East Lothian Council

REPORT TO:	East Lothian Council
MEETING DATE:	13 December 2022
BY:	Executive Director for Council Resources
SUBJECT:	Financial and Capital Strategies

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1 PURPOSE

1.1 To provide Council with an update on the mitigation measures agreed at the Special Council meeting on 22 November in response to the in-year budget overspend.

1.2 To seek approval for the 2023/24 – 2027/28 Financial and Capital Strategies, attached as Appendices 1 and 2 respectively.

2 RECOMMENDATIONS

2.1 The Council is recommended to:

- Note the progress made to date to mitigate the in-year forecast budget overspend in line with the additional measures agreed at the Special Council meeting on 22 November, and agree that these remain under review and further updates will continue to be provided to Members;

- Agree to formally approach the relevant Scottish Government directorates to request flexibility in the funding streams outlined at paragraph 3.4;

- Agree to the redeployment of earmarked reserves to mitigate the revenue overspend, as outlined within paragraph 3.4;

- Approve the proposal to place on hold the capital schemes detailed within paragraph 3.4 until further notice, with a commitment to review this decision as part of the 2023/24 budget report to Council on 28 February 2023;

- Note the proposal to mothball the operational properties detailed within paragraph 3.4;

- Approve the Financial Strategy 2023/24 – 2027/28 within Appendix 1;
- Approve the Capital Strategy 2023/24 – 2027/28 within Appendix 2;
- Note that the first phase of the budget consultation has now been launched.

3 BACKGROUND

3.1 In response to a significant deterioration in the budget position at the end of Quarter Two, a Special Council meeting was called on 22 November to set out the scale of the financial risks and challenges facing the Council and to agree a set of enhanced mitigation measures aimed at controlling the escalating cost pressures. Forecasts at that time were projecting an un-budgeted overspend in excess of £5 million in addition to a planned draw-down of reserves of just under £13 million. An update on the actions taken to address the overspend and minimise the unplanned use of reserves is provided within paragraph 3.4.

3.2 The current Financial Strategy was approved by Council in December 2021. Although the strategy covers a five-year period, it is subject to an annual refresh to ensure that it remains appropriate and reflects any developments relevant to financial planning. Since the current strategy was agreed, the Council has seen an escalation in the external risk environment and now faces unprecedented challenge to delivering sustainable financial plans. The revised strategy covering 2023/24 to 2027/28 is attached at Appendix 1, and this builds on some of the principles agreed by Council earlier in the year. A summary of the key changes is provided at paragraph 3.8 to this report.

3.3 Alongside the Financial Strategy, CIPFA's Prudential Code requires local authorities to produce a Capital Strategy to set the framework for capital investment decisions, ensuring that these plans are prudent, affordable and sustainable. The current five-year strategy was approved by Council in December 2021. Since that time, a range of issues including high inflation, supply chain issues and rising interest rates have adversely impacted on the affordability of the Council's current and future capital plans. A refreshed Capital Strategy covering the five-year period from 2023/24 can be found at Appendix 2 to this report, with the key features summarised in paragraphs 3.11–3.15.

Update on agreed mitigation measures

3.4 Officers continue to explore all options to mitigate the forecast revenue overspend. Progress with respect to the enhanced mitigation measures agreed at the Council meeting on 22 November is outlined below:

<u>Funding flexibilities</u>

- The opportunity to apply flexibilities within national funding streams is currently being explored in response to the Deputy First Minister's letter regarding the 2022/23 pay settlement.

- Initial work in this area has focussed on options to mitigate the in-year budget overspend; however, given that the unfunded element of the pay settlement will represent a recurring pressure for the Council, it will be necessary to look to other funding streams to find ongoing savings. If funding streams are redirected in this way, then it is inevitable that this will compromise the delivery of national policy commitments. This work is ongoing and further updates setting out the specific impact of applying any such flexibilities will be included in future reports to Council.

- Through discussion with the Executive Director for Education and Children's Services and the Head of Education, an option to redeploy 1140 hours funding totalling £1.7m carried forward from 2021 has been identified. Since this is a carry forward, this would not deliver a recurring budget saving, but would help to mitigate the in-year overspend. Officers met with civil servants on 29 November to discuss the scope for flexibility in this funding and it is now proposed that a formal approach be made to Scottish Government requesting this flexibility to offset the impact of the unfunded element of the pay award in 2022/23.

- Flexibilities within health and social care funding streams have been considered; however, the governance arrangements relating to the IJB present a potential barrier to the scope for applying flexibilities in this area. Officers will continue to work with HSCP colleagues to explore opportunities where possible.

- The Council has received a capital funding allocation of £0.581m to support the expansion of free school meals to primary 5 and prepare for primary 6 and 7 expansion. This funding will be applied to capital expenditure already incurred in the delivery of primary 5 expansion to alleviate pressure on the Council's borrowing requirement. This is within the intended purpose of the grant, so does not represent a flexibility; however, it should be noted that the level of funding received will not be sufficient to enable the delivery of primary 6 and 7 expansion. It should be noted that, based on a desktop study, the cost of the proposed expansion for East Lothian Council would require in the region of £10million capital investment, £1.6m non-recurring revenue and £0.9m recurring revenue funding.

<u>Reserves & Carry Forwards</u>

- A review of the Council's reserves has been undertaken, and where possible the Council will seek to utilise opportunities to offset the 2022/23 overspend on a one-off basis and conserve the unallocated balance on the general fund.

- This position will need to be revisited at year-end; however, as an interim measure we will seek to minimise new commitments against earmarked reserves which could be used flexibly (except where proposed spend will support the delivery of recurring savings). This includes DSM carry forwards of £1.148m, of which approximately £0.25m has been committed to date.

- As reported to Council on 22 November, £0.332m of the forecast overspend relates to the IJB, and has arisen as a result of the 2022/23 public sector pay award. It should be noted that if this element of the overspend materialises at year-end, it will be offset against the IJB reserve with no net impact to the general services revenue account. At 31 March 2022, the balance on the IJB reserve was £1.5m, of which £0.92m was earmarked for specific commitments. The forecast outturn for the IJB is currently subject to review. In the event that the IJB delivers an underspend for 2022/23, then it may be appropriate to revisit the previous commitment to transfer the share of £485k received in relation to the 2022/23 pay settlement, in light of the Council's own financial position.

<u>Review of capital programme</u>

- Officers are in the process of reviewing the capital programme to identify projects that can be placed on hold in response to the current budget pressures and unfavourable interest rate environment. With this objective in mind, it is recommended that:

    - the full Brunton Hall capital works programme be paused, with a view to setting aside an allowance of £50,000 to provide minor upgrades at this stage. The full budget for this scheme is £1.73m. Further work will be undertaken to determine the scope of future capital investment required, and how this will be funded;

    - the pace of work to progress new schools at Blindwells and Craighall will be slowed, pending assurance over developer contributions for these schemes. The total estimated cost of these schemes combined is £42m, and expenditure of £1.25m has been incurred to date.

    - the replacement Children's House project be re-profiled and the funding model to deliver this project potentially re-visited. Work in this area has already slowed down, although officers are continuing to explore options for taking this project forward. The budget for this project is £0.8m, and no expenditure has been incurred to date.

- It is proposed that a commitment be made to revisiting this decision as part of the budget meeting on 28 February 2023.

- Further options to pause projects where spend is not yet committed are currently under review and will be reported back to Members in due course.
- Work is ongoing to develop a disposal strategy and bring forward capital receipts through the further disposal of surplus property.

Energy Efficiency

- In support of the requirement to minimise the Council's energy costs as far as possible, temperatures in public buildings are being maintained at a maximum of 18 degrees where possible. Officers are in the process of exploring the option of introducing energy champions for Council buildings and in the community.
- Opportunities to suspend the use of some Council buildings are currently under consideration. Current proposals include blocks A and C of John Muir House, and 9-11 Lodge Street, Haddington. This will be taken forward by officers in consultation with Members through cross-party forums.
- Further options to mothball buildings and deliver efficiencies in energy usage are currently under review and will be reported back to Members in due course.

3.5 The Deputy First Minister's letter also noted the decision by UK Government to scrap the National Insurance rise. As there was no reversal of this decision announced through the Chancellor's Autumn Statement, this will result in a reduced costs in the current year of approximately £0.3m. The recurring benefit of this change is estimated at £0.8m.

Financial Strategy

3.6 The Financial Strategy sets out the Council's strategic approach to the management of its finances and outlines the wider context within which these plans have been developed. It covers the 5-year period from 2023/24 and has been developed against a backdrop of unprecedented challenges arising from the wider economic environment.

3.7 The scale of the financial challenges now facing the Council will require us to think very differently about how services are delivered and prioritised to best meet the needs of residents and local communities in the future. As noted in the urgent update to Council in November, without a significant uplift in national funding to meet the costs of growth and wider pressures, it is unlikely that the Council will be in a position to deliver on all existing policy commitments.

3.8 The strategy within Appendix 1 has been updated in light of these challenges, and the revised budget development framework adopted by Council earlier this year. Key features of the proposed strategy include:

- A range of updates to reflect the priorities in the 2022-2027 Council Plan, and current risks which impact on financial planning;

- Incorporation of the budget development principles agreed by Council on 29 March 2022;

- Aligned to the budget development principles agreed by Council, introduction of the following key themes to support cost reduction, increase income generation and deliver efficiencies to enable the development of a balanced budget:

  1. Asset rationalisation and energy efficiency
  2. Income generation
  3. Transformation, service redesign and digitalisation
  4. Early intervention and prevention
  5. Service reduction

- Recognition of the following critical enablers, which will underpin the delivery of these key themes:

  1. Investing in digital transformation
  2. Resourcing and enabling the asset review
  3. Support for service reviews & wider transformation
  4. Cost reduction through energy efficiency
  5. Investment in early intervention and prevention
  6. Developing and growing income streams

- Proposed increase to the minimum level of reserves to be held as contingency for unforeseen events, from £5.2m to £7.2m, (circa 2.5% running costs), reflecting the critical nature of the concurrent risks which now threaten the Council's capacity to demonstrate financial sustainability;

- Commitment to maximise the level of Capital Financed from Current Revenue (CFCR) per annum for the Housing Revenue Account.

- Proposal that the affordability of capital expenditure plans be controlled by regular review by the Chief Finance Officer, with reference to overall borrowing levels and the impact of debt repayment charges on the revenue account. To support this, work is ongoing to strengthen the governance arrangements in place to oversee the capital programme to enable regular consideration of the overall affordability of the programme as well as monitor delivery.

3.9 The strategy also incorporates:

- The General Services Financial Strategy incorporating both revenue and summarising the Capital Strategy;

- The Reserves Strategy relating to management of General Service reserves;
- The HRA Financial Strategy incorporating revenue, capital and wider application of reserves.

3.10 Members are asked to agree the strategy document set out within Appendix 1.

Capital Strategy

3.11 The updated Capital Strategy is attached at Appendix 2 to this report, and covers the five-year period 2023/24–2027/28. The role of capital expenditure in providing long-term solutions that will yield benefits over a number of years is key to the delivery of the Council Plan priorities. Unlike revenue expenditure, which supports day-to-day operational costs, capital expenditure may create or acquire new assets, increase the value or useful life of existing assets or, generate economic and social value and an income stream to the Council.

3.12 In March 2022, Council agreed an ambitious capital programme which will seek to deliver in excess of £500million investment in East Lothian over the next 5 years:

	General Services	**Housing Revenue Account**	**Total**
	£000	£000	**£000**
Gross expenditure	344,642	192,979	**537,621**
Income + CFCR	(196,047)	(44,080)	**(240,127)**
Net borrowing	**148,595**	**148,899**	**297,494**

Planned capital expenditure 2022/23 to 2027/27 agreed by Council, 1 March 2022

3.13 This expenditure is predominantly financed through prudential borrowing, which will result in significant debt financing costs which will need to be met from the revenue budget. This level of investment will also give rise to substantial revenue consequences to service the day-to-day operational costs for maintaining these assets after construction. With this in mind, it is essential that the capital and revenue strategies interact in a manner that will enable the development of sustainable budgets with a holistic view to matching resources to organisational priorities.

3.14 Since the current Capital Strategy was agreed in December 2021, external factors have given rise to increased risk to the deliverability and affordability of the current capital programme. Supply chain issues and high inflation have increased the cost of individual schemes, leading to the need to re-engineer and review the scope of what can be delivered within the approved budgets. Additionally, interest rate rises now mean that the debt financing costs to the revenue account have increased to such a level that the planned level of new borrowing over the next five years will no longer be affordable, with recent turbulence in the financial markets and action taken by the Bank of England to try and control inflation contributing to this. To put this in context, the PWLB 50-year borrowing rate in December 2021 was 1.25% at its lowest point and the equivalent rate is now 4.4%. This creates significant pressure and affordability risk on both the General Services and Housing Revenue Accounts.

3.15 Given these risks, and the significant value of planned capital investment, it is vital that the Council has a robust capital strategy and governance arrangements in place to support these plans, respond to the heightened risk environment and manage affordability constraints. The key elements of the strategy are summarised below:

- Ensuring that capital investment plans are affordable, to enable the Council to continue to support its capital investment programme, to stimulate and support economic growth and deliver of the Council's strategic priorities.

- Ensuring that capital expenditure plans remain affordable based on a clear understanding of both capital and future revenue costs.

- Enhancing the review of the existing governance arrangements for capital investment to ensure that they enable regular consideration of the overall affordability of the programme as well as monitor delivery.

- Minimising the impact of additional net borrowing on the revenue account by ensuring that use of alternative sources of funding is maximised.

- Continuing 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.

- Creating a robust framework for developing the five-year Capital Plan (for both General Services and HRA) with reference to prudential limits and the constraints of the revenue budget.

- 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.

3.16 Members are asked to agree the strategy document set out within Appendix 2.

Budget Consultation

3.17 We have now launched an online consultation giving people the chance to have their say on the Council's future budget priorities.

3.18 This represents the first phase of our budget consultation programme, and we will continue to engage with the public over budget proposals over the coming years.

3.19 This stage of the consultation asks for views on what people value most about where they live, which service areas they would like to see improved, which local issues are most important to people and what the Council should be doing differently to reduce the budget gap.

3.20 The results will be used to inform the development of future budget proposals, and recommendations on how the Council targets it limited resources to best meet the needs of its communities.

4 POLICY IMPLICATIONS

4.1 The Council's budget and financial strategies should be a representation of the Council Plan and strategic priorities in financial terms. The proposals within this report are intended to support the effective delivery of policy objectives as far as possible.

5 INTEGRATED IMPACT ASSESSMENT

5.1 Impact assessments may be required for budget proposals that involve a significant change to delivery of services by East Lothian Council. Political groups will be provided with all relevant information relating to the potential impact of budget saving proposals as part of the budget development process.

6 RESOURCE IMPLICATIONS

6.1 Financial – as described above and in the supporting appendices.

6.2 Personnel - none

6.3 Other – none

7 BACKGROUND PAPERS

7.1 Council – 22 November 2022 – Finance Update

7.2 Council – 1 March 2022 – Item 1 – Budget Development including setting of Council Tax and Council Rent for 2022/23

7.3 Council – 1 March 2022 – Item 2 – Budget Proposals on General Service – Amendment Submitted by the Labour Administration

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Appendix 1

East Lothian Council

Financial Strategy 2023-2028

East Lothian Council

Contents

1. Introduction

1.1 The Financial Strategy sets out the Council's strategic approach to the management of its finances and outlines the wider context within which these plans have been developed. It links the priorities and ambitions outlined within the Council Plan with forecast resources and will be used as the framework for setting detailed budgets to ensure that these resources are effectively managed and allocated to ensure that the Council is able to meet its statutory responsibilities and deliver on key priorities.

1.2 This strategy covers the 5 year period from 2023/24 and has been developed against a backdrop of unprecedented challenges arising from the wider economic environment. Funding from Scottish Government has reduced in real terms at a time when demand for Council services is increasing, and costs are escalating as a result of high inflation and rising interest rates. The local authority sector continues to face significant uncertainty surrounding future funding settlements with economic instability and the prospect of a recession creating significant pressure on public finances. This is compounded by the wide range of concurrent risks including the financial consequences of recovery from the Covid-19 pandemic, the Russia's invasion of Ukraine and the cost of living crisis which are creating increased pressure on council services.

1.3 The Council currently receives a significant proportion of its funding from Scottish Government. The UK Government made its autumn statement announcement on 17 November 2022, and the draft Scottish Government 2023/24 budget will be published on 15 December 2022 ahead of the draft Local Government finance order. Similar to previous years, the national funding settlement will remain in draft until it passes through the Parliamentary scrutiny process in the Sottish Parliament, with the final position unlikely to be confirmed until mid-February 2023. It is anticipated that this will be a one year settlement, which creates further uncertainty for the period beyond 2023/24. Given the acute pressure on public finances, it is inevitable that the gap between available resources and expenditure demands will increase significantly, meaning that the council will need to find further ways to reduce its cost base, or grow its income streams.

1.4 The scale of the challenge now facing the Council means that it will not be possible to close the budget gap through efficiencies alone, and it will now be necessary to think differently about how the Council interacts with and supports its residents, ensuring that scarce resources are directed to maximise impact and improve financial sustainability. In light of this, on 29 March 2022, Council adopted the below principles to guide the development of its budget strategy:

1. Establishment of a cross party budget working group to oversee the development of detailed budget proposals and the different work streams supporting this.

2. Commitment to developing an approach aligned to the financial strategy which combines a range of options to close the gap between available funding and anticipated expenditure including an enhanced programme of transformation, asset review, income generation, cost reduction and efficiency.

3. A holistic approach to budget development, which recognises the relationship between capital and revenue planning and the role of investment in cost reduction strategies.
4. Commitment to minimising the use of one off resources to balance the budget and ensuring that use of reserves is limited to investment that will deliver ongoing cost reductions.
5. Ensuring alignment of financial planning and resources with wider strategic priorities, the Council Plan and consultation results.
6. Consideration of a 5 year budget plan aligned to the financial and capital strategies.

1.5 This strategy will support financial sustainability by:

- Outlining high level financial projections for 2023/24 to 2027/28 based on a range of key assumptions.
- Setting out the wider economic context and external factors which will impact financial planning and available resources.
- Ensuring that limited available resources are focused on delivery of the Council's approved key priorities and plans and their associated key outcomes.
- Providing a solid financial planning platform for the development of a sustainable revenue budget which will support the Council's key priorities.
- Documenting range of financial challenges and uncertainties facing the council, and setting out the approach for responding to these challenges,
- Defining the Council's approach to holding and utilising balances and reserves, ensuring that an appropriate balance between risk management and investment is achieved.
- Increasing 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.

1.6 The strategy covers the financial planning period until 2027/28 for the General Services and Housing Revenue Account (HRA). This document should be read in conjunction with the council's capital strategy which sets the framework for the council's capital expenditure plans and the governance

2. Current Economic Context

2.1 The council is now facing unprecedented financial challenges with external factors placing acute pressure on resources and the council's capacity to balance its budget and set sustainable spending plans. Inflation recently hit a 40 year high, and is forecast to peak at 11.1% in the fourth quarter of 2022. The cost of essential items like energy and food is forcing households and businesses to make difficult decisions to limit their spending, while public finances and government spending plans are also being squeezed.

2.2 The economic impacts of the pandemic, coupled with Russia's invasion of Ukraine and the ongoing effects of Brexit have been compounded by the UK Government's mini budget announcement in September which created turmoil in the financial markets. These factors have resulted in a rapid escalation of cost pressures facing the council and increased demand for services.

2.3 High inflation has influenced public sector pay negotiations, with agreements reached for local government staff and craft workers. To support the 2022/23 pay settlement, Scottish Government agreed to provide an additional £140 million of recurring revenue funding from 2022-23 and an additional £120.6 million of capital funding in both 2022-23 and 2023-24 which will then be baselined as General Revenue Grant from 2024-25 onwards. However, this leaves circa £2million unfunded for East Lothian council, creating a significant recurring pressure on the revenue budget. Teachers' pay remains subject to ongoing negotiations, and any settlement in excess of 5% which does not come with further additional funding will exacerbate the existing pressure.

2.4 Within the capital programmes, significant interest rate rises present a threat to affordability of the existing capital programme, a risk that is compounded by the impact of high inflation meaning that previously agreed budgets will no longer be sufficient to fulfil capital commitments.

2.5 The Scottish Government Emergency Budget review identified £615 million of in-year savings to tackle the budgetary challenges brought about by rising inflation and the 2022-23 pay settlement, in addition to the package of £560 million of savings which were announced to Parliament on 7 September 2022. The savings come predominantly from reprioritisation of spend within the Health and Social Care portfolio (£400m), and savings from capital and financial transactions (£150m).

2.6 The Scottish economy shrank by 0.2% in July, the second consecutive month of negative growth. This was primarily driven by a fall in the services sector of 0.3%, which accounts for around two thirds of the Scottish economy – and tends to be the section of the economy most supported by consumer spending. It is now widely accepted that the UK entered into a recession in the third quarter of 2022, which could mean a return to austerity and real term cuts in unprotected public service budgets.

2.7 The UK Government's Autumn Statement announcement on 17 November 2022 set out the Chancellor's plans for increased taxation, cuts to departmental budgets and further support for households to offset the impact of inflation. Barnett consequentials cumulatively amount to around £1.5 billion for the two years 2023-24 and 2024-25, with much of this sum relating to the NHS, adult social care and education. The Scottish Government has previously made a commitment to pass on all health consequentials but made no such commitment for education. It also states that the budget position for 2023-24 is unclear but it is believed likely that this will represent a real terms cut.

2.8 While recent settlements have represented year on year growth, this has typically been given with additional policy commitments, or ring fenced to specific service areas, often within education or health and social care. Without any realistic prospect of additional funding through the national settlement, the council will face some hugely difficult decisions as to where limited resources will be directed in the future.

2.9 The Resource Spending Review, published in May 2022 made reference to agreeing a new deal for local government in Scotland in advance of next year, and this was also referenced recently by the Deputy First Minister in his letter to councils regarding the public sector pay settlement. The precise implications of this are not yet clear, however the Resource Spending Review states that this will:

- Build on the Review of Local Democracy and develop a deeper dialogue and debate on how Scottish and Local Government will work together to achieve better outcomes for people and communities.
- Seek to balance greater flexibility over financial arrangements for local government with increased accountability for the delivery of national priorities so that both partners can have certainty over inputs and outcomes alongside scope to innovate and improve the delivery of services to local communities.
- Explore greater scope for discretionary revenue-raising, such as the Visitor Levy and the newly created Workplace Parking Levy.
- Explore further with COSLA, Digital Office and Revenue Scotland how best to transform the digital administration of the Non-Domestic Rates system.
- Confirm that further flexibilities requested by COSLA will be made available to councils for existing service concession arrangements such as PFI or NPD funded projects; and
- Ensure these decisions are supported by a phased approach towards alignment with the CIPFA Code of Practice for Local Authority Accounting through a comprehensive Capital Accounting Review in partnership with COSLA, Audit Scotland and CIPFA.

2.9.1 The next key Budget event will be the Scottish Government Budget, due on December 15th.

3. Local Context

3.1 The local environment within which the Council operates continues to change and evolve and in recent years the county has seen rapid population growth. East Lothian continues to be one of the fastest growing authorities in Scotland, but this growth is not being matched with funding increases through the local government finance settlement which is creating significant additional cost pressures on the council. This financial strategy is being developed within an extremely challenging economic environment, while the Council continues to recover from the impacts of Covid 19, and respond to increased demand for its services as a result of the Ukraine war and the impact of the cost of living crisis on local residents and businesses. Developing customer expectations present an opportunity for the Council to do things differently, and to work in partnership with its communities to redesign and modernise service delivery, ensuring that resources are directed to the areas of greatest need.

Council Plan

3.2 The 2022 – 2027 Council Plan was adopted by Council in August 2022. This high level statement of objectives, priorities and strategic goals aims to meet the challenges the Council, East Lothian and its citizens and communities face to achieving the Council's vision of '*An even more prosperous, safe and sustainable East Lothian, with a dynamic and thriving economy, that enables our people and communities to flourish*.'

3.3 The plan is based on the following overarching objectives:

- **Recovery and Renewal –** recovering from the COVID pandemic by investing in regeneration and a sustainable future.
- **Reducing poverty and inequality -** supporting our communities to deal with the growing levels of poverty and inequality.
- **Responding to the Climate Emergency -** meeting our net zero climate change targets.

3.4 The plan also sets out four thematic objectives:

- **Grow our Economy -** increase sustainable and inclusive growth as the basis for a more prosperous East Lothian.
- **Grow our People -** give our children the best start in life and protect vulnerable and older people.
- **Grow our Communities -** give people a real say in the decisions that matter most and provide communities with the services, infrastructure and environment that will allow them to flourish
- **Grow our Capacity -** deliver excellent services as effectively and efficiently as possible within our limited resources.

Local Development Plan (LDP) & City Deal

3.1 The Council has an approved Local Development Plan (ELLDP 2018), which addresses housing need identified in the south east Scotland region and will mean a sustained growth in population across the area. It is estimated that the population will be 120,000 by 2037. This will continue to bring changes to the demography within the area, with significant growth in particular in the number of school-age children and the number of pensioners.

3.2 Population growth will create opportunities for the Council, but will also contribute to significant financial challenges in terms of the provision of necessary services to meet needs, for example the increased number of school children, care packages and households requiring waste collection. It will be important to ensure that the Council has the appropriate infrastructure in place to support the growth in service requirements.

3.3 Housing growth will give rise to increased council tax income, however the council does not currently receive any uplift through the national funding formula to offset the additional costs of growth. Given that national funding comprises approximately three quarters of the council's revenue budget, the impact of growth presents a huge risk to financial sustainability. In response to this challenge, it is important that as part of our strategy we continue to ensure that these concerns are heard by Scottish Government, and request that their support for growth is demonstrated through the national distribution of funding. At a local level we will need to think differently about how the limited resources we have can be used to support our changing communities.

3.4 The Council is also part of a wider Edinburgh and South East of Scotland City Deal. This will see significant investment across the region by partners including the UK and Scottish Governments, and will include the development of an Innovation Hub in East Lothian, that is being developed in partnership with Queen Margaret University. This exciting new building will accommodate a new Scottish Centre for Food Development and Innovation and will therefore support the wider food and drink sector, which is a core component of the East Lothian economy.

3.5 1.4 East Lothian is experiencing the impacts of the wider macro-economic climate, in common with the whole of Scotland and growth and change will be affected to some degree by the rising costs of construction and the move to new zero. The Council will work during 2023 towards a new economic development strategy and also make progress towards a replacement for the ELLDP 2018, reflecting the Scottish Government's aspirations and policies in the new National Planning Framework 4, to ensure a policy context that encourages economic growth and continues to meet the needs of the population of East Lothian.

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. The Council will consider how its ambitions for growth can be realised and recognises the challenges in terms of how we use limited resources to support the needs that arise from demographic growth. This may require some changes in what we do and how we do it.

Reducing Poverty and Inequality

3.7 The East Lothian Poverty Plan 2021-2023 , which was adopted by the Council and the East Lothian Partnership in October 2021, sets out seven outcomes based around a prevention and early intervention approach:

- Working and free from in-work poverty
- Financially included - people have access to income maximisation and money advice
- Having a decent, affordable, warm and dry home
- Educated – reduce the attainment gap and raise the attainment and achievement of our children and young people

- Healthy and Well – people in East Lothian are enjoying healthier lives and health inequalities are eliminated
- Resilient and Well Connected individuals and communities
- Empowered and Responsible

3.8 This strategy will seek to ensure that resources are directed accordingly in support of these objectives, providing both responsive support and investing in preventative action.

Responding to the climate emergency

3.9 The Council declared a climate emergency in August 2019 and developed a Climate Change Strategy & Action Plan in January 2020 to take urgent action to mitigate and adapt to climate change. The Strategy sets a route to creating a Net Zero Council and a Carbon Neutral East Lothian in partnership with the community. It includes key priorities to improve sustainability, encourage a low carbon lifestyle and look after the environment.

3.10 The Council needs to take action to tackle the climate emergency, and this will require a change in what we are doing, and how we are using our resources.

Other Developments

3.11 Learning Estate Review - 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.

3.12 National Care Service (NCS) – Scottish Government has consulted on the NCS bill although significant uncertainty remains on this issue. If the NCS proceeds it will have a substantial impact on social care services, as well as the wider organisation.

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.

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 2021 set out below.

General Services – Revenue	**2022-23**	**2023-24**	**2024-25**

	£'000	£'000	£'000
Approved Expenditure	293,615	290,942	299,306
Financed by:			
RSG (including NDR)	(195,103)	(195,533)	(197,927)
Other Government Grants	(19,774)	(19,774)	(19,774)
Council Tax	(69,958)	(75,545)	(81,515)
Other	(90)	(90)	(90)
Transfer (from) / to Reserves	(8,690)	0	0
TOTAL	**(293,615)**	**(290,942)**	**(299,306)**
Delivery of Planned Efficiencies (contained in above)	**(2,543)**	**(8,446)**	**(6,002)**

Table 1: General Services Revenue budget summary 2022/23 – 2024/25, agreed by Council on 1 March 2022

4.3 The budget development principles agreed by Council on 29 March 2022 included a commitment to considering a 5 year budget plan aligned to the financial and capital strategies. Given the level of uncertainty and short term nature of local government funding settlements, on 28 February 2023, Council will be presented with a detailed budget for 2023/24 accompanied by high level projections and savings plans covering the 5 years to 2027/28.

4.4 Key assumptions within these plans are set out below:

- Pay increases – 2%
- Gas and electricity - £2.9m
- Interest on new borrowing – 4.4%
- General inflation – 10%
- Increase in council tax band D charge 5%
- Flat cash settlement from Scottish Govt.

Pay increases are broadly aligned to the public sector pay policy and the 5% increase in council tax is aligned to previous assumptions agreed by Council on 1 March 2022.

4.5 On 28 June 2022, the following high level scenarios were presented to Council, setting out the potential budget gap for 2023/24 onwards:

Scenario	2023/24 £'000	2024/25 £'000	2025/26 £'000	2026/27 £'000	2027/28 £'000	TOTAL £'000
1	8,808	8,631	8,373	6,666	8,579	**41,057**

2	10,553	8,779	10,057	8,406	8,406	**48,173**
3	12,233	11,114	11,720	16,156	16,156	**63,442**

Table 2: High level budget scenarios from 28 June 2022 Council report

4.6 Given the escalation of external pressures which impact on these assumptions since the report to Council in June, most notably the unfunded element of the 2022/23 local government pay settlement, significant increases in gas and electricity prices, high inflation and increased demand for Council services arising from the cost of living crisis, the budget gap facing the council is now expected to reflect the most pessimistic scenario reported in June, with a requirement to deliver savings in excess of £60m over the next five years.

5. General Services Capital Budget – Medium Term Outlook

5.1 The new budget development principles include a commitment to *a holistic approach to budget development, which recognises the relationship between capital and revenue planning and the role of investment in cost reduction strategies.*

5.2 The Capital Strategy sets the framework for capital expenditure decisions and the arrangement for governance and monitoring of these plans. Given the significant impact of debt financing costs and revenue consequences of capital spend on the revenue budgets, it is important that these strategies are closely aligned and the interdependencies are understood. On 1 March 2022, the Council approved an ambitious, growth driven 5 year General Services capital budget, a summary of which is set out in the table below.

	2022-23 £000	2023-24 £000	2024-25 £'000	2025-26 £'000	2026-27 £'000	TOTAL £'000
General Services Gross Expenditure	94,759	102,774	75,748	40,107	31,254	344,642
General Services Income	(38,648)	(38,542)	(56,421)	(35,239)	(25,796)	(194,645)
Net General Services	**56,110**	**64,232**	**19,328**	**4,869**	**5,459**	**149,997**

Table 3: General Services Capital budget summary 2022/23 – 2024/25, agreed by Council on 1 March 2022

5.3 Funding for the capital plan comes from a range of sources including; Scottish Government (General Capital Grant and Specific Ring-Fenced Capital Grants), developer 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.

5.4 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.

5.5 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 emergence of a subsequent successor LDP.

5.6 As highlighted in previous Council reports, there remains significant external market challenges with wider supply and cost pressures as well as implications from on-going management of COVID and wider external risks. This has continued to add significant additional financial challenges on the current approved capital programme and borrowing levels. Whilst current indications suggest the wider market conditions may stabilise in due course, the financial impact and risk on future capital projects will remain a key area of focus.

5.7 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.

5.8 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. Interest rates have recently increased to a level not experienced for many years. The rates are forecast to stabilise and then only fall gradually in the medium term, which directly impacts on interest payable on new borrowing. It is important to remember that any new borrowing is in addition to existing borrowing and that 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. The 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.

5.9 The previous capital strategy imposed an upper limit on new borrowing for General Services of £150 million over the next five years to safeguard the revenue account from excessive debt charges. Given the significant and rapid increase in interest rates since this limit was set, the repayment of this level of borrowing has now become unaffordable for the council. Whilst recognising the important role that capital investment has to play in stimulating economic growth and providing communities with vital infrastructure, a limit at this level is no longer sustainable. The Capital Strategy for 2023/24 – 2027/28 therefore recommends that General Services capital expenditure affordability is controlled through regular review by the Chief Finance Officer, with reference to overall borrowing levels and the impact of debt repayment charges on the revenue account. With this in mind, the upper limit on new borrowing will be revised and recommended to Council for agreement as part of budget setting on 28 February. This will then be reviewed by the Chief Finance Officer at regular intervals throughout the year, and reported to Council through quarterly budget monitoring reports. To support this, a review of the governance arrangements in place to oversee the capital programme is under way, with a view to ensuring that these arrangements enable regular consideration of the overall affordability of the programme as well as monitor delivery. This will include strengthening the role of the Corporate Asset Group (CAG) and Capital Investment and Asset Management Group (CIAMG) to support the operational delivery of the capital plan and associated strategies, and ensuring that the newly created cross party sustainability forum enhances these arrangements.

5.10 In order to ensure that this control does not adversely impact on the council's capacity for future investment, this strategy will also 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.

5.11 Much of the capital 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. Given the current economic climate, the situation will need to be monitored closely and the ability to be flexible and adaptive with our capital planning will prove critical.

6. Reserves

6.1 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.

6.2 General Services reserves (excluding HRA reserves) available as at 31 March 2022 totalled £36.970m million. A breakdown of this total is shown within table 4.

	31 March 2021 Balance	Movement	31 March 2022 Balance
GENERAL FUND RESERVE			
EARMARKED			
Requirement to support future budgets	3,095	5,612	8,707
Cost Reduction / Transformation	3,445	0	3,445
DSM	1,071	77	1,148
MELDAP	36	0	36
Other	440	0	440
Council Tax 2nd Homes	2,064	-1,032	1,032
Other Ring Fenced funds	932	1,501	2,433
COVID Fund	8,900	-3,421	5,479
Civil Emergency*	2,000	0	2,000
General Services Capital*	2,282	0	2,282
	24,265	**2,737**	**27,002**
CONTINGENCY			
Balance – uncommitted*	4,063	-1,381	2,682
	4,063	**-1,381**	**2,682**
Total General Fund Reserves	**28,328**	**1,356**	**29,684**
OTHER RESERVES			
Insurance Fund	2,306	378	2,684
Capital Grants Unapplied	245	-245	0
Total	**2,551**	**133**	**2,684**
Total General Fund / Other Reserves	**30,879**	**1,489**	**32,368**
HRA	2,009	-261	1,748
Capital Receipts Reserve (incl. HRA)	2,201	2,401	4,602
Total Other Reserves	**4,210**	**2,140**	**6,350**
TOTAL RESERVES	**35,089**	**3,629**	**38,718**

Table 4: Usable reserves at 31 March 2021 and 31 March 2022, as reported in the audited financial statements

* For 2022/23, the approved minimum level of uncommitted reserves was set at £5.2 million (circa 2% of running costs). The minimum level of reserves includes the following balances:

- Civil Emergency £2.000 million
- General Services Capital £2.282 million

- Uncommitted Balance* (note below) £2.682 million

  TOTAL **£6.964 million**

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

Earmarked Reserves

1. **Requirement to support future budgets:** This balance is held to support future budget plans, aligned to the approved General Service budget for 2022-2025. Note this includes updated funding made available in 2021/22 to support Business and Low Income Households (LACER funding) amounting to £1.517 million

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.

3. **Cost Reduction Fund (Transformation Fund):** This fund is used to support delivery of change which will realise a financial saving and/or service efficiency going forward. As part of the closedown of the 2021/22 revenue account, Council agreed that this reserve would be repurposed as a Transformation Fund. Authority is delegated to the Chief Finance Officer to approve the commitment of funds against this reserve, and this will be reported through the Members Library Service.

4. **DSM:** These funds represent balances established from both Primary and Secondary Devolved School Management schemes.

5. **MELDAP:** This fund will be used to support targeted interventions, through the Midlothian Drug and Alcohol Partnership.

6. **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.

7. **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. Authority is delegated to the Chief Finance Officer to approve the commitment of funds against this reserve, and this will be reported through the Members Library Service.

8. **COVID Fund (Recovery and Renewal Fund):** This fund was established as part of the 2020-21 accounts closure from late national funding to support COVID interventions aligned to the Council's recovery and renewal strategy. As part of the closedown of the 2021/22 revenue account, Council agreed that resources within this fund could be used to support the council's response to the broader range of risks which the council is now facing.

9. **Other Ring Fenced Funds:** This earmarked reserve has been established to support specific funding commitments within service areas relating to previously committed expenditure obligations which have not materialised. Funds sitting within this balance have been legally ring fenced for a specific purpose.

10. **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.

11. **Capital Receipts Reserve:** This fund was 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.

12. **Capital Grants and Receipts Unapplied:** Allows capital receipts to be used to transform service delivery to reduce costs and / or reduce demand. This flexibility was only available to Councils until 2021-22 and no further activity is anticipated for this category of reserve in the future.

13. **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 with more detail set out below.

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

6.4 It should be noted that many of the reserves listed within table 3 already have post 31 March commitments against them and will be spent during 2022/23. Furthermore, the forecast revenue outturn at the end of quarter two indicates that reserve drawdowns totalling £18m may be needed during the current financial year. This includes unplanned drawdowns of over £5m, although in a special meeting on 22 November 2022, Council agreed a series of mitigation measures with a view to reducing the forecast in year overspend.

Reserves Strategy

6.5 The budget development principles agreed by Council include a commitment to minimising the use of one off resources to balance the budget. While this may be unavoidable in certain circumstances, this should be a short term response only and should not replace the development of a sustainable budget.

6.6 As noted above, the Council maintains reserves as a safety net to allow for unforeseen circumstances. There is no statutory definition of the minimum level of reserves: the amount required is a matter of judgement. However, Council has previously agreed to set aside 2% of the net revenue budget as the minimum unallocated balance on the general fund, which equates to approximately £5.2m.

6.7 Given the current risk environment, at this point is considered appropriate to increase this level up to £7.2m, which represents circa 2.5% of the net revenue. Holding an excessive level of unallocated reserves rather than investing these in improving services would not represent value for money or effective use of resources. However, the range and extent of risks currently facing the council increases the likelihood that reserves will be needed to support mitigation measures. Given that reserves are not recurring resources meaning that they can only be used once, targeting a minimum unallocated balance of this level is proportionate and not excessive. Rather than expressing the minimum balance as a percentage of the net budget, which may reduce over the coming years, it is recommended that the target minimum unallocated balance is fixed at £7.2m but kept under regular review.

6.8 In order to reach a minimum level of £7.2m for 2022/23, unallocated balances will need to be increased by £0.536m. At this stage it is recommended that this is achieved through a transfer from the Recovery and Renewal (formerly COVID) fund, to the Civil Emergency reserve. This will need to be revisited at year end, in light of the in year financial outlook.

6.9 In the event that reserves fall below the minimum level, then action will need to be taken to replenish balances accordingly. In the first instance, we would seek to use other earmarked balances for this purpose. If this is not possible then a recovery plan would need to be implemented, with a view to replenishing reserves from the revenue account over the subsequent twelve months.

7. General Services Financial Strategy

Balancing the Budget

7.1 The council is legally required to set a balanced budget for the forthcoming financial year and will need to develop detailed and robust plans for closing the gap between expenditure demands and available resources.

7.2 Council has committed to developing an approach which combines a range of options to close the gap between available funding and anticipated expenditure including an enhanced programme of transformation, asset review, income generation, cost reduction and efficiency.

7.3 Given the scale of this challenge over the next five years, it is prudent for the council to develop credible plans to close this gap in the years subsequent to 2023/24. The size of the potential revenue budget shortfall means that no single initiative can been expected to close the gap. A blend of different approaches will therefore be required, and detailed plans will be developed, aligned to the following broader categories:

1. **Asset rationalisation & Energy Efficiency** - 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. The Council has embarked on an ambitious programme to review and rationalise the Council's office estate, in order to support the delivery of approved budget saving, and to support continued flexible approach to working which has been successful since March 2020. Going forward there is further scope to rationalise assets, which would be critical to support the affordability of future capital investment plans, and support future service delivery. The establishment of the Cross Party Sustainability Forum will support this important area of work by providing oversight and governance to the programme.

   The Energy Transformation Board meets regularly to actively explore opportunities for reducing expenditure and potentially raising income from energy such as exploiting renewable energy sources.

   Both of these work streams align to the Council Plan priority of responding to the climate emergency and meeting our net zero climate change targets.

2. **Income generation** – Where savings can be delivered through income generation, this helps to reduce the extent to which cuts are required to front line services. This strategy therefore recommends that, as part of the development of the budget, consideration is given to increasing existing charges, and implementing new charges where appropriate. Work is already underway in this area and as outlined in the council's charging policy, the implementation of charges can also be used to support wider priorities aligned to the Council Plan.

3. **Transformation, service redesign & digitalisation** – A broad range of transformation projects is already underway and the council has robust governance arrangements in place to oversee this. Current projects include the transforming services for children project, facilities management review, purchase to pay review, and redesign of print and mail services. The council also recognises the important role that technology has in making services more efficient and is committed to enabling this. Current digital projects include the online customer platform to improve the customer experience, replacement of the housing management system, upgrading the Mosaic case management system for social care services and improvements to the asset management system. As part of this strategy, it is important that visibility of the financial and wider benefits of these projects is maintained. Given that 70% of the council's expenditure represents staffing costs, it will not be possible to close the budget gap without a reduction in this area and it is hoped that the projects in this area will help to deliver some of the change required to manage these reductions.

4. **Early intervention & prevention –** investment in preventative measures supports cost reduction by reducing the need for expensive interventions over time, and also results in improved outcomes for the council's service users. The council is already doing this successfully in a number of areas but there is an opportunity to go further. Potential areas of focus in relation to this objective include childrens services, homelessness and implementation of the poverty and inequality plan.

5. **Service reductions -** Service reductions will be treated as a last resort as part of this strategy, however, all options will need to be considered in order to safeguard statutory services which are relied upon by the most vulnerable in our communities.

7.4 It will not be possible to deliver all of this overnight. These plans will therefore need to be aligned to the five year financial strategy, with plans for savings and additional income featuring in each of the five years. This will be a continuous programme of work which will be underpinned by robust governance arrangements to develop plans, monitor progress and evaluate the resources required to progress the different elements of this strategy.

Critical Enablers

7.5 This strategy recognises that the scale of change needed to deliver a balanced budget and ensure financial sustainability will now require a fundamentally different approach to the way in which the council delivers its services.

7.6 This is an opportunity to do things differently, and to ensure that the council has the capacity and resources to deliver modern services, aligned to its strategic objectives which meet the needs of the changing demographic of East Lothian.

7.7 Investment will be required in order to make it possible for the council to act upon these opportunities, and the following critical enablers have been identified to support the delivery of this strategy:

- **Investing in digital transformation**
- **Resourcing and enabling the asset review**
- **Support for service reviews & wider transformation**
- **Cost reduction through energy efficiency**
- **Investment in early intervention and prevention**
- **Developing and growing income streams**

Fiscal Flexibilities

7.8 In response to the Covid-19 pandemic, Scottish Government provided councils with the discretion to apply fiscal flexibilities in response to dealing with financial pressures. Three options are currently available; flexible use of capital receipts, the loans fund repayment holiday and service concession flexibilities. Given the acute financial pressures which the Council now faces, it is appropriate to consider these options in light of these challenges as part of the development of the Council's Financial Strategy. Consideration of each option is set out below:

1. **Flexible use of capital receipts** - Use of capital receipts is typically restricted to capital investment or the repayment of debt but this option permits the council to use capital receipts flexibly to support the revenue budget under certain circumstances. However, given the current pressures on the capital programme and associated financing costs, it is appropriate to continue to apply capital receipts to fund capital. Further, the Council does not currently hold or generate sufficient capital receipts for this intervention to have a significant benefit.

2. **Loans fund repayment holiday** – This option gives flexibility to reduce the Council's statutory repayment of debt in a single year through a repayment 'holiday'. Previous plans had been to take this in 2021/22, but at the time this was deferred due to underspend on the revenue account and increased pressure from rising interest rates. The council currently has the opportunity to take this flexibility in 2022/23 only. The potential one off benefit of utilising this flexibility would be a one off benefit to general services reserves of approximately £6 million in 2022/23. This amount would then be repaid over subsequent years.

3. **Service concession flexibilities** – this option allows the council to Option to spread the cost of service concession assets over their useful life, rather than over the duration of the contract, resulting in a financial benefit for the remainder of the contract including a one-off benefit in the region of £14.5m in 2023/24, and an annual reduction in charges of £0.5m - £1m for the remainder of the service concession contracts, up until 2034/35. The costs would then be spread over a longer period, beyond the contract end date. It should be noted that this option is not available in perpetuity, and the council will need to take a decision on this by 2023/24.

7.9 Each of the above options presents the opportunity to generate a one off benefit to the revenue account, at the expense of deferring repayment of liabilities related to capital spend. Overall, this will result in higher debt repayment charges, and increased pressure on the Council's borrowing requirement. However, the benefits could be used to enable investment needed in measures which will deliver a sustainable benefit to the revenue account, such as the critical enablers outlined above.

7.10 As a general principle, subject to the approval of Council, we will seek to apply these flexibilities only where this can be justified through wider plans to deploy resources in a way which will support future financial sustainability.

7.11 This approach aligns to the budget development principle of minimising the use of one off resources to balance the budget and ensuring that use of reserves is limited to investment that will deliver ongoing cost reductions.

7.12 It should be noted that Council approval and external audit advice will need to be sought prior to proceeding with any of these options.

Wider Revenue Flexibilities

7.13 In November 2022 the Deputy First Minister wrote to councils, recognising the challenging resourcing position presented as a result of the 2022/23 pay deal. Although additional revenue and capital funding to partially offset increased costs has been distributed to local authorities, for East Lothian Council circa £2million remains unfunded. In the context of existing financial pressures and wide ranging national policy commitments, the Council will not be able to address this funding gap through efficiencies, creating a need to revisit existing commitments to assess what can now be delivered within the resources available.

7.14 The letter noted that ‘it is for individual councils, as democratically elected bodies, to consider the needs of their communities with a focus on the most vulnerable, their legal obligations and the totality of resource funding available to them, and to then take the decisions necessary, openly and transparently, to operate as effectively as possible within this context.’

7.15 The letter invites councils to engage with the relevant Scottish Government directorates where consideration is being given the redirecting funding which is legally ring fenced for the delivery of specific policy commitments. With this in mind, the council will undertake an assessment of its ring fenced funding streams with a view to ensuring that resources are directed towards the areas of greatest need and accepts that, subject to consultation with Scottish Government, this will mean that it may no longer be possible for the council to deliver on all of the existing national policy commitments. The majority of ring fenced funding currently supports priorities within education, childrens services, health and social care and the wider impacts of decision making around potential flexibilities will require careful consideration.

7.16 Furthermore, the need to consult with Scottish Government means that the council’s powers to enact this element of our financial strategy will remain somewhat limited if support for our proposals is not conferred by the relevant directorate.

8. Housing Revenue Account

8.1 The Local Housing Strategy sets the strategic approach for the delivery of 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. Ukraine Energy Efficiency

8.2 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.

8.3 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.

8.4 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.

8.5 East Lothian Mid-Market Homes LLP supports the provision of mid-market rental property, 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.

8.6 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. Current budget projections assume a 5% annual increase in rents for 2023/24 onwards. Increases below this level will likely require a reduction in the capital investment programme.

8.7 Given this ambition, key areas of focus for the HRA financial strategy 2023/24 to 2027/28 are as follows:

- Reviewing the existing rental levels and implementing a rent restructure within the financial strategy term, to promote fairness and transparency across the HRA portfolio.
- Ensuring that capital expenditure plans remain affordable and sustainable by maximising subsidy available to support capital investment and maximising the level of Capital Financed from Current Revenue (CFCR).
- Maximising efficiency and value for money, ensuring that expenditure is focussed on priority areas to maintain and improve the service for tenants.
- Working with RSL partners to deliver the affordable housing needs across East Lothian and support the ambition set out in the Strategic Housing Investment Plan.
- Reducing rent arrears, ensuring targeted and flexible support is provided to tenants to who are experiencing financial difficulties.
- Implementing the new housing management system to support and improve forward planning and customer service;
- Minimising the impact of debt charges by operating within the recommended upper limit for the ratio of debt charges to income of 40% and maximising the in-year use and application of capital receipts, available capital grants, and revenue balances where possible.

- In support of contingency planning, ensuring that the reserve or balance left on the HRA does not fall below £1.0 million, allowing the Council to maintain a cushion against any unexpected increase in costs or loss of income.

9. Financial Management

9.1 Financial management at East Lothian Council comprises a number of elements. Officers and members are fully engaged in the annual budget setting process, through regular updates and the Cross Party Budget Working Group, which will create a shared understanding of financial plans and budgets, as well as the wider external pressures on the council's finances.

9.2 The current external operating environment is extremely challenging, very dynamic and subject to constant change. 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.

9.3 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.

9.4 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.

9.5 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 Executive Director who has the flexibility to manage budgets across various business groups.

9.6 Although the Financial Strategy quite properly covers the 5 year period until 2027/28, the Strategy will be continue to 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.

Financial Management System (FMS)

9.7 In support of good financial management, the council will need to upgrade or replace its financial management system in the coming years. Although this will represent a complex project with significant resourcing implications, support for the database and operating system for the current software will end in 2026 and 2027 respectively. The considerable benefits that will be derived from updating the legacy system, including greater efficiency and improved management information are fundamental to the successful delivery of this strategy and to sound financial management, meaning that it is advisable to begin this process as soon as possible. This aligns to the council's digital strategy, and the principle of investing in digital transformation as a critical enabler, as outlined in section 7 of this strategy.

Cross Party Budget Working Group

9.8 As part of its revised budget development framework, Council agreed to establish a cross party budget working group to oversee the development of detailed budget proposals and the different work streams supporting this.

9.9 This group has now been established and its role and objectives are as follows:

- Supporting the development of a balanced budget through consideration of budget proposals intended to close the gap.
- Receiving updates on the development of the Council's capital strategy and programme via the asset governance political oversight group, and considering the overall impact of the proposed programme on revenue budgets.
- Providing strategic oversight for transformation work streams.
- Providing political oversight to steer strategic financial planning to ensure alignment between resource allocation and the priorities identified within the Council Plan.
- Promoting greater awareness and understanding of the stakeholder engagement plan and using consultation results to inform the development of political priorities.
- Providing political oversight on transformational work streams and the HRA programme board.
- Communicating financial challenges and opportunities to respective political groups and acting as a conduit to represent the priorities of wider political groups in relation to budget planning.
- Developing effective cross-party working on the development of the annual budget and financial strategies.
- Overseeing the planned deployment of the council's usable reserves and balances.
- Offering feedback and learning opportunities for continually improving this process, through debrief following the Council budget meeting.

9.10 The role of this group is important for the implementation of this strategy, by facilitating greater involvement of all political groups in the development of budget proposals at an earlier stage in the process.

10. Risk Management

10.1 The council's financial strategy is subject to a high degree of risk and uncertainty. In November 2022, managing the financial environment was elevated to a score of 25, which is the highest rated risk that the council has ever seen within its corporate risk register. The council has robust risk management processes in place to capture risks and to ensure that appropriate mitigations are developed.

10.2 The major risk areas that have been identified in relation to this strategy are summarised below. These are documented in full within the council's Corporate and Service Risk Registers:

- Rising gas and electricity costs;
- High inflation, impacting on the cost of goods and services, as well as contract price increases;
- Meeting the total costs of public sector pay awards;
- Increased demand for council services arising from external factors including the Ukraine war and cost of living crisis, and recovery from the pandemic;
- Reducing levels of core national funding relative to demand, with an increased proportion of overall funding being allocated to specific or new policy objectives;
- Short term funding settlements which create significant uncertainty and impede robust medium term financial planning;
- Supporting the resource requirements associated with the delivery of the growth agenda resulting from the Local Development Plan, in particularly the revenue consequences associated with growth;
- Associated demographic change and social-economic pressures;
- Potential financial costs associated with a wide range of new obligations or legislative changes;
- Enhanced risks relating to receipt of S75 contributions arising from wider economic risks which will impact on capital and revenue financial planning;
- Rising interest rates resulting in increased capital financing costs which will present a risk to the sustainability of the capital programme;
- Proposed capital accounting review, with potentially significant financial impact, albeit this has been delayed by 12 months.

10.3 It is recognised that this is not an exhaustive list. By reviewing risk registers on regular basis, it is expected that any major new risks will be identified and appropriate mitigations developed. This information is shared with senior managers, CMT, Audit and Governance Committee and full council on a regular basis.

11. UNCRC

10.4 We will ensure that Council commitments to the Children and Young People (Scotland) Act 2014 (Corporate Parenting responsibilities) and Article 12 of the UN convention on the Rights of the Child are reflected in our budget planning. We will do this by ensuring that the voice of children and young people is included through the budget consultation process and aligning our resources to support these objectives and ensure that as a Council we are doing all that we can to meet the needs of children and young people.

12. Summary

11.1 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.

11.2 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.

11.3 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.

11.4 This financial strategy provides a robust framework for setting the budget for 2023/24 onwards and highlighting the need to take action to ensure the Council can continue to be financially sustainable over the medium term. The current forecast position is extremely challenging, with additional budgetary pressures and expenditure demands significantly exceeding the funding available.

11.5 The strategy will be kept under regular review and updated at least annually.

Appendix 2

East Lothian Council

CAPITAL STRATEGY

2023/24 to 2027/28

Funding and affordability.
Asset maintenance, enhancement and aquisition.

Contents

INTRODUCTION

East Lothian Council has a focus on ensuring existing and new communities continue to be great places in which to live and work, with an even more dynamic local economy. Between now and 2033, the population of South East Scotland is expected to grow by 220,000 people and the Council will need to ensure that services and infrastructure provided are fit for purpose and meet the needs and aspirations of the residents of the county. East Lothian Council's Local Development Plan allocated land capable of delivering just over 10,000 new homes to 2024. It also identifies some 200 hectares of employment land for job creation. The plans are ambitious and the Council will need to balance an increasing demand through demographic requirements with the additional pressure on revenue and capital resources.

To safeguard the delivery of sustainable services into the future, it will be necessary to change the way that we do things. This will require a level of investment in transformational change.

The Capital Strategy 2023/24 to 2027/28 outlines the Council's priorities as well as the due considerations required relating to funding and assessing affordability. Governance of all aspects of the capital plans are considered and there is recognition that there is a need to balance any investment for the maintenance and enhancement of existing assets against any ambition for the acquisition or construction of new assets. If assets fall into disrepair and they are no longer able to fulfil their primary purpose, then the Council's ability to deliver the associated services is impacted and it has resources tied up in assets that it cannot use.

The Council has a very ambitious set of plans to deliver over £750 million of capital investment over the next ten years, including significant expenditure on the education estate, infrastructure and housing. The investments are crucial to deliver statutory services and to achieve the plans as set out in the East Lothian Council Plan.

The Council's challenging financial position means that it is more important than ever to ensure that we make the best use of the capital resources that are available to us. There is a need to demonstrate that capital expenditure and investment decisions are taken in line with the Council's aims and objectives and, in line with the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code, take account of governance, stewardship, value for money, prudence, sustainability and affordability. Cash flow and the phasing of expenditure has to be considered in order for the Council to maximise opportunities for securing external funding.

REGULATION

Local Authorities are required by regulation to have regard to the Prudential Code for Capital Finance in Local Authorities (December 2021) when carrying out their duties in Scotland under Part 7 of the Local Government (Scotland) Act 2003. The key messages from the code are, in relation to capital expenditure, the consideration of Prudence, Affordability and Sustainability.

The format of the Capital Strategy reflects the requirements of both the latest Prudential Code for Capital Finance in Local Authorities and the Treasury Management in Public Services Code issued by the Chartered Institute of Public Finance and Accountancy (CIPFA). Recent Code revisions have been incorporated into the strategy.

CIPFA's Prudential Code provides a framework for the self-regulation of the authority's capital financing arrangements. It requires local authorities to determine that capital expenditure and investment decisions are affordable, prudent and sustainable, and to set limits on the amount they can afford to borrow in the context of wider capital and revenue planning.

A Capital Strategy is part of the Prudential Code requirements and sets out the long-term context in which capital expenditure and investment decisions are made and that gives due consideration to both risk and reward and to the impact of the strategy on the achievement of the authority's priority outcomes.

The Financial Management Code of Practice has been issued by CIPFA 'to provide guidance for good and sustainable financial management in local authorities and will provide assurance that authorities are managing resources effectively'. The Financial Management Code applies to all local authorities and brings together statutory requirements and Codes of Practice into one document.

CIPFA's current Prudential Code requires the Capital Strategy to demonstrate the concept of proportionality between treasury operations and non-treasury operations. Non-treasury investments are shown in the Proportionality of Non Treasury Investments section.

OBJECTIVES OF THE CAPITAL STRATEGY AND OTHER KEY DOCUMENTS

The Capital Strategy is a key document which sets out how the Council will realise its strategic objectives through investment over the medium term, and the governance arrangements which support this. Many other plans and strategies influence capital investment plans, and the strategy seeks to ensure that capital plans are aligned to the Council Plan. The priorities are that:

- capital investment plans are affordable, prudent and sustainable;
- financing decisions are taken in accordance with good professional practice and with a full understanding of the risks involved; and
- robust governance arrangements are in place to support its capital planning activities.

The Capital Strategy is therefore the policy framework document that sets out the principles to be used to guide the allocation of capital investment across all the Council's services and informs decisions on capital spending priorities within the Council's 5-year Capital Plan.

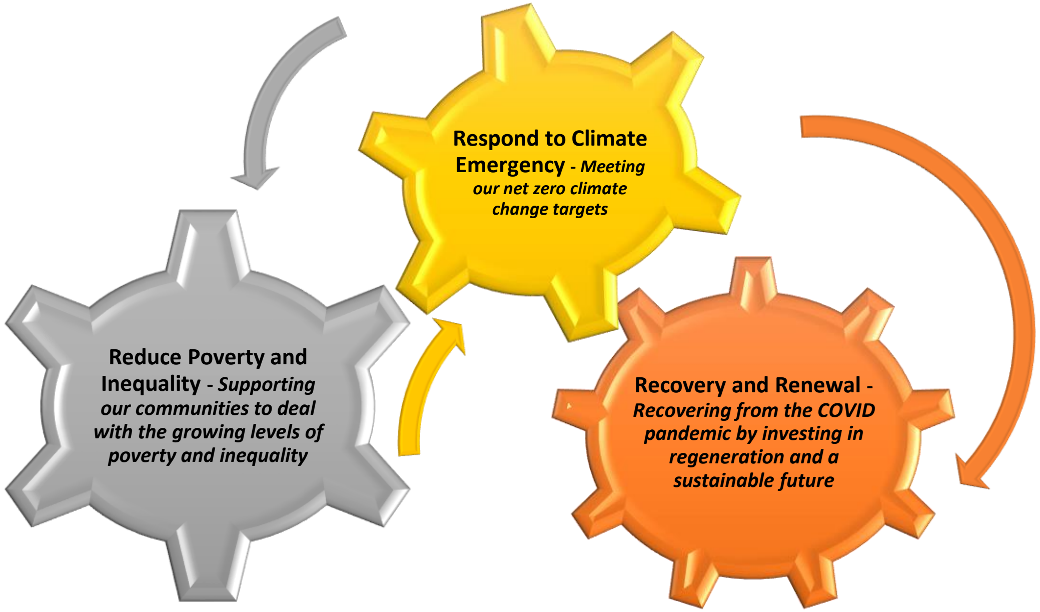
The overarching aim of the strategy is to provide a framework within which the Council's capital investment plans will be delivered. This Capital Strategy for 2023/24 to 2027/28 initially covers a five-year timeframe to allow sufficient opportunity for strategic capital planning. A key purpose of the Capital Strategy 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.

Inevitably, the full picture of the control system around the Council's wide range of capital expenditure and its funding is reflected in a range of documents, monitoring and management arrangements. A summary of four key aspects of capital activities is shown in the following table and further information on the other corporate plans can be found in the next section.

CAPITAL EXPENDITURE	TREASURY MANAGEMENT	OTHER LONG-TERM LIABILITIES	KNOWLEDGE SKILLS AND EXPERIENCE
Capitalisation rules	**Authorised limits and operational boundary**	**Public Private Partnerships and Lease arrangements**	**Availability of suitably skilled staff**
Long term forecasting	**How Treasury Management decisons are reached and then scrutinised**	**Assets financed by credit arrangement and not part of CFR**	**Use of professional advisors**
Sensitivity to risk/Basis of estimating future costs	**Repayments of debt**	**Ongoing monitoring**	**Professional competence in specialist areas**
Strategic service plans/Asset Management plans	**Projections of external debt and internal borrowing**	**Creation of liabilities on the Balance Sheet**	**Training plans**
Sustainability of the existing asset base			

The **East Lothian Council Plan** drives capital investment plans. The Council Plan is the Council's key strategic document. The current plan covers the period from 2022 to 2027.

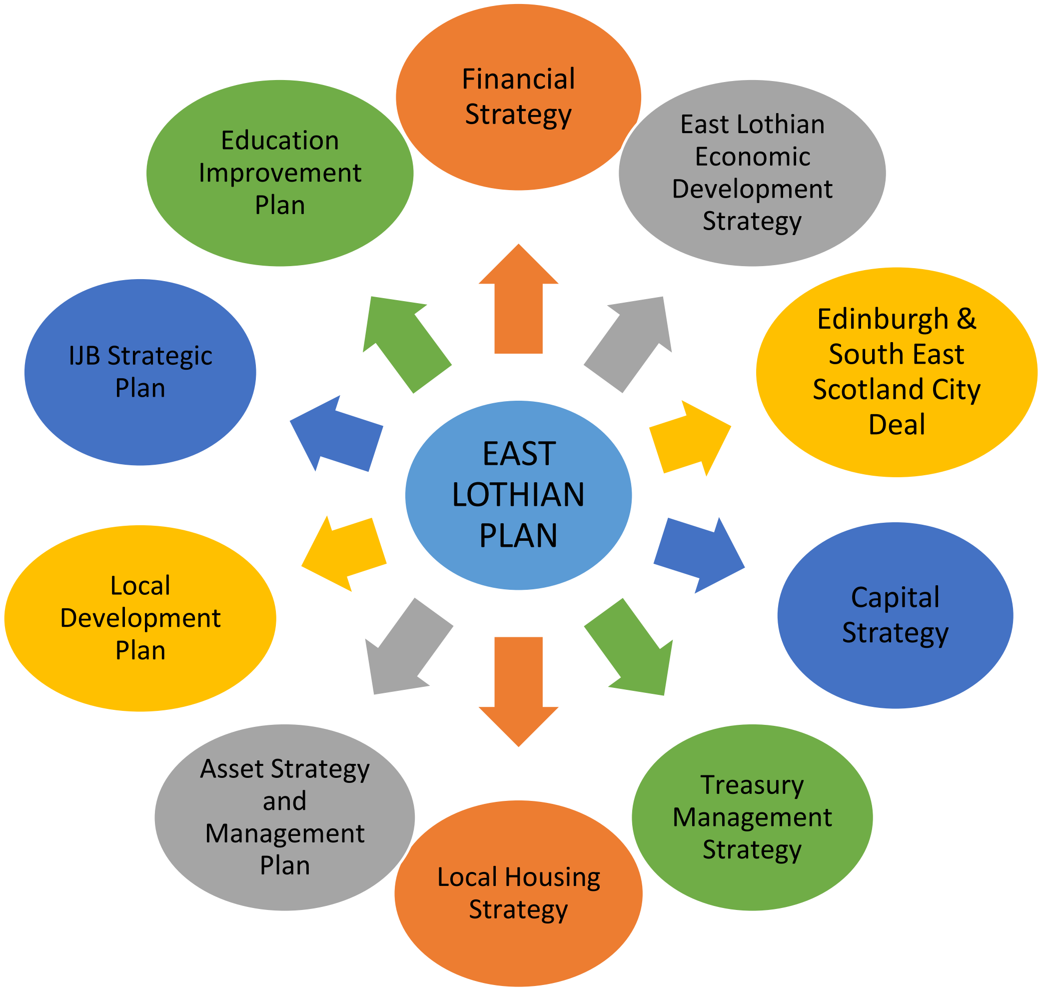
It is based around three overarching objectives that have been set in response to the three fundamental challenges we face:



The Council Plan sets out the Council's ambitious vision of '***an even more prosperous, safe and sustainable East Lothian with a dynamic and thriving economy that will enable our people and communities to flourish.'*** The Plan sets out how the Council will strive to achieve this vision with an overarching objective to '***Reduce inequalities within and across our communities'*** and four themes:

Growing our Economy	• *to increase sustainable and inclusive economic growth as the basis for a more prosperous East Lothian*
Growing our People	• *to give our children the best start in life and protect vulnerable adults and older people*
Growing our Communities	• *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*
Growing our Capacity	• *to deliver excellent services as effectively and efficiently as possible within our limited resources*

The Council Plan does not sit alone; it is part of a suite of strategies and plans which all focus on achieving the vision for East Lothian. These plans and strategies are pieces of the jigsaw (or Golden Thread) that form the whole picture of what the council and its partners are doing to achieve the East Lothian vision. They include:



In addition to the Council Plan, there are a number of complementary proposals and plans which will also drive the capital strategy. Examples are outlined below:

- The **Financial Strategy** sets out a number of requirements to assist capital investment decisions and importantly, manage the associated risk. For the Housing Revenue Account (HRA), the capital Strategy includes recommended limits from the Financial Strategy to maintain an appropriate long-term balance between the various elements of the HRA budget. The ratio of debt charges to income should be no more than 40%, maximising the use and application of capital receipts, capital grant and the level of Capital Financed from Current Revenue (CFCR) in order to minimise the future impact of debt charges. There is also a minimum reserves policy ensuring that the reserve or balance 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, and to help to mitigate against risks inherent in UK welfare reform proposals.
- The **Local Housing Strategy** is the sole strategic document for housing, bringing together a wide range of housing related priorities into one place and enabling a co-ordinated response in terms of action. The strategic vision for housing in East Lothian is to have healthy, sustainable homes in vibrant communities that meet increasing levels of need, reduce inequalities and improve wellbeing across all stages of people's lives. There is also a strong connection with the East Lothian Health and Social Care Partnership in providing specialist housing to enable independent living where appropriate and supporting the wider integration of health, social care and housing.
- The main aim of the **Local Transport Strategy** is to provide a mechanism for clean, green and safe travel patterns across the County and beyond. The strategy demonstrates how the Council has applied national, regional and local guidance to its operations. The vision for the Local Transport Strategy has been defined as; "East Lothian will have well-connected communities with increased use of sustainable transport modes to access services and amenities". There are four documents that support this strategy; Road Safety Plan, Road Asset Management Plan, Active Travel Improvement Plan and the Parking Management Strategy.
- The central purpose of the **East Lothian Economic Development Strategy** is to identify the opportunities which east Lothian can exploit to maximise its sustainable economic competitiveness. The strategy contributes directly to economic development objectives set out in the East Lothian Plan. Inclusion in the Edinburgh and South East Scotland City Region Deal is a key opportunity for East Lothian and it will be important to ensure East Lothian optimizes potential economic and social benefits through close partnership working including the opportunity to develop aligned initiatives and funding mechanisms available through the City Deal. Each project must take cognisance of the deal and capture benefits that can be delivered through it. The Cockenzie site is a central area of economic development and unlocking the site and adjacent assets is a key development opportunity for East Lothian.
- Effective management of fleet related assets is critical to the delivery and performance of council services. The **Sustainable Fleet Management Strategy** sets out and controls the management of council fleet related assets. "Our vision is to provide effective fleet procurement, management, and a workshop maintenance service, with a commitment to significantly reducing our reliance on fossil fuels and to make our assets environmentally sustainable within the UK and Scottish governments' timeline of key deliverables". All asset expenditure will be managed by Transport Services via an agreed sustainable replacement/maintenance plan, appropriately funded from dedicated budget allocations. Transport Services will work with services when additional / high cost assets are required that are outside of the approved replacement/maintenance plan to determine if the need can be met through existing wider fleet assets or confirm the need for service units to identify funds to cover such items.
- The **Climate Change Strategy** sets out the Council's vision and overall aims for a Net Zero Council and a Carbon Neutral East Lothian. It sets out what we will do over the next 5 years towards achieving these overall aims, and the specific targets and actions which will help progress towards achieving net zero.

- Capital spending on assets should be fully aligned to the Council's Asset Strategy and Management Plan and the annual review of the Capital Strategy will ensure that these are aligned as the strategies are reviewed and developed.
- The Council does not work in isolation to deliver capital investment for the county. 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:
    - **East Lothian Partnership Governance Group** whose core membership includes the partners who have statutory responsibility for governance under the Community Empowerment (Scotland) Act 2015.
    - **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.
    - 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.
- The Council is undertaking a Learning Estate Review to consider how the existing capital programme can meet the challenges of population growth and expanded early years' provision (1140 hours), creating environments that support excellence and equity. A Learning Estate Investment Plan (LEIP) is in place to outline how the Council intends to realise its ambitions to develop a modern, safe, sustainable learning estate that enhances and supports communities whilst improving the lives of families in an equitable manner.
- The Local Development Plan sets out the planning strategy and policies to guide growth and deliver new required infrastructure, in particular for education, community, transport and employment.

The current volatile economic environment will have an impact on the Council and its community in the years to come. It is essential that the capital investments are targeted to ensure it provides essential investment aligned to Council priorities, to 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.

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.
- 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 impact of additional net borrowing on the revenue account by ensuring that use of alternative sources of funding is maximised. The previous capital strategy imposed an upper limit on new borrowing for General Services of £150 million over the next five years to safeguard the revenue account from excessive debt charges. Given the significant and rapid increase in interest rates since this limit was set, this level of borrowing has now become unaffordable. Capital expenditure affordability for General Services will be controlled through regular, ongoing review by the Chief Finance Officer, with reference to overall borrowing levels and the impact of debt repayment charges on the revenue budget. The Capital Strategy for 2023/24 – 2027/28 therefore recommends that General Services capital expenditure affordability is controlled through regular review by the Chief Finance Officer, with reference to overall borrowing levels and the impact of debt repayment charges on the revenue account. With this in mind, the upper limit on new borrowing will be revised and recommended to Council for agreement as part of budget setting on 28 February. This will then be reviewed by the Chief Finance Officer at regular intervals throughout the year, and reported to Council through quarterly budget monitoring reports. To support this, a review of the governance arrangements in place to oversee the capital programme is under way, with a view to ensuring that these arrangements enable regular consideration of the overall affordability of the programme as well as monitor delivery. This will include strengthening the role of the Corporate Asset Group (CAG) and Capital Investment and Asset Management Group (CIAMG) to support the operational delivery of the capital plan and associated strategies, and ensuring that the newly created cross party sustainability forum enhances these arrangements.
- For HRA, the ratio of financing costs to rent income should not exceed 40%.
- 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 grants, 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 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.
- There is a commitment by the Council to identify Common Good assets to ensure that ongoing investment related to these assets is considered and funded appropriately.

GUIDING PRINCIPLES

APPROACH TO BORROWING

The Council is able to borrow money on the money market or from HM Treasury (via the Public Works Loans Board (PWLB)) to fund capital schemes or, on a short term basis, use its own internal resources (i.e. cash flow). However for all capital schemes initially funded from borrowing, the Council will have to fund the principal repayment and interest costs, these ongoing borrowing costs are unavoidable revenue consequences.

Borrowing can only be considered under the guidance contained in the CIPFA Prudential Code whereby, in summary, the Council is required to ensure that all borrowing is both prudent and affordable. The Prudential Code was revised in December 2021 and requires authorities to ensure that decisions for capital expenditure and investment plans are made with sufficient regard to the long run financing implications and potential risks to the authority and include effective due diligence.

The Council takes a prudent approach to capital investment decisions, paying particular regard to service objectives, value for money, sustainability and affordability. Prudential indicators such as the ratio of financing costs to net revenue are used as an indication of the impact of the capital investment plans on the Councils overall finances.

For any new capital business case, which is not self-funded, the responsible manager must, as appropriate, clearly identify and consider the ongoing revenue implications of:

- Fixed interest and principal repayment costs
- Any associated income streams and potential sensitivities
- Project sustainability
- Exit strategies and potential costs
- The relationship between asset carrying values (revalued net book value) in comparison to outstanding debt
- Demonstrating value for money

All of the above should be considered for the life of the asset.

Each business case must clearly identify and consider the ongoing Balance Sheet implications of:

- The expected change in the level of Council Debt
- Address how any changes in asset value would be funded i.e. impairments

- Maintenance of the asset to ensure sustainable use

The Council's Treasury Management Strategy provides further information on the Council's borrowing strategy for the coming financial year.

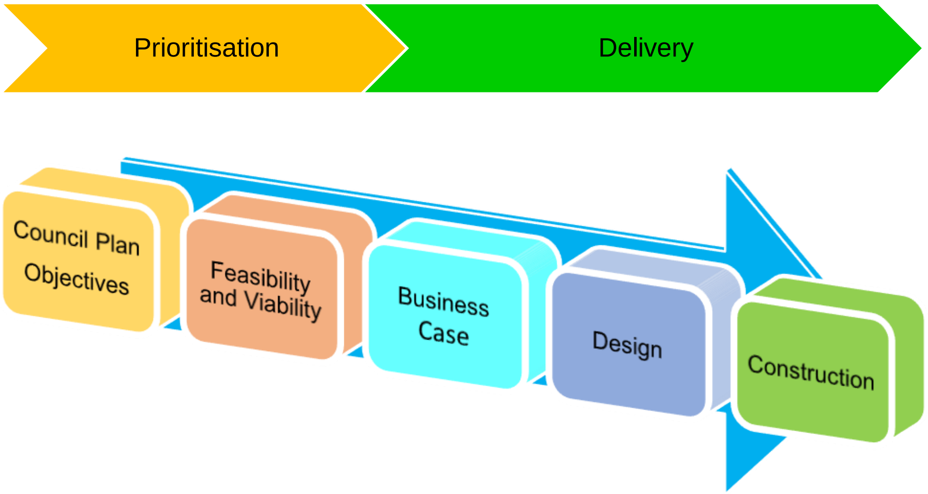
CAPITAL EXPENDITURE BUSINESS CASE

The Capital Business Case will identify the projected running costs and financing costs of the relevant asset and assess the affordability of the proposals both for the initial investment and over the life of the asset. In all cases, the capital expenditure and any ongoing costs must be sustainable in relation to the Council's medium term financial plans.

The business case should take consideration of:

- service objectives and alignment to the council plan;
- stewardship of assets, e.g. asset management planning;
- value for money, e.g. option appraisal;
- prudence and sustainability, e.g. risk, implications for debt and whole life costing;
- affordability, e.g. implications for council tax payers; and
- practicality, e.g. achievevability of the forward plan.

Each project is brought through a standard process characterised by the following stages, which focus and reduce the options taken forward:



PRIORITISATION AND APPROVAL

It can be difficult for a Council to make choices between competing priorities considering the varied and many services that it provides, balancing delivery of Council Plan objectives against wider statutory obligations within the constraints of affordability. It is the responsibility of senior officers and members to consider and prioritise the competing demands for capital resources in the context of local government funding awarded.

Like many public sector bodies, the Council has experienced significant delays in the physical progress of projects against the approved profile and some cost overruns. This can be directly linked to the size of the programme, capacity to deliver and over optimism about the project in terms of cost, time and external factors outside of the Council's control. When capital schemes are approved their inclusion into the capital programme is based on best estimates and slippage is measured against the approved profile at the end of the financial year. The Council will need to ensure that all projects being proposed for inclusion can be delivered within the timeframe and budget stated prior to programme entry. Resource capacity and size of the programme will need to be assessed annually as part of the budget setting process and a business case assessment of the potential delivery of major projects, as well as at a programme level, should be carried out annually.

When developing a proposal for inclusion within the capital programme, the proposal must meet at least one of the following criteria:

- **The expenditure is required for statutory reasons, for example to ensure that an asset meets any health and safety requirements;**
- **A self-funding scheme which fits in with strategic planning priority outcomes;**
- **A priority scheme with significant external funding;**
- **A scheme directly focused on Council Plan priority outcomes.**
- **A scheme which will support the delivery of recurring savings within the Councils revenue budget**
- **A scheme which will deliver significant social and health benefits within the housing provision**

It is essential that capital proposals take cognisance of the associated revenue consequences of the initial investment, and demonstrate that these will be affordable on an ongoing basis.

The Council maintains and reports on a rolling five-year capital plan (including its funding) which is updated and reported to the senior leadership team and members on a quarterly basis. The capital plan will include any capital expenditure re-profiling in the previous quarter.

The capital programme is subject to annual approval by Council and it should be noted that any new schemes being added to the programme outside of the budget setting process would also be subject to approval. Reports and business cases must be submitted to an appropriate group for example (CIAMG (Capital Investment and Asset Management Group) for CAG (Corporate Asset Group), LESM (Learning Estate Senior Managers), HRA Programme Board) prior to formal political approval at Cabinet/Council.. There are many groups which consider different elements of the capital plan, and these governance arrangements are currently under review to ensure alignment to the newly established cross party political oversight groups.

The key stages in the Council's prioritisation and approval process for new capital schemes are as follows:

1. The business case can be submitted where a proposal meets the key considerations and Council objectives shown above. The business case would then be considered for progression by the Executive Director for Council Resources and the Head of Finance. Unless there are extenuating circumstances this would be during the capital budget setting process only.

2. For a specific scheme to be approved/funded there will be a requirement for a detailed capital business case. After the initial submission noted above, the capital business cases will be taken through to a wider consultation with the senior leadership and executive teams. Business cases should include evidence of an options appraisal process and its considerations.

   If a change in a scheme is to be funded from a previous approval from Council, for example a timing change in construction with no impact to the overall cost of the project, re-profiling of the scheme will be carried out as part of the capital budget setting or monitoring process. This may be a re-profile for slippage or acceleration, depending on circumstances, approval and the maximisation of grant funding opportunities.

If new and confirmed funding is to be used for a scheme to be funded by e.g. a specific grant and if the scheme is supported by the Executive Director for Council Resources, it will be reported to Council.

If a project has a change in cost estimates or scope, an updated business case should be provided which will then go through for Council approval.

Business cases will be subject to annual review and updates, and will incorporate key information required to determine initial and ongoing revenue consequences.

3. Any proposals for invest to save schemes, which are usually funded from prudential borrowing, will also require a detailed business case.

4. Where there is a proposal to transfer capital resources from a previously approved scheme to a new scheme and therefore there is a change to “policy”, the new scheme should be approved by Council with a detailed business case.

5. The Council Management Team, Corporate Asset Group and HRA Programme Board alongside Cabinet/Council have responsibility for the oversight and challenge on the delivery of the capital plan including slippage and outcomes.

6. The Council Management Team and Cabinet/Council will receive three quarterly monitoring reports and one outturn report each financial year.

MANAGEMENT AND MONITORING OF THE CAPITAL PLAN

The key objective of the Council’s management and monitoring of the Capital Plan is to ensure that all Members and the Council Management Team (CMT) have visibility of the capital plan and the approval of individual capital projects to encourage collective responsibility for the capital expenditure on a project and the success of the schemes themselves.

The Council’s CMT should ensure that progress against the programme, in terms of expenditure and timescales, is in line with what has previously been agreed. Where projects are exhibiting cost overruns or delays in the completion schedule, these should be addressed promptly.

Arrangements for approval and monitoring of the capital plan are shown in the Prioritisation and Approval section above, with further information provided within the Executive Director of Council Resources Report below.

GRANT ALLOCATIONS

The Council receives general capital grant funding from the Scottish Government as part of the annual Local Government Settlement. Councils are able to spend this on capital projects that meet local and national priorities to deliver their Single Outcome Agreement or the national Strategic Objective and Purpose.

The Council will consider any possible flexibility in funding streams to seek to ensure that funding is deployed to provide maximum benefit in line with the paramateters of the legislation.

Specific Capital Grants, also known as specific purpose grants or ring-fenced grants, are also received and may only be used by local authorities to fund specific capital expenditure. The terms and conditions of each grant are set out separately in the grant offer letters.

The government provides local authorities with some Specific Capital Grants through the Local Government Finance Settlement. Additional Specific Capital Grants are paid to local authorities in Scotland outwith the Local Government Finance Settlement.

The Council can bid for additional external grant funding outwith these funding routes, aligned to support corporate priorities or statutory service objectives and where it can be proved that the project is sustainable, and requirements for match-funding and future revenue consequences have been considered and approved.

CAPITAL RECEIPTS AND CAPITAL CONTRIBUTIONS

The Council receives capital receipts and contributions from:

- Asset Disposals – all capital receipts will be held corporately and used to fund future capital investments or offset debt charges.
- Developer Contributions – unless there are service specific conditions on the use of the contribution, the monies will be used to support existing council priorities and commitments rather than be allocated to new schemes.
- Second Homes Council Tax payments – used for the provision of affordable housing.

- Grant funding from other bodies

The Council is able to use revenue funding and reserves for capital schemes. However, as a result of competing revenue budget pressures and the continued reduction in government support for revenue expenditure, the Council's policy is generally not to budget to use revenue or reserve funds to directly fund capital projects after the feasibility stage.

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. This remains subject to regular ongoing review.

- 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. Generally capital receipts will be treated as a corporate resource. 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.

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. These 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.

Some flexibility has already been applied relating to loans fund repayment holiday during 2021-22, with national discussions on-going seeking clarity on the application of these flexibilities. The application of any wider fiscal flexibilities going forward may be considered depending on further national clarity, the impact of which may have future implications for both future capital investment and revenue plans as well as borrowing requirements.

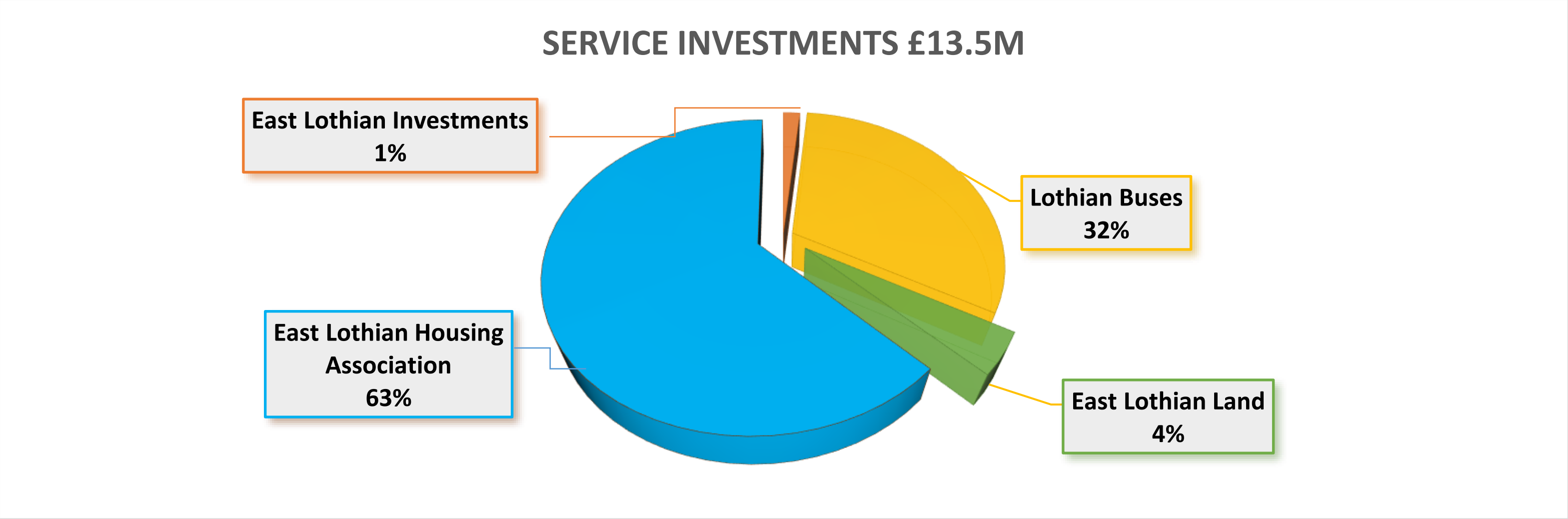
ALTERNATIVE FUNDING AND DELIVERY OPPORTUNITIES

The Council, as appropriate, will continue to consider other methods of supporting capital expenditure within East Lothian and can use its assets to support schemes or aim to maximise funding from any source possible.

The Council continues to bid for additional external funding and/or work with other bodies to secure capital investment or consider use of its own assets in a development, but restricts schemes to those that support corporate priorities or statutory service objectives and where it can be proved that the project is sustainable. Requirements for match-funding and future revenue consequences must be considered and approved along with an assessment of the opportunity costs of alternative options. All schemes are to be agreed with the Executive Director for Council Resources prior to submission and/or contractual commitment.

PROPORTIONALITY OF NON-TREASURY INVESTMENTS

Non-treasury investments include material investments in subsidiaries, joint ventures, loans to third parties and financial guarantee activities and are separate from the day-to-day treasury management activities. The Council holds non-treasury investments in East Lothian Land, East Lothian Investments, East Lothian Housing Association and Lothian Buses to the value of £13.5 million. The Council also holds investment balances with Investec for Common Good and Trusts. Non-Treasury Investments represent investment for service reasons to meet the needs of the people of East Lothian. They are investments for areas such as transport, investment in growth for the county and social housing. They do not generate a return in monetary terms but result in a social, economic or environmental gain.



ASSET DISPOSAL STRATEGY

Purchases of assets are primarily to be retained in the long term. However, the Council Management Team will regularly review the asset base to consider where the costs of maintaining any assets outweigh the ability of the asset to fulfil its role in the delivery of services. The review will need to consider the resulting impact on the Council's operational delivery and any costs of disposal.

The strategy for fleet assets is that where the fleet life has not expired but due to either reliability, being beyond economical repair or unable to be reallocated due to changes in service requirements, assets will be disposed. Where the fleet life has expired, either an asset will be held for ongoing use or sent to auction for disposal. Auction disposal provides transparency and provides best disposal value. At all times when considering fleet replacement/disposal overall fleet efficiency is a key consideration.

The strategy for asset disposal is that if an asset is no longer required for service delivery and does not meet the criteria for retention or for inclusion within the non-operational property portfolio, the asset will be declared surplus to the Council's requirements and will be placed on the market for sale. Where a market sale may not be achievable, for example if the market is depressed, retention and inclusion of the asset within the non-operational property portfolio may be considered, provided the following criteria are met:

- market demand – there is a good letting prospect
- suitability for inclusion in the non-operational property portfolio
- good revenue potential with minimal short to medium capital outlay
- good potential for medium to long term capital growth

There is also the option for a community asset transfer to take an asset out of use by the Council. Part 5 of the Community Empowerment Act from the Scottish Government introduced a right for community bodies to make requests to all Scottish Local Authorities, Scottish Ministers and a range of public bodies for any land or buildings they feel they could make better use of. A request can be made for ownership, lease or other rights as they wish. The Council must transparently assess requests against a specified list of criteria, laid out in the Act, and agree the request unless there are reasonable grounds for refusal.

Surplus assets are managed during the disposal process to minimise vacant property, maintenance and security costs.

All capital receipts will be held corporately and used to either offset debt charges or fund future capital investments.

TRAINING AND SKILLS

The Corporate Finance Capital and Treasury teams have responsibility for both the preparation of and on-going management of the capital and treasury management strategies and Capital Programme. The team is staffed by professionally qualified accountants with extensive Local Government finance experience. Team members attend relevant training courses, workshops and events to ensure that their knowledge and skills are up to date and the Council is in a position to address all new technical developments. They follow a Continuous Professional Development Plan (CPD) as part their individual accountancy accreditation. The overall responsibility for capital and treasury activities lies with the Council’s Section 95 Officer who, in accordance with statute, is professionally qualified and is suitably experienced to hold the post.

The Council aims to provide training to Members on a regular basis, which is delivered by Council officers and external advisors. This ensures Members have a full understanding of key issues and have the appropriate knowledge and skills to make capital and treasury decisions. Members are updated on developments and issues of significance throughout the year, with information presented to the Audit and Governance Committee (for Treasury Management), Cabinet and Council meetings as part of the Financial update (monitoring) reporting.

The Council currently uses the Link Group, Treasury Solutions as its external Treasury Management advisors and recognises that it is essential to engage with external providers of Treasury Management services in order to acquire access to specialist skills and resources.

TREASURY MANAGEMENT LINKS

All capital decisions to be funded by prudential borrowing will directly affect the Council’s Treasury Management activities. The level and timing of the capital expenditure will be reflected in the capital plan once approved and in the strategic cash flow forecasts to plan for the required borrowing.

The resulting costs and any income to fund those costs will be included in the standard budget monitoring and budget setting process. The annual setting of both the Operational and Authorised Limits (for borrowing) will also monitor total borrowing.

BALANCE SHEET CONSIDERATIONS

The impact of capital projects and any prudential borrowing taken have an impact on the Council's balance sheet.

1. Increase in the value of the Council's non-current assets
2. Increase in the Council's long-term borrowing
3. Maturity profile of borrowing and repayment of borrowing
4. Profile of loans fund repayments
5. Increase/decrease in Capital Financing Requirement (CFR)
6. Annual depreciation on operational assets
7. Regular revaluation or impairment on operational assets
8. Impact on Council's cash flow in delivery stage or on purchase
9. Impact on Council's cash flow at time of borrowing

EXECUTIVE DIRECTOR OF COUNCIL RESOURCES:
STATEMENT ON DELIVERY, AFFORDABILITY AND RISK OF THE CAPITAL STRATEGY

BACKGROUND

The capital strategy is designed to comply with the requirements of the CIPFA Prudential and Treasury Management Codes and the relationship between the Council's capital programme funding and the resulting treasury management activity and the implications for future sustainability considering affordability and sustainability.

SUMMARY OF THE BORROWING POSITION

The table below shows the Council's current forecasted borrowing position and borrowing need including the Capital Financing Requirement (CFR). The CFR is the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is a measure of the Council's indebtedness and the underlying borrowing need. Any capital expenditure which has not immediately been paid for through a revenue or capital funding stream, will increase the CFR.

The Council has a number of on-going Public Private Partnership (PPP) and lease arrangements shown as Other Long-Term Liabilities (OLTL) in the table below. The Council currently had £35.356m (at the end of 2021/22) of OLTL within the CFR.

The Council's actual level of borrowing at the end of 2021/22 was £458.540m. The Council is currently in an under borrowed position. Under borrowing is the difference between the CFR and external debt. This means that the capital borrowing need is not fully funded by external debt but is supported by the Council's reserves and working balances as a temporary measure.

Actual Debt and the Capital Financing Requirement (CFR)
(including Other Long Term Liabilities)

£'000	2021/22 Actual	2022/23 Q2 Estimate	2023/24 Estimate	2024/25 Estimate	2025/26 Estimate	2026/27 Estimate
External Debt						
Debt at 1 April	365,549	424,761	496,372	571,834	596,532	631,210
Expected change in Debt	59,212	71,611	75,463	24,698	34,678	21,347
Other long-term liabilities (OLTL)	35,356	33,779	32,213	30,686	29,103	27,243
Expected change in OLTL	(1,577)	(1,566)	(1,527)	(1,583)	(1,860)	(2,096)
Actual gross debt at 31 March	458,540	528,585	602,520	625,635	658,453	677,704
Capital Financing Requirement	511,228	582,883	660,119	698,765	720,318	737,285

The CFR does not increase indefinitely, as annual repayments from revenue are made which reflect the useful life of capital assets financed by borrowing. The repayment of loans fund advances ensures that the Council makes a prudent provision each year to pay off an element of the accumulated loans fund advances made in previous financial years as per Section 2.3 of the Treasury Management Strategy 2022/23.

The operation of the loans fund is regulated by statute, with updated regulations: (The Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016 (the 2016 Regulations)) being in force from 1 April 2016.

It is important to note that the Council has for a number of years been projecting a significant borrowing requirement but has not yet needed to undertake the full projected borrowing as there has been reprofiling of the Capital programme and working balances available, resulting in an under borrowed position.

EXECUTIVE DIRECTOR OF COUNCIL RESOURCES REPORT

The Prudential Code states that it is the responsibility of the Council's Chief Finance Officer (Executive Director for Council Resources) to explicitly report on the affordability, deliverability and the risks associated with this Strategy. These key elements are set out in the following paragraphs.

Affordability is a key criterion when considering whether a project should be approved for inclusion within the Capital programme. Before any decisions are made, new schemes must be underpinned by a business case identifying the expenditure and funding, appraisal of alternative options and the risks and rewards associated with the scheme. The Business Case preparation and consideration process is set out fully in the Capital Business Case and Prioritisation and Approval sections of this Strategy.

All projects must also have a clearly identified capital funding source with a definite commitment of financial support if external funding, such as an external grant, is to be used. Also, there must be an identified source of funding to support any on-going revenue costs associated with the use of a capital asset, and these must be built into future years financial projections.

Where borrowing is to be used, the affordability test is the ability to fund interest costs linked to the borrowing, together with the statutory repayment of the borrowing (the loans fund charge). This repayment is matched to a prudent asset life and any income streams estimated to fund this asset must be sustainable. The 2016 Regulations set out the requirements for the appropriate governance of such borrowing and the Council's processes comply with the requirements of the Regulations.

The **delivery** of the individual projects within the Capital Programme is directly linked to the process of approving the capital scheme. Each scheme has a project sponsor and a manager responsible for the delivery and the subsequent achievement of the scheme objectives.

The Corporate Asset Group (CAG) meets on a regular basis to discuss and make decisions on areas such as the Community Intervention Fund and any Community Asset Transfer requests as well as the wider capital plan. The Asset Project Board meets on a monthly basis to discuss and support the asset review and a Cross Party Sustainability Forum has been established to provide political oversight on wider sustainability which will include assets and alignment to the Cross Party Budget Working Group.

Project updates are provided at the regular meetings of CMT as well as an overarching update on the Capital Programme. This facilitates the review and challenge to the delivery of projects and any changes to both the timing and value of the programme. In addition, an annual Financial Review of the Capital Programme is completed each year and submitted to full Council. The financial review process should ensure that all schemes are examined to determine whether they are still aligned to corporate priorities. In year quarterly reporting also considers the deliverability and progress of schemes including any reasons for delayed starts or variations to approved budgetary allocations. It also considers re-profiling of planned expenditure and identifies any unutilised or underutilised resources, which could be reallocated to other projects.

The Council's senior officers also have the opportunity to review and challenge project and programme delivery via monthly updates on the changes/re-profiling of expenditure.

The Council is exposed to a range of **risks** with regard to the continued affordability and delivery of the Capital Programme as follows:

- Financial risks related to the investment of the Council's assets, cash flow and market volatility;
- Macroeconomic risks related to the growth or decline of the local economy, interest rates, inflation and the wider national and global economy. Of particular relevance in this regard is the legacy of the COVID-19 pandemic and Brexit which some commentators believe has contributed to significant increases in material prices and supply chain disruption across the construction industry.

- Inflationary pressures currently being experienced may have adverse financial implications for other approved capital projects that are currently under development;
- Insurance risks whereby some contractors are either unable or unwilling to put policies and cover levels in place which meet the Council's requirements. Equally, some insurers are broadening the scope of policy exclusions which may mean some construction risks are uninsurable;
- Credit and counterparty risks related to investments, loans to public and private institutions;
- Operational risks related to operational exposures within its organisation, its counterparties and partners;
- Strategic risks related to key initiatives undertaken by the Council such as areas of organisational change deemed necessary to enable the Council to meet its goals and objectives, significant capital schemes, major acquisitions and new ventures;
- Reputational risks related to the Council's dealings and interests, and the impact of adverse outcomes on the Council's reputation and public perception;
- Environmental and social risks related to the environmental and social impact of the Council's strategy and interests. This is a risk that is becoming more high profile given the recent national and international publicity in relation to climate change;
- Governance risks related to ensuring that prudence and careful consideration are prominent in the Council's decision-making, augmented by quality independent advice and appropriate checks to ensure that the Council has the correct level of oversight, scrutiny and efficiency; and
- Risks arising from a financial commitment by the Council in line with Government policy when that policy is then changed mid-stream leaving the Council to manage the position.

CONCLUSION

Managing the Council's risks is an area of significant focus for senior management and Members. It is important to recognise that there are significant risks associated with a large capital programme and associated borrowing, but as far as possible these are mitigated as part of the Council's Treasury Management Practices.

As advised above, where there is a robust capital business plan process, project management arrangements and/or project boards in place and all projects are delivered by suitably skilled staff. Appropriate consideration is also given to tax (VAT) planning, cash flow and the operational planning and resource implications for the use of any asset. Governance is addressed by the establishment of officer/Member working groups with regular and transparent reporting. Due diligence is undertaken on loans and purchases and external advice is sought where necessary.

There are clear links from the Capital Strategy to the Financial Strategy and Treasury Management Strategy, prudential indicators, authorised borrowing limits and the revenue budget. These are also subject to review and oversight by Members at Audit and Governance Committee, Cabinet and Council.

Risk increases with any new borrowing and officers and members must be mindful of this when considering funding arrangements for capital investment. New borrowing will increase the Council's annual level of fixed interest and repayment costs which are already currently forecast to increase in the coming years and could have a borrowing liability of £652.556m by the end of 2026/27.

Because of this, monitoring and reporting arrangements must allow for capital plans to be regularly revisited and updated with reference to ongoing considerations around prudence, affordability and sustainability.

The pace and level of change in the Council's borrowing is still significant and all members need to be fully informed as to all implications of its capital investment decisions with particular bias on those funded from borrowing.

APPENDIX A

KEY RATIOS AND PRUDENTIAL INDICATORS

Note: Years 2023/24 – 2026/27 are budgets approved in March 2022

Ratio of financing costs to revenue stream

	Year End 2021/22 £'000	Qtr 2 2022/23 £'000	Estimate 2023/24 £'000	Estimate 2024/25 £'000	Estimate 2025/26 £'000	Estimate 2026/27 £'000
General Services						
GS Revenue Stream	279,553	276,375	284,739	293,103	298,965	304,944
GS Financing Costs	11,500	14,500	13,486	19,229	18,435	18,473
Ratio - Financing/Revenue Stream	4.11%	5.25%	4.74%	6.56%	6.17%	6.06%
HRA						
HRA Revenue Stream	36,194	34,713	37,288	39,662	42,321	45,380
HRA Financing Costs	10,494	11,592	13,963	15,021	16,531	18,119
Ratio - Financing/Revenue Stream	28.99%	33.39%	37.45%	37.87%	39.06%	39.93%

Actual Debt and the Capital Financing Requirement (CFR) – excluding Other Long Term Liabilities

	Year End 2021/22 £'000	Qtr 2 2022/23 £'000	Estimate 2023/24 £'000	Estimate 2024/25 £'000	Estimate 2025/26 £'000	Estimate 2026/27 £'000
Total External debt at start of year	365,549	424,761	496,371	571,834	596,532	631,210
Expected/Actual change in debt	59,212	71,611	75,463	24,698	34,678	21,347
Actual/Estimate gross debt at 31 March	424,761	496,371	571,834	596,532	631,210	652,556
The Capital Financing Requirement	477,448	550,670	629,433	669,662	693,075	712,137
(Under)/Over borrowing	(52,688)	(54,299)	(57,599)	(73,131)	(61,865)	(59,581)

Authorised Limit for External Debt

	Year End 2021/22 £'000	Qtr 2 2022/23 £'000	Estimate 2023/24 £'000	Estimate 2024/25 £'000	Estimate 2025/26 £'000	Estimate 2026/27 £'000
Borrowing	519,000	602,000	677,000	735,000	738,000	749,000
Other long term liabilities	34,000	33,000	31,000	30,000	28,000	26,000
Total	**553,000**	**635,000**	**708,000**	**765,000**	**766,000**	**775,000**

Operational Boundary for External Debt

	Year End 2021/22 £'000	Qtr 2 2022/23 £'000	Estimate 2023/24 £'000	Estimate 2024/25 £'000	Estimate 2025/26 £'000	Estimate 2026/27 £'000
Borrowing	477,448	550,670	629,433	669,662	693,075	712,137
Other long term liabilities	33,775	32,209	30,682	29,099	27,240	25,143
Total	**511,224**	**582,879**	**660,115**	**698,761**	**720,314**	**737,281**

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