-going impact of COVID and wider economic uncertainty associated with Brexit, and there is a significant risk that the Council will be unable to support all future commitments and effectively mitigate against future financial risks. The level of general uncommitted reserves should remain at a minimum of 2% of the Council's annual running costs (per 2020-21 approved budget £5.2 million). Given the significance in many of these uncertainties, particularly caused by COVID and Brexit, it is recommended that at least for 2021-22 a higher general reserve balance should be maintained. This will allow flexibility to support any shortfall in balances should all other mitigation options not materialise:

• Civil Emergency Fund	£2.000 million;
• General Services Capital Fund	£2.282 million;
• Uncommitted balance (per previous min level)	£0.798 million;
• Uncommitted balance	£3.142 million
TOTAL	**£8.222 million**

5.8 From 2022-23, should the projected level of uncommitted reserves fall below the 2% minimum level, Members must have a clear route for bringing reserves back up to the minimum level over the subsequent three financial years.

5.9 In October 2020, in response to COVID related financial implications, the Cabinet Secretary for Finance advised of work being progressed by Scottish Government and COSLA that would potentially open up some additional financial opportunities described collectively as Fiscal Flexibilities. Although no substitute for full and proper funding, they would provide some further scope for managing the severe impacts of COVID and any consequence of full funding not being made available by national governments. Should any additional balances arise through the current review of flexibilities permissible by the Scottish Government and or Treasury, any uncommitted balance will initially be held in a specific earmarked COVID fund until that need has expired. Anticipated statutory guidance is still being developed.

6 General Services Financial Strategy

6.1 The Council continues to operate in a very uncertain and challenging financial environment, and this predominant feature of uncertainty is likely to continue at least in the immediate short to medium term. It remains clear that the potential impact of a wide range of variables facing the Council is very significant and it is unlikely that the total resource available to the Council will be able to support all of the requirements that we have. In addition, COVID has created significant financial pressures for our partner ALEO's, and there is a need to continue to work collaboratively to ensure future financial sustainability. COVID has unquestionably created significant financial challenges, but there may also be opportunities to consider how services are delivered in future years. This must act as a solid foundation to support how we support our communities, and interact with our customers in the future.

6.2 As a consequence, the Council must now re-focus our efforts and consider an extensive programme of transformational change that will look at a range of options including alternative service delivery models and identification of significant new income streams. Only by doing so, will it be possible to protect and preserve what are deemed to be essential priority services whilst supporting the Council in realising its ambition and plans, but at all times, ensuring future financial sustainability.

6.3 The General Services Financial Strategy for the next 5 years will focus on the following:

- Delivering essential sustainable services within approved budget levels which support the Council Plan and outcomes;

- Delivering a refreshed and extensive change programme designed to transform services that will help protect essential services aligned to core objectives and priorities within Council plans;

- Maximising the income generation opportunities available to the Council in order to protect vital services;

- In support of a changed approach post COVID, as to how we support and use our assets, focus on a comprehensive review of the Council's asset base which will support the way in which we deliver and support services, minimise future revenue costs, and maximise where appropriate capital receipts which in turn can be used to support future capital investment plans;

- Enhanced focus on procurement and contract monitoring of goods and services, ensuring good financial control by managers and delivery of best value;

- Continue to explore options for the Council to become more entrepreneurial;

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

- Continue to constrain cost growth – through effective demand management, continuous review of all expenditure commitments, sound financial control by managers and through effective negotiation with suppliers;

- Consider greater focus on prevention and early intervention, which is designed to reduce future demand for council services by stopping problems arising or by addressing them early on, and supports the Council's overarching priority to reduce inequalities;

- Continue to support a Capital Investment Programme, which will provide essential investment aligned to Council priorities, stimulate and support economic growth and critically, remain affordable based on a clear understanding of both capital and future revenue costs;

- In support of ensuring affordability for current and future tax payers, the Council should work to minimise the additional net borrowing over the next 5 years, by ensuring it does not exceed £150 million;

- The Council should continue to manage and review the General Services Loans Fund balance ensuring prudence, 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;

- In recognition of the continued uncertainty arising from COVID, continue to seek assurance from national governments that full and appropriate funding is provided to meet the cost implications from COVID. Within this context, continue to explore options to apply fiscal flexibilities in line with national guidance.

6.4 Taking these specific areas of attention into consideration, alongside the Reserves Strategy outlined in Section 5 above, it is also recommended that budgets are developed annually in accordance with the following approach:

- Develop a sustainable three year General Services budget avoiding the use of reserves in Year three (2023-24).

- Develop a five year General Services Capital Plan aligned to the new Capital Strategy, which seeks to ensure capital investment decisions remain affordable.

7 Housing Revenue Account

7.1 In recent years there has been a significant increase in HRA capital spend as both the modernisation and Council house building programmes have been expanded, and as a consequence, the share of revenue spending on debt charges has also increased.

7.2 The Local Housing Strategy continues to set 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, and 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.

7.3 Against this backdrop, increasing the supply of affordable housing continues to be a high priority for East Lothian Council ensuring that it meets the needs and aspirations of local people that they live in good quality homes which are located in strong, safe communities.

7.4 The Strategic Housing Investment Plan (SHIP) sets out the priorities for affordable housing investment in East Lothian over the next five years and 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.

7.5 During 2019-20, East Lothian Mid Market Homes LLP was established to support the provision of mid-market rent, and is a partnership between East Lothian Council and Scottish Futures Trust. The establishment of this vehicle will allow further opportunities to support the delivery of affordable housing across East Lothian.

7.6 The Housing Revenue Account is a balancing act between the income raised through rent, the revenue expenditure to support the tenants, and necessary capital investment to support and modernise existing council housing stock and deliver new Council homes. To support this ambition, the financial strategy must ensure that financial plans remain affordable and sustainable both for existing and future tenants.

7.7 Given this ambition, the financial strategy for the HRA will continue to focus upon the following;

- Review the existing rental levels, to ensure consistency across the housing stock where relevant, and ensure rental income and any future rental increase remains affordable for tenants whilst benchmarked against national average;

- Continue to constrain cost growth – through effective demand management continuous review of all expenditure commitments, good financial control by managers and by effective negotiation with suppliers and focusing spend in line with agreed priorities whilst maintaining high quality service delivery for Council House tenants;

- Ensure that the HRA can sustainably support the ambition set out in the Strategic Housing Investment Plan, working with RSL partners to deliver the affordable housing needs across East Lothian, and maximise subsidy opportunities to support capital investment;

- Ensure capital investment is prioritised to support statutory requirements, such as Scottish Housing Quality Standards and EESSH (Energy Efficiency Standard in Social Housing);

- Recognise the challenges faced by the global health pandemic, aligning targeted intervention which best supports tenants in the immediate short term, whilst supporting the longer term ambitions;

- Reduce rent arrears, ensuring targeted and flexible support is provided to tenants to who are experiencing financial difficulties;

- Delivering a new housing management system, which will provide an integrated management system designed to support and improve forward planning and customer service;

- Ensure that the Council stays within the recommended upper limit for the ratio of debt charges to income of 40%, maximising the in-year use and application of capital receipts, available capital grants, 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;

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

8 Financial Management

8.1 The Council's current external operating environment is very dynamic and subject to constant change. The continuing impact of COVID has required the Council to support and deliver significant change and has created significant financial challenges for the Council to manage. The financial performance relative to approved financial plans is kept under constant review, and this is supported by regular financial monitoring and scrutiny reports provided to Council.

8.2 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.

8.3 The need for continued application of enhanced cost control measures remains a vital discipline that all managers should continue to operate, demonstrating effective stewardship and application of council funds at all times.

8.4 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 expenditure commitments within approved budgets 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 who has the flexibility to manage budgets across various business groups.

8.5 Should this not prove possible, the Chief Financial Officer can ask Heads of Service to prepare a cost recovery plan, which will seek to demonstrate actions, designed to bring the budgets back into financial balance. Cabinet/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.

8.6 Although the Financial Strategy quite properly covers the 5 year period until 2025-26, the Strategy will be subject to an annual refresh to ensure that it remains relevant and enables the Council to respond to any future financial challenges to ensure its on-going sustainability.

9 Summary

9.1 Unquestionably the Council is continuing to operate with a very uncertain financial and economic environment. In support of the continuing global health crisis caused by COVID, the Council has experienced unprecedented levels of need amongst the communities we serve. This in turn has created significant financial challenges in the immediate short term for the Council to manage, but will also create a degree of opportunities to change the way in which we support and deliver services going forward.

9.2 The strategy must find a way of bridging the immediate financial imperatives and continuing to support the approved future direction of the Council. The Council plan has the ambition to reduce inequalities and create a more prosperous, safe and sustainable East Lothian. To achieve this, the Council must continue to embrace inclusive growth and both the benefits and challenges it brings, but it must also ensure that it can continue to deliver essential core statutory services against the backdrop of significant economic uncertainty.

9.3 It is recognised that there are a wide range of risks and variables facing the Council, and there is a need to ensure that the Council has sufficient financial resilience to satisfy delivery of approved outcomes whilst ensuring future financial sustainability. It is now clear that the level of future resources available to the Council will not be sufficient to meet future demand and pressures, and as such, the way in which we deliver services to the community must change.

9.4 To achieve this, the Council must embark on an enhanced programme of transformational change, which embraces digital technology and continues to support Council plans. To protect the delivery of vital essential services, the Council must do all that it can to maximise revenue income streams available, and to support economic growth and achieving wider aims and outcomes, the Council must accelerate a review of all Council assets, which will seek to minimise future revenue costs, and maximise future capital investment.

9.5 The financial strategy set out will assist the Council in meeting the future financial challenges ahead. It is recognised that the wider economic uncertainty and potential scale and significance may mean that the Council must prioritise its resources to deliver and support essential services, and this may in turn require some difficult decisions and choices ahead.

Appendix 2

East Lothian Council

Capital Strategy

Capital Strategy

1. Introduction

1.1 The Capital Investment Strategy provides an overview of how capital expenditure plans, capital financing and treasury management activity contribute to the necessary infrastructure supporting the provision of services for the benefit of East Lothian communities and citizens. Its purpose is to firmly place decisions around borrowing in the context of the overall longer-term financial position of the Council and to provide improved links between the revenue and capital budgets.

1.2 The existing Capital Strategy was approved by Council in December 2019, and has been updated to inform longer term capital investment decisions.

1.3 The Capital Strategy supports the wider Financial Strategy for the Council. It is recognised that there are many plans and strategies which impact on capital investment plans, and the strategy seeks to ensure:

- Capital Plans are aligned to the strategic priorities of the Council;
- Capital investment plans are affordable, prudent and sustainable;
- Financing decisions are taken in accordance with good professional practice and a full understanding of the risks involved.
- Robust governance arrangements to support its capital planning activities.

1.4 In doing so, the strategy effectively sets the framework within which capital financing decisions are considered and provides background to the funding sources available to meet the costs of capital projects.

1.5 The Capital Strategy is subject to an annual review and has a key role in supporting the delivery of the Council's corporate priorities.

2. Current Operating Environment

2.1 The Financial Strategy sets out the financial context within which the Council is operating and highlights many of the key pressures that may impact upon the way in which the Council spends its limited resources.

2.2 Unquestionably, the Council is continuing to operate with a very uncertain financial and economic environment, and the continuing implications faced by the global health crisis caused by COVID, has created significant financial challenges in the immediate short term for the Council to manage, but will also create opportunities to change the way in which we support and deliver services going forward.

2.3 Despite this, the Council must balance the immediacy of the short term financial challenges and the future direction which supports the journey towards realising the Council's 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 future capital investment stems across a 10 year planning horizon, and will be aligned to the approved Local Development Plan (ELLDP 2018) and commitment to the Edinburgh and South East of Scotland City Deal. The related investments will create significant economic long term benefits for the East Lothian economy, but will place a significant financial burden upon council finances, and affordability remains a key consideration both in terms of the short and longer term.

2.4 The Council is also faced with significant external factors which may influence future capital strategies. The Community Empowerment (Scotland) Act 2015 enables community bodies to request to: purchase, lease or occupy land or buildings owned by the Council. This places significant additional duties on the Council and can inform future asset strategies and capital planning. In addition, there may be wider implications arising from a judicial review involving Common Good assets which may impact on future capital strategies.

2.5 The primary purpose of the Capital Investment Strategy is to provide an overarching view of how various plans and strategies depend upon capital investment and to demonstrate that this is both affordable and sustainable. The associated plans and strategies focus on specific priority areas and, through appropriate governance structures, ultimately shape and influence the investment plans delivered through the Capital Investment Programme.

2.6 Underpinning the Capital Investment Programme is the Treasury Management and Investment Strategy which considers the delivery of the capital programme within the context of affordability and risk and apply a measurement of what this means against key prudential and treasury indicators. The aim being to demonstrate affordability and sustainability over the long term.

3. Key Resource Plans

3.1 The identification of capital investment requirements are governed by a number of key resource plans, all of which will be linked to the delivery of the Council's corporate objectives. More details around these key documents are set out below.

Council Plan 2017-2022

- The Council Plan sets out a vision to create an even more prosperous, safe and sustainable East Lothian with a dynamic and thriving economy that allows our people to flourish. It's overarching priority is "To reduce inequalities across and within our communities" and has four key objectives:

    - *Grow our Economy*
        - To increase sustainable and inclusive economic growth as the basis for a more prosperous East Lothian

    - *Grow our People*
        - To give our children the best start in life and protect vulnerable and older people

    - *Grow our Communities*

- o To give people a real say in the decisions that matter most and provide communities with the housing, transport links, community facilities and environment that will allow them to flourish

- *Grow our Capacity*
  - o To deliver excellent services as effectively and efficiently as possible within our limited resources

- All capital investment decisions must demonstrate alignment with the Council's strategic priorities.

Community Planning Partnerships and Local Outcomes Improvement Plans

- The East Lothian Partnership is a partnership across a number of organisations from public, private, third and community sectors, working together to make life better for the people of East Lothian. The Local Outcomes Improvement Plan (LOIP) 2017-2027 provides a commitment by all partners to deliver improved outcomes for East Lothian people, with a focus particularly on reducing inequalities and prevention and early intervention.

- The East Lothian Partnership aims to work collaboratively across its partners with existing governance arrangements including:

  - o **East Lothian Partnership Governance Group** whose core membership includes the partners who have statutory responsibility for governance under the Community Empowerment (Scotland) Act 2015.
  - o **East Lothian Partnership Forum** which brings together a wide range of partners with the aim of actively involving them in the Partnership's work including the Area Partnerships.
  - o A number of **Strategic / Delivery Groups** who play a role in delivering the outcomes in the East Lothian Plan - these include East Lothian's Area Partnerships

- A strategic 'one council' approach to capital investment decisions must be adopted, ensuring a joined up approach to investment in community priorities.

Council Asset Strategy and Management Plan

- The Council Asset Strategy and Management Plan is a high-level document, which sets out how asset management is delivered for the Council to meet our long term goals and objectives. East Lothian Council's vision is to ensure that the assets that the Council holds are fit for purpose supporting the delivery of the strategic goals set out in the Council Plan, provide value for money and are efficient and sustainable.

- The Council manages its assets as a corporate resource to support the wider objectives and for the benefit of local communities. Management of the Council's asset base is particularly important in the light of financial pressures to ensure that investment in assets results in the greatest positive impact for the people and communities of East Lothian.

- The purpose of the Council Asset Strategy and Management Plan is:

  - To align how the Council manages its assets with the Council's key objectives to reduce inequalities across East Lothian;
  - To maximise the use of those assets to provide best value for our services;
  - To target limited resources to those assets to ensure they are maintained in satisfactory condition and in compliance with statutory obligations;
  - To provide a clear framework within which decisions relating to the planning and management of assets are made.

- In support of this, the Council has in place a number of Asset Management Plans which are used to support decisions to ensure that the Council holds the right assets and that they remain fit for purpose in terms of condition, suitability and accessibility. Many of these plans are currently being updated and reviewed, and will inform future capital strategies and associated investment plans.

- These plans include an on-going review of the Council's operational asset portfolio with an immediate focus on the provision of office accommodation, which will support service delivery and maximise new ways of working.

- In addition, the Council has agreed to undertake a Learning Estate Review to assess the condition and suitability of our assets. This review will inform the establishment of a Learning Estate Investment Plan which will inform future capital investment plans for the Council.

- Much of this is informed by the condition of the existing asset base, future investment required to support service delivery including on-going repairs and maintenance and wider lifecycle investment, and wider affordability of both capital and associated revenue costs both in the short and longer term.

Local Housing Strategy and Strategic Housing Investment Plans

- The key strategic outcomes for the Local Housing Strategy for East Lothian include increasing the supply of housing, ensuring it meets the needs and aspirations of local people providing good quality homes which are located in strong, safe communities. The Strategic Housing Investment Plan (SHIP) sets out the priorities for affordable housing investment in East Lothian over the next five years.

- The SHIP is currently being updated but will seek to provide sustainable, affordable and accessible high quality homes, and will seek to work with its partners to deliver the requirements and allocate Scottish Government resources in the best way to maximise delivery and funding.

- The Council continues to have ambitious capital investment in modernising existing housing stock and investment in new homes. The wider capital investment strategy must ensure that plans remain affordable working with partners to improved outcomes in supporting future programmes.

Financial Strategy

- The purpose of the Financial Strategy is to provide clear direction on how the Council will manage its financial resources over the forthcoming years to ensure they are deployed effectively to achieve Council plans and outcomes. It plays a vital part of decision-making and forms the basis of the Council's stewardship over taxpayers' funds, and sets the overarching framework for managing both revenue and capital investment decisions over a 5 year financial planning period, and is updated on an annual basis.

Treasury Management and Investment Strategy

- The Treasury Management and Investment Strategy recognises that the Council is required to operate a balanced budget, which broadly means the charges made against the General Fund should not exceed the taxation and grant funding available. Part of the treasury management operation is to ensure that the Council's cash flow is adequately planned to support expenditure, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or financial instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

- The second main function of the treasury management service is the funding of the Council's capital investment programme. The programme will provide an indication of the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or making best use of longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet prevailing Council risk or cost objectives.

4. Governance Arrangements

4.1 The Council adopts a Corporate Landlord model and oversees asset management and capital investment at a council wide level; its governance ensures that there is an integrated, cross service approach to decision making. The governance arrangements for capital investment decisions across the Council are set out in the sections below.

4.2 New investment requirements are typically prepared by services and set out in the form of capital bids. These bids are assessed against a range of criteria, which are used to determine and assess the investment decision. This evidence includes assessment against the Council Plan and LDP priorities, external funding requirements; as well as the future cost implications both in terms of revenue and capital.

4.3 A number of officer Groups will consider these bids and make recommendations to be included within the Council's capital investment plans which are subsequently considered and approved by Council as part of the annual budget setting process. These officer groups include:

- The **Corporate Asset Management Group (CAMG)** is the strategic body for asset management and capital investment decisions and projects. It is responsible for effective and efficient asset management at a corporate level. The CAMG is chaired by the Chief Executive, sets the direction, and provides leadership in relation to how the Council manages and develops its assets. The CAMG includes all CMT members and informs capital investment recommendations to Council.

- The **Capital Investment and Asset Management Group (CIAMG)** provides operational and professional oversight to the coordination of Council asset management projects and initiatives. The membership of the CIAMG includes all Asset Lead Officers and representatives from a range of council services.

- Furthermore there are a wide number of additional groups which support these groups including:

    - Learning Estate Managers Group which is designed to provide strategic oversight of the Council's learning estate;

    - The transformational work streams are directed by the Executive Team comprising of the Chief Executive, Depute Chief Executive and supported by the Head of Communities and Partnerships. These projects are aligned the Council plan and priorities and include a range of specific project Boards including: Energy, Commercialisation and a specific board to support the on-going implementation of the HR & Payroll system, each chaired by a member of Council Management Team (CMT).

    - A Section 75 Group has been established with representation from across Council services. The purpose of this group is to provide guidance and direction to support the realisation and delivery of developers obligations.

- The **Council's Chief Finance Officer (CFO)** has statutory responsibility to manage the Council's financial affairs and safeguarding public monies, ensuring immediate and longer term implications, opportunities and risks are fully considered and aligned within the financial strategy.

- The Council has in place a contract with **external Treasury Advisors** who provide professional treasury management and investment/cash flow management advice. This arrangement enables an external and expert validation to the Council's approach to managing its treasury and investment decisions.

- **East Lothian Council** consists of all elected members and approves both the Finance and Capital Strategy and capital investment plans. The Cabinet is delegated to receive in-year financial performance reports, but most recently these have been reported to Council.

- The **Audit & Governance committee** provide the scrutiny arrangements including: Risk and Internal Controls; financial matters including review of the financial performance as contained within the annual accounts, review of annual report to Members from External Audit, and Treasury Management reviews including a mid-year Treasury report and final Treasury report; and review of corporate governance.

5. Approved Capital Investment Plans

5.1 The Council's capital investment plans are updated annually (General Services and Housing Revenue Account (HRA)) and extend beyond the approve 5 year programme, covering a 10 year planning horizon.

5.2 The 5 year capital investment plans approved in February and March 2020 totalled over £531 million (General Services - £357 million and HRA £174 million), and are set out in the table below.

	2020-21 £000 *	**2021-22 £000**	**2022-23 £000**	**2023-24 £000**	**2024-25 £'000**	**TOTAL £'000**
General Services Gross Exp	98,152	81,480	76,824	72,038	28,966	357,460
HRA Gross Exp	33,540	37,248	36,747	32,752	33,801	174,088
TOTAL Gross Exp	**131,692**	**118,728**	**113,571**	**104,790**	**62,767**	**531,548**

General Services Income	(48,433)	(30,670)	(43,411)	(49,935)	(18,131)	(190,580)
HRA Income	(11,217)	(8,396)	(8,896)	(8,596)	(7,296)	(44,401)
TOTAL Income	**(59,650)**	**(39,066)**	**(52,307)**	**(58,531)**	**(25,427)**	**(226,976)**
Net General Services	**49,719**	**50,810**	**33,414**	**22,103**	**10,835**	**166,881**
Net HRA	**22,323**	**28,852**	**27,851**	**24,156**	**26,505**	**129,687**
TOTAL Net Borrowing	**72,042**	**79,662**	**61,265**	**46,259**	**37,340**	**296,568**

*Note * - 2020-21 has been updated to reflect 2019-20 outturn as reported in 2020-21 financial update reports*

Capital Funding

5.3 Key to the capital investment decisions are the affordability requirements. It is recognised that our financial operating environment is both complex and challenging and also that any capital investment decisions must consider both current and future financial implications.

5.4 The Council's capital investments are made in accordance with the Prudential Code which aims to ensure that the capital investment plans of the Local Authority are affordable, prudent and sustainable. The prioritisation of capital investment is directly linked to the Financial Strategy and/or in-year budget amendment processes which are undertaken in an open and transparent manner.

5.5 Funding for the capital plans comes from a range of sources including; Scottish Government (General Capital Grant and Specific Ring-Fenced Capital Grants and Housing Specific Grants), developers contributions, capital receipts from asset disposals, other income such as grant funding from other bodies, with the balance made up from borrowing funded through loan charges to the revenue budget. The cost of borrowing is included within the Council's revenue budgets through Loans Fund Charges (for the principal element of borrowing) and annual interest charges relating to the Council's debt. The impact of borrowing is included as part of the Council's Treasury Management and Investment Plans.

5.6 As part of the Council's reserves balance and in line with the reserves strategy, the Council has in place the following reserves that can be applied to offset the cost of future borrowing. These funds are not currently reflected to finance existing approved capital investment plans, but remain within the wider Council's General Fund reserves.

- Capital Fund & Capital Receipts - established from Capital Receipt income which has not yet been applied in year. This Fund can be used to either reduce loans fund advances or providing funds to cover the principal repayments of the loans fund. There is no equivalent fund balance within the HRA account principally due to the cessation of the Right to Buy.

- General Services Capital - established in recent years from flexibility from year end underspends, in order to mitigate against the future impact of growing capital infrastructure commitments.

- Council Tax 2nd Homes - An earmarked fund established by reducing the second home or empty property Council Tax discount for the development of affordable housing. Under Scottish Government direction, Local Authorities can now use this income to support the development of affordable housing, including the disbursement of funds to other organisations or individuals, as well as RSLs.

5.7 In addition, the Scottish Government have allowed a number of permissible ‘fiscal flexibilities’ to support in the management of the unmet funding pressures being experienced from COVID. Anticipated statutory guidance is still being developed but include; the application of capital receipts to finance COVID revenue expenditure; flexibility to review the accounting treatment for debt relating to credit arrangement charges; and a loans fund principal repayment holiday. It is not yet clear the full extent of any flexibility, but should additional balances arise through the current review, any uncommitted balances will be held in a specific earmarked COVID fund, and this may help to support the management of on-going revenue and capital implications being experienced by COVID.

Treasury Management and Investment Strategy

5.8 The Prudential Code for Capital Finance in Local Authorities enables councils to set their own borrowing limits with a requirement to ensure that investment plans are affordable, prudent and sustainable. The Council can borrow over a number of years to supplement its capital income, provided the resultant annual debt repayments can be accommodated within future years’ revenue budgets. The Council’s annual Treasury Management and Investment Strategy sets out the prudential indicators and parameters over the medium to long term, with mid-year reporting to Council members during the year.

5.9 The key prudential and treasury indicators include:

- Capital Financing Requirement (CFR)

- Operational Boundary

- Authorised Limit

5.10 Whilst current prudential limits remain within the overall Authorised Limit these must be considered within the wider financial environment facing the Council.

Despite current low interest rates, any borrowing will need to be repaid in the future, and it remains essential that current capital investment decisions are made taking into consideration the implications for current and future Council tax payers.

5.11 Furthermore, the capital investment programme has significant revenue consequences for the Council, such as staffing, rates, utility costs, cleaning etc, which must be met from within the revenue available to the Council.

6. Management of Risk

6.1 The economic environment can have a significant impact both in terms of the deliverability and funding of capital investment programmes, and the Council must understand these risks and ensure these are managed in a practical and prudent approach.

6.2 There remains significant uncertainty in current economic conditions faced by the continuing implications from the global health pandemic, as well as the UK’s departure from the European Union.

6.3 As such there are a number of significant risks and variables which can impact on the affordability and realisation of capital investment plans and these include:

- Increased infrastructure costs due to current economic conditions.
- Ability to realise developer contributions payment in line with approved plans which are essential to support the funding of capital projects. Delays in developer house building programmes will delay payment of associated developer contributions. This may impact on the timing and delivery of planned projects, and may have a corresponding impact on cash flow projections for the Council.
- Future interest rate rises, which can substantially increase the cost of future borrowing.
- Significantly enhanced pressure on revenue budgets, which may require reprioritisation of capital investment decisions in order to minimise future revenue costs.

6.4 Given the scale of the future capital programme and associated risks, the financial strategy and associated supporting strategies (including Capital Strategy and Treasury Management Strategy) must support the effective management of these risks. The affordability of capital investment decisions remains critical to ensure the Council has in place a prudent approach to management of risk.

- The Treasury Management Strategy specifically sets out the prudential indicators and operational boundaries which the Council should operate including effective management of the Capital Financing Requirement, and future investment decisions.

- Furthermore the Treasury Strategy sets out the Council's approach to treasury management investment decisions and ensures that surplus monies are providing adequate liquidity before considering any potential investment and related return. This is consistent with the Council's adopted prudent approach to managing investment risk and return.

7. Capital Strategy

7.1 The economic impact from COVID will have an impact both on the Council and its community in the years to come. It is essential that the capital investment plan is targeted to ensure it provides essential investment aligned to Council priorities and stimulate and support economic growth. Nevertheless, the on-going financial challenges requires enhanced affordability criteria to be applied to the capital investment programme to protect both current and future Council Tax payers. Within this context, the Strategy focuses on an enhanced review of the Council's asset base, with a view of maximising capital receipts in order to support transformation of council services and maintain a level of future capital investment, and minimising on-going revenue costs.

7.2 With this in mind, the Capital Strategy will focus on:

- Continuing to support a Capital Investment Programme, which will provide essential investment aligned to Council priorities both in the short and medium term, stimulate and support economic growth and critically, remain affordable based on a clear understanding of both capital and future revenue costs.

- Explore and review all options available to manage COVID implications through the application of permissible fiscal flexibilities.

- Maximising the capital income available to the Council.

- In support of ensuring affordability for current and future tax payers, the Council should work to minimise the additional net borrowing by ensuring that over the next 5 years, net additional borrowing for the General Fund does not exceed £150 million;

- The Council should continue to manage and review the General Services Loans Fund balance ensuring prudence, 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;

- Develop an approved five year Capital Plan (for both General Services and HRA) underpinned by longer term models 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.

- Continuing to manage and review 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.

- Delivering an enhanced review of the Council's assets, which will support the way in which we deliver and support services, minimise future revenue costs, and maximise where appropriate capital receipts which can be used to support future capital investment plans;

- For HRA, 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.

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

8. Summary

8.1 Unquestionably the Council is continuing to operate with a very uncertain financial and economic environment, and the implications arising from the current global health crisis has created significant financial challenges in the immediate short term for the Council to manage.

8.2 The Council must ensure it finds a balance of bridging the immediate financial challenges and supporting future plans and ambitions. Given the current and future financial challenges, it remains absolutely critical to ensure capital investment decisions remain affordable to both current and future residents of East Lothian.