East Lothian Council

REPORT TO:	East Lothian Council
MEETING DATE:	11 December 2018
BY:	Depute Chief Executive (Resources & People Services)
SUBJECT:	Financial Strategy 2019-2024

1 PURPOSE

1.1 This report sets out an updated Financial Strategy for the Council, covering a five-year period from 2019-2024, also incorporating the new requirement to produce a Capital Strategy.

2 RECOMMENDATIONS

2.1 The Council is recommended to:

- Approve the Financial Strategy set out in **Appendix 1** of this report together with the new Capital Strategy included at **Appendix 2**.
- Approve the further refinements to the new budget development process, set out in paragraph 3.6 of this report.

3 BACKGROUND

3.1 The current approved Financial Strategy was approved by Council in December 2017 and covers a five-year financial planning period from April 2018 until March 2023. It is important that each year the Strategy is refreshed to reflect any changes in the financial planning landscape and ensure that the Strategy which is set remains appropriate.

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

3.3 The 2017 Prudential Code has introduced a new obligation upon Local Authorities to produce a capital strategy. The purpose of the capital strategy is to firmly place decisions around borrowing in the context of the overall longer-term financial position of the authority and to provide improved links between the revenue and capital budgets. The Capital Strategy is set out in Appendix 2 of this report.

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

Budget Process

3.5 The budget development framework was approved by Council in October 2018 as part of the Financial Prospects report. The key variables of the framework are set out below.

- DRAFT budget proposals (covering both General Services and HRA) are developed by the Administration and considered by Cabinet in January 2019 covering both revenue and capital budgets.
- Other Political Groups will have the option to develop any amendments to the Administration budget, with formal proposals to be considered by Council at the Council meeting in February, where the Council budget for both General Services, HRA and Council Tax setting will be approved.

3.6 Similar to last year and reflecting the decision already taken in October, the following arrangements will be put in place to support any budget amendments which may arise between the Administration draft budget and the Council's special budget-setting meeting currently scheduled for 12 February 2019:

- Any amendment to be made against the Administration's Draft Budget Proposal approved by Cabinet in January can only be made through Party Group Leaders.
- All amendments must be presented to Council in the form of an alternative budget proposal based around the Administration draft. The amendment must be deemed competent, both in its ability to be delivered as well as ensuring that it can still deliver a balanced budget.
- Political Group Leaders may work with the Finance Team on any potential budget changes which may be reflected within proposed amendments. Any final amendments to be considered by Council at the February Special Meeting must be submitted through Group Leaders to the Chief Financial Officer (delegated to the Service Manager, Business Finance) **<u>no later than Friday 1 February 2019</u>**.

3.7 Should Council wish to approve this framework for amendments in respect of the budget development process, this will require a specific departure from existing Standing Orders and therefore would require the support of two-thirds of those who are present at the meeting.

4 POLICY IMPLICATIONS

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

5 INTEGRATED IMPACT ASSESSMENT

5.1 The subject of this report has been considered and given there is no direct change in policy direction, there is no immediate requirement to undertake any further impact assessment.

6 RESOURCE IMPLICATIONS

6.1 Financial – as set out within the strategy

6.2 Personnel - none

6.3 Other – none

7 BACKGROUND PAPERS

7.1 Council 19 December 2017 – Item 4 – Financial Strategy 2018-23

7.2 Council 30 October 2018 – Item 4 – Financial Prospects 2019-20 and Beyond.

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DATE	30 November 2018

Appendix 1

Financial Strategy

2019-20 to 2023-24

Financial Strategy 2019-20 to 2023-24

1 Introduction

1.1 The Council continues to operate in an uncertain and challenging financial environment. There remains significant uncertainty around the wider economic impact on the UK and Scotland arising from the UK's departure from the European Union at the end of March 2019. The recent UK budget announcement at end of October, whilst indicating some additional resource to Scotland, is unclear as to how this will be prioritised within the overall Scottish Government budget. However, the funding priorities set out in the Scottish Government's Five Year Financial Strategy suggest that there is limited scope that any additional resource will be directed towards local government.

1.2 The Council has one of the fastest areas of growth in population across Scotland, rising by around 17,000 by 2037. As part of this, it is estimated that the number of older people over the age of 75 will double, and the number of children under the age of 15 will grow by over 15%.

1.3 Current forecasts indicate that it is highly likely that the Council will receive further reductions in grant funding over the next few years, and this alongside the growing demand for services, suggests that there will be a requirement to deliver significant, additional budget reductions going forward to ensure that services can be delivered within a balanced budget.

1.4 The purpose of the financial strategy is to provide clear direction on how the Council will manage its financial resources in the medium to long term to ensure they are deployed effectively to achieve corporate objectives. It plays a vital part of decision-making and forms the basis of the Council's stewardship over taxpayers funds. Given the extent of financial challenges ahead, it remains essential that the Financial Strategy enables the Council to develop a better understanding of the wider policy and financial environment within which it operates, and ensure that it can identify and respond flexibly to opportunities and threats, and manage and mitigate risks whilst ensuring that financial resources are contributing to achieving Council objectives and outcomes. The principal objectives of the financial strategy are:

- Outline the Council's high level financial position over the years 2019-2024 based on a range of assumptions.
- Highlight the key influential issues that have been considered in developing the strategy.
- Ensure that limited available resources are focused on delivery of the Council's key priorities.
- Provide a financial planning platform for a sustainable revenue budget and capital investment programme which will support the Council's key priorities.

- Ensure that the Council is fully aware of the financial challenges and uncertainties that it faces and is in the strongest possible position to deliver the best possible quality and range of services within available resources.

- Increase both organisational awareness and wider community understanding of the Council's financial position and the challenges it is facing over the medium term in balancing its budget.

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

1.6 The Strategy covers the five year planning period from 2019-20 to 2023-24 and includes both the General Services and Housing Revenue Account (HRA) revenue and capital budgets.

2 Current Economic Context

2.1 The Financial Prospects report which was considered and approved by Council in October 2018 set out the financial context within which we are currently operating and many of the key pressures that may impact on the way in which the Council spends its limited resources.

2.2 With so many external influences currently impacting on the wider economy, forecasting remains very difficult. At the time of writing, discussions are still on-going to agree the final terms of the departure for the UK leaving the European Union at end of March 2019. This creates significant uncertainty around the wider impact on the UK and indeed Scottish economy. Balancing the public sector books currently places a considerable reliance upon economic growth but if there is either a downturn or further slowdown in economic activity within the UK this could lead to a prolonged period of public sector expenditure restraint.

2.3 In Scotland, as well as any limitations imposed through the UK Budget, the spending available to Scottish Local Government is dependent on the Scottish Government's budget priorities. The Scottish Government have signalled through their Five Year Financial Strategy published in May 2018, their continued policy commitments which will require significant investment. These areas are:

- Health: to increase NHS resource spending by £2bn over the parliament.

- Police: to protect the resource budget of the Scottish Police Authority in real terms over the parliament.

- Early Learning and Childcare: to increase resource funding to local authorities to £567m annually by the end of the parliament to support 1,140 hours per year of childcare.

- Attainment: to allocate £750m to the Attainment Scotland Fund over the parliamentary term.

- Higher Education: to continue to allocate £1bn each year to the sector.

- Social Security: to deliver a more generous Carer's Allowance Supplement from 2018 and a new Best Start Grant (replacing Sure Start Maternity Grant) from 2019.

2.4 Whilst some of these priorities may directly benefit Local Government spending, these elements are targeted at specific policy areas such as Early Learning & Childcare. In recent years Local Government's core settlement, on a like-for-like basis, has declined by more than headline reductions suggest. If the Scottish Government's overall resource budget continues to fall in real terms, then there may be a greater than proportionate impact on 'other' areas of spend (those that are not mentioned as a specific priority), and a continued squeeze on Local Government services remains most likely.

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

2.6 The most recent UK Government budget announced in October 2018, has indicated an overall increase in cash resource of £679m, most of which has already been earmarked as Barnett consequentials that will flow through to Health. The Scottish Government will now publish its draft budget on 12 December 2018 to allow a full 10 week period for the Parliamentary Subject Committees to complete their pre-Budget scrutiny, and we await to see the outcome on the Local Government settlement generally and specifically for East Lothian Council.

3 Local Context

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

Council Plan

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

Local Development Plan (LDP)

3.3 The Council now has an approved Local Development Plan (LDP). This plan will require the building of an additional 10,050 homes in East Lothian by 2024, and with it will see a rapid expansion in population across the area, with estimated population growth of an additional by 17,000 to 120,000 by 2037. This will impact on the wider demography within the area, with significant growth in particular in the number of school-age children and the number of pensioners.

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

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

Changing Public Sector Landscape

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

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

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

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

3.10 A joint review of Local Governance is currently being undertaken by Scottish Government and COSLA, which focuses on all public services not simply councils, and both national and local spheres of government. The review includes two strands; Strand 1 focuses on a programme of 'Democracy Matters' community engagements being coordinated by an Enabling Group involving a range of organisations from public services, the third sector and wider civic Scotland. Strand 2 of the Review involves the Scottish Government, local authorities, CPPs and other public-sector organisations proposing approaches to governance, powers, accountabilities or ways of working that could improve outcomes, reduce inequalities, and improve democracy locally. The Council has established a cross party working group that will make a response to the review.

4 General Services Revenue Budget – Medium Term Outlook

4.1 Despite the many uncertainties facing Scottish local authorities, in particular those arising from reduction in Government funding, the need for medium to longer term financial planning is becoming increasingly important. Councils must ensure that they have robust financial plans in place to mitigate any potential impact arising from a wide range of variables highlighted earlier in this report. This need for medium to longer term financial planning is promoted by Audit Scotland both nationally and locally to help ensure longer term financial sustainability in the delivery of public services.

4.2 With this in mind, the October 2018 Financial Prospects report set out scenario based financial modelling across a 5 year planning horizon. These assumptions were based on the approved 3 year budget, and have now been updated to reflect latest assumptions and extended to cover a new financial year 2023/24.

4.3 A summary of the Spending Plans for 2018-21 approved by Council in February 2018 are set out in the table below.

General Fund – Revenue	**2018-19** **£'000**	**2019-20** **£'000**	**2020-21** **£'000**
Approved Expenditure	237,337	236,889	239,992
Financed by:			
RSG (including NDR)	169,053	167,840	167,840
Other Government Grants	9,383	9,383	9,383
Council Tax	56,690	59,595	62,698

Other	71	71	71
Transfer from Reserves	2,140	0	0
TOTAL	**237,337**	**236,889**	**239,992**
Delivery of Planned Efficiencies (contained in above)	**5,017**	**5,612**	**1,894**

4.4 The current spending plans remain crucially dependent on services being able to both manage existing spending commitments within available budgets as well as the delivery of already planned efficiency savings. In total the current approved spending plans require that around £12.5 million of additional efficiencies are delivered between 2018-19 and 2020-21. Whilst substantial progress has been made in the delivery of these new savings proposals, the delivery of this level of savings over the next few years does not come without significant challenges. Any delays regarding the implementation and delivery of these recurring savings will create further problems, and ensuring that the Council has resilient plans in place to minimise any potential delays, or accelerate any new efficiency programmes remains critical.

4.5 Effective monitoring of the in-year financial position remains critical. The 2018-19 quarterly reports have continued to highlight significant service pressures, and a number of service areas are at a High Risk of overspending and consequently have been asked to develop and implement cost recovery plans with enhanced financial controls and additional monitoring checks are now in place. Current forecast projections for the Council suggest there is a High risk that the Council will overspend during the year. Officers are working hard to identify further options to manage any overspend but it remains challenging. Any overspending during 2018-19 may have a recurring impact on future year spending plans, and the ability to address the in-year and crucially the recurring nature of these overspends remains critical in assessing the future financial landscape for the Council.

Scottish Government Grant Funding

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

4.7 The Council also receives additional specific revenue grant funding of around £10.3 million from the Scottish Government; including investment in Health and Social Care through the Social Care Fund, Pupil Equity Fund devolved directly to Head Teachers, Criminal Justice Funding as well as additional funding provided to support the delivery of Early Learning and Childcare – 1140 hours expansion. Over the past few years, there has been an increasing level of national policy commitments being funded by grant which can only be used for these specific purposes at the same time as we are facing reductions in the core grant for the provision of existing services. The earmarking of these new resources, reduces the scope for flexibility in how the Council delivers services in a way which best meets local priority outcomes.

4.8 In recent years including 2018-19, we have only received one year grant settlement from the Scottish Government and the lack of certainty around future grant awards, significantly weakens longer term planning and continues to place a high degree of volatility around future spending plans. Despite the introduction of the Scottish Government's new 5 Year Financial Strategy mentioned earlier, we still anticipate a one year settlement for 2019-20.

Council Tax

4.9 Following years of relative stability as a result of the nationally imposed Council Tax Freeze from 2007-08, the projected Council Tax income within the 3 year approved budget includes: anticipated income relating to the change in Council Tax multipliers introduced in 2017-18, increased yield from additional household properties expected to be built in the next 3 years, and an assumed annual Council Tax increase of 3% per annum in line with the maximum level of Council Tax increase allowable in 2018-19.

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

Workforce Plan

4.11 The workforce is the Council's most valuable asset and accounts for around 60% of the Council's overall running costs. With this comes significant financial contractual commitments in terms of pay and pensions. The Council has in place a Workforce Development Plan which will assist in planning the workforce to ensure it can meet the Council plan and obligations. The Plan has in place a number of key workstreams all of which are sponsored by a member of CMT. These include: Workforce Planning; Employer of Choice; PRD, Performance and Development; Leadership and Development; Wellbeing and Recruitment, Selection and Retention and finally Rewards and Recognition.

4.12 Given the cost associated with staffing, any changes contractual commitments in relation to pay and pensions can have a substantive impact on the overall costs. In recent years, any public sector pay annual increase has been approved broadly in line with public sector pay policy which has been around 1%. In 2018-19 the

Scottish Government set out its intention to remove the public sector pay cap, with the key elements of the policy set out below, and applied to the Council's 2018-19 budget plans.

- An increase of 3% up to £36,500, a 2% for those earning above £36,500 and below £80,000 and a flat increase of £1,600 for those earning above £80,000.

4.13 Despite the pay policy, multi-year pay settlements have been agreed for a number of public sector staff including Police and NHS, at a higher level. In relation to all Local Government staff groups (Local Government workers, Teachers, Craft and Chief Officials) there is still no formal pay award agreed for 2018-19, however the latest pay offer for all staff groups is already in excess of budgeted levels at 3%. Whilst the national pay negotiations remains on-going, it remains likely that the pay award will be in excess of the current budget levels and will place a recurring and increased pressure on the wider Council budget. As a broad indication every 0.5% increase amounts to around £0.650 million on our annual pay bill, and therefore the potential implications of rising pay awards will be significant.

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

4.15 All public sector pension schemes are subject to on-going scheme valuations to establish the financial sustainability of the schemes to ensure that they meet their future liabilities, and set any future employers contribution rates for the scheme for the next few years based on these results. The most recent Local Government Pension (LGPS) actuarial valuation was undertaken as at April 2018. The Council has in place a formal Contribution Stability Mechanism agreement with Lothian Pension Fund which provides a degree of certainty around current employer's pension contribution rates. As part of this stability mechanism, a further increase in employer's pension contributions of 0.5% increase has been budgeted for 2019-20, and a further 0.5% for 2020-21. This will place an additional burden in successive financial years of around £0.300 million per annum.

4.16 Furthermore, the Teacher's Pension Scheme and associated actuarial factors have been subject to on-going review, and there is a potential change (can we establish whether or not this change is to be made or not) which may impact on contribution rates from April 2019, and increase the employers' contribution rate for the Teacher's Pension Scheme from 17.2% to 22.4%. If the Council were not to receive any funding support for this within the Financial Settlement, the potential impact of this for East Lothian Council could be around £2.0 million per annum.

Scenario Planning / Funding Gap

4.17 Despite the many uncertainties facing Scottish local authorities, in particular those arising from reduction in Government funding, the need for medium to longer term financial planning is becoming increasingly important. Councils must ensure that they have robust financial plans in place to mitigate any potential impact arising from a wide range of variables. This need for medium to longer term financial planning is promoted by Audit Scotland both nationally and locally to help ensure longer term financial sustainability in the delivery of public services.

4.18 The scenario based financial modelling which was highlighted in the recent Financial Prospects report presented to Council in October 2018, and covered a 5 year financial planning period until 2023-24. The modelling highlighted the potential impact on three separate scenarios based on a relatively limited number of key variables which can have the greatest impact on the on the spending projections for the Council (RSG, Pay, Non-pay inflation, existing Budgetary Pressures and Council Tax yield) and different assumptions within these variables based on potential outcomes. These scenarios were modelled on the assumption that the current approved spending plans, including the planned efficiencies, can be delivered. The total estimated level of revenue savings which will be required to be delivered over the next 5 years is therefore over and above the current planned savings, and is summarised in the Table below. The scenario based modelling is in reality different from the approved budget model which includes a wide range of different variables all of which may ultimately impact on any future funding gap.

Estimated Funding gap 2019-20 to 2023-24

Scenario	**18/19 £'000**	**19/20 £'000**	**20/21 £'000**	**21/22 £'000**	**22/23 £'000**	**23/34 £'000**	**TOTAL**
Existing Planned Efficiencies	5,017	5,612	1,894	-	-	-	**12,543**
1	320	1,266	1,203	1,228	1,165	1,102	**6,283**
2	1,320	5,539	3,392	2,589	2,215	2,152	**17,207**
3	3,320	10,100	8,475	3,703	3,640	3,576	**32,814**

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

General Services Capital Budget – Medium Term Outlook

4.20 A five year General Service capital budget covering the period until 2022-23 was approved in February 2018 is summarised in the table below. These spending plans in-year have been subject to re-profiling and updating following the 2017-18 outturn, but in broad terms indicate a continuing growth in the capital plans.

General Fund – Capital	**18/19 £'000**	**19/20 £'000**	**20/21 £'000**	**21/22 £'000**	**22/23 £'000**	**TOTAL £'000**
Approved Spending (Gross)	44,974	46,097	52,639	59,572	59,768	**263,052**

Capital Funding

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

4.22 The General Services capital grant funding for Scottish local authorities received from the Scottish Government during 2016-17 had been reduced by £150m with the promise that this would be returned to local authorities over the next spending review period. This was not included within the 2017-18 or 2018-19 settlement although there remains a commitment this will be returned in full to Councils during the period 2019-20.

4.23 Uncertain economic conditions places further risk on the deliverability of current and future capital plans and the associated funding. There are risks associated with the infrastructure costs due to the included within the capital plans due to inflationary increases particularly relating to projects which are not due to commence in the short term. Similarly, there are risks associated with funding the capital investment plans relating to any future level of interest rates and associated cost of borrowing, and cash flow management as well as the timing and realisation of any anticipated capital receipts, and other associated contributions. The Council has approved a new Developers Contribution Framework (DCF) as part of the recently adopted Local Development Plan (LDP), and any change in economic conditions can place a significant risk on the Council on the timing of any developer's contribution.

4.24 Given the scale of the future capital programme an associated risks, the financial strategy and associated supporting strategies (including Capital Strategy and Treasury Management Strategy) must support the management of these risks. Affordability remains paramount in investment decisions also ensuring that the Council has in place a prudent approach to management of risk.

Future Capital Commitments

4.25 The Council has invested significantly in its infrastructure over recent years and this growth is likely to continue with the current plans designed to support the future infrastructure requirements across the Council area. Linked to the growth agenda, the Council now has an approved Local Development Plan (LDP). This plan will require the building of an additional 10,050 homes in East Lothian by 2024. Given this, the capital programme includes the additional enabling infrastructure costs that will fall due to the council to support these new additional homes. These additional infrastructure costs are supported by developer's contributions in line with the approved Developer Contribution Framework.

4.26 A formal agreement has now been signed in relation 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.

4.27 Subject to affordability, the detailed structure of any deal will need to be more fully incorporated within our existing financial plans. The majority of the costs associated with the City Deal are likely to fall outwith the current 5-year approved budget, however the financial implications of supporting both the adopted LDP and emerging City Deal commitments are significant and the Council budgets will need to be updated to reflect the related capital and revenue implications.

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

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

4.30 Given this, the Financial Strategy aims to set an affordability limit to protect both current and future Council Tax payers, based on the future loan charge costs. This limit will be set at an overall percentage of the total income received from Government (RSG + specific grants) and Council Tax income over the lifetime of the project and will be capped at a maximum of no more than 12%.

5 Reserves

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

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

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

5.3 The General Services reserves (excluding HRA reserves) available as at 31 March 2018 as per the audited accounts was £19.038 million with more detail around the breakdown of this reserves set out below. It should be noted that many of these reserves already have commitments against them and will be spent during this year.

General Services Reserves	**£'000**
Required to support future budgets (Note 1)	2,794
Civil Emergency	2,000
Cost Reduction Fund	3,767
Earmarked Reserves	
• DSM (Devolved School Management)	391
• MELDAP	303
• Other reserves	575
Insurance Fund	1,883
General Services Capital Receipts Reserves	4,600
Gen Services Capital Fund	2,282
Balance 2017-18 (Note 2)	443
Sub-total General Services Reserves	**19,038**

Note 1 – Includes the early payment of RSG received in 2017-18 of £0.654 million and will be used in 2018-19

Note 2 – Reflects the balance of additional surplus delivered in 2017-18

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

5.4.1 **Requirement to support future budgets**: This balance has already been committed to support the budget in 2018-19 as per approved budget plans in February 2018.

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

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

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

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

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

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

Reserves Strategy

5.5 The 2017-18 financial year delivered an increase in useable reserves of £1.034 million relative to approved financial plans. £0.654 million relates to Revenue

Support Grant (RSG) which was received in 2017-18 but included in budget plans for 2018-19. It is recommended that the unallocated balance of £0.443 million is maintained in general reserves and is used to mitigate the impact of any overspending on approved budget plans during 2018-19. If the Council delivers a surplus during 2018-19, it is recommended that the balance is transferred to the Capital Fund to mitigate the impact of the growing infrastructure commitments.

5.6 In line with the current Financial Strategy, the reliance on the use of reserves to support future revenue budgets is not sustainable and therefore the preferred and more sustainable direction is by having the final year of the three year budget showing balanced income and expenditure without the use of reserves. Borrowing is usually repaid over a longer period than three years, and the best indicator of whether the future repayments are sustainable is a longer term budget that does not rely on temporary sources of funding such as reserves. In other words, to sustain the capital investment plan the Council needs to demonstrate that there is no structural deficit in its budget by 2021-22.

5.7 Taking into account in year financial performance, it is unlikely that the Council will deliver a surplus contribution to reserves in 2018-19. Furthermore, it is clear that the Council faces significant challenges over the medium term, with continued reductions in funding and increasing demand for many of its services. General Reserve levels are already running at a relatively low level It will therefore be necessary to maintain balances at an appropriate level to support any future commitments and mitigate future financial risks, and it is recommended that there is now a need to establish a minimum level of uncommitted General Reserve balances which can be used to support any unforeseen / unquantifiable event. This level should equate to a minimum of 2% of the Council’s annual running cost (£4.27 million). Taking into account the Civil Emergency Fund (£2 million) and the General Services Capital Fund (£2.282 million) the Council currently meets this minimal required level of balance at just over £4.282 million, however there is currently no headroom in this. In the event that the Reserves are projected to fall below this level then Members must have a clear route for bringing Reserves back up to the level over the subsequent three financial years.

6 General Services Financial Strategy

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

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

- Maximising the income generation available to the Council. This will include; ensuring the Council recovers all income due and takes appropriate approach to recovering any outstanding debt and a prudent approach to managing any bad and doubtful debt; ensuring the Council maximises the use of available revenue and capital funding streams where appropriate; ensuring that where the Council has decided to charge, these are where possible based on the principle of full cost recovery, whilst ensuring existing charges are benchmarked against other similar authorities. This will also include the exploration of new opportunities for income generation where it is deemed possible;

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

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

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

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

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

- Continuing to invest where appropriate in the Capital investment programme, ensuring the plans will support the Council’s key priorities, and remain affordable based on a clear understanding of both capital and future revenue costs, with future loans fund charges to be set at a limit over the lifetime of the project of no more than 12% of the total revenue income (RSG + specific grants and Council Tax).

- 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.

- Apply flexibility in the application of capital receipts to maximise any potential interest rate fluctuation.

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

- Develop a sustainable three year General Services budget avoiding the use of reserves in Year three (2021-22).

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

7 Housing Revenue Account

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

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

7.3 A new and updated Local Housing Strategy has been adopted for 2018-23, with the housing need and demand assessment a key part of the evidence base for the Strategy. The current SESplan housing need and demand assessment was approved by the Scottish Government in March 2015. Within this, the plan indicated the requirement for circa 553 new additional units of housing per annum in East Lothian over the period 2012-30, comprising 370 affordable housing units and 183 units of market housing. The SESplan core Housing Market Partnership was tasked with setting HSTs, considering how housing need and demand can best be met over the whole housing market area and across all tenures. An affordable housing supply target of 189 units per annum (36%) and a market housing supply target of 330 (64%) were determined for East Lothian in partnership with SESplan authorities leading to a combined target of 519 units, for the period 2018-30. The ability to deliver will be dependent upon a combination of affordable housing providers, which includes Registered Social Landlords (RSLs), East Lothian Council and the private sector. It will also be dependent on complex funding models delivering different tenures.

7.4 For the Council, the timing around the delivery of many of the affordable housing sites remains key, coupled against the affordability to deliver the plans. ELLDP 2018 identifies housing land that will deliver in excess of 2,500 affordable homes. The Council is developing its supporting Supplementary Guidance on Affordable Housing and its Local Investment Framework on the back of ELLDP 2018 adoption. The Council has submitted its latest Strategic Housing Investment Plan and is engaging with Government on Housing Beyond 2021. The overall HRA budget is a balancing act between the income raised through rent, the revenue expenditure such as staffing & repairs and the capital spending which is undertaken on modernisation and provision of affordable homes.

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

- Ensuring rental income and any future rental increase remains affordable for tenants, whilst benchmarked against national average;

- Continuing to constrain cost growth – through effective demand management and good financial control by managers, focusing spend in line with agreed priorities whilst maintaining high quality service delivery for Council House tenants, whilst recognising the need to deliver a significantly expanded affordable housing supply programme, a growing Health & Housing agenda and deliver on substantially increased government driven intervention like Rapid Re-housing.

- Ensuring that the HRA can sustainably support the required housing capital programme associated with building new Council Houses and modernising existing homes. This will be delivered working alongside wider RSL partners to deliver the affordable housing needs across East Lothian in line with the objectives of the Council's Local Housing Strategy and LDP requirements and the Scottish Government's aim to deliver an additional new affordable housing;

- Continuing to meet on-going statutory requirements, including; Scottish Housing Quality Standards and EESSH (Energy Efficiency Standard in Social Housing);

- Responding to the challenges arising from recent and proposed UK benefit reforms;

- Reducing rent arrears; an area which has been particularly challenging following the roll out of Universal Credit;

- Delivering the efficiencies required across the housing management and repairs service;

- Ensuring that the Council stays within the recommended upper limit for the ratio of debt charges to income of 40%, maximising the in year use and application of capital receipts, capital grant, and any flexibility arising from revenue balances, in order to minimise the future impact of debt charges. This limit maintains an appropriate long term balance between the various elements of the HRA budget;

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

8 Financial Management

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

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

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

8.4 Despite the Financial Strategy covering the period until 2023-24, given the uncertainty around the financial planning landscape which the Council operates within, the Strategy will be subject to an annual refresh to ensure that it remains appropriate to respond to the future financial challenges.

9 Summary

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

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

Appendix 2

Capital Strategy

Capital Strategy

1. Introduction

1.1 The 2017 Prudential Code introduced the requirement for authorities to produce a capital strategy. The purpose of the capital strategy is to firmly place decisions around borrowing in the context of the overall longer-term financial position of the authority and to provide improved links between the revenue and capital budgets.

> *The capital strategy is intended to give a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services along with an overview of how associated risk is managed and the implications for future financial sustainability. Para 21 Prudential Code*

1.2 The Code refers to affordability, prudence and sustainability, which are related concepts. In order to ensure long-term affordability, decisions have also to be prudent and in the long term sustainable. Therefore, in carrying out their duties under Part 7 of the Local Government in Scotland Act 2003 (Scotland) in respect of affordability, local authorities are required to have regard to all those aspects of the Code that relate to affordability, sustainability and prudence.

1.3 The Local Government in Scotland Act 2003 refers to and places significant importance upon affordability. This means that an authority must consider the affordability of its capital investment during all the years in which it will have a financial impact on the authority.

1.4 The Strategy sets out the wider operating context, and aims to set out the arrangements and processes in place to manage capital resources how corporate priorities are linked to other key resource strategies and also clarified the related roles and responsibilities of members and officers. In doing so, the strategy effectively sets the framework within which capital financing decisions are considered and provides background to the funding sources available to meet the costs of capital projects.

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

2. Current Operating Environment

2.1 The Financial Strategy sets out the financial context within which the Council is operating and highlights many of the key pressures that may impact upon the way in which the Council spends its limited resources. The Council continues to operate within a challenging financial environment. The local environment within which the Council operates has changed significantly in recent years and will alter further in future years due to the impact of national legislation and policy, further economic turbulence, societal changes and developing customer expectations.

2.2 Despite this, the Council has set an ambitious course which continues the journey towards realising our vision for an even more prosperous, safe and sustainable

East Lothian, with a dynamic and thriving economy that enables our people and communities to flourish.

2.3 The Council now has an approved Local Development Plan (LDP). This plan will require the building of an additional 10,050 homes in East Lothian by 2024, and with it will see a rapid expansion in population across the area, with estimated population growth of an additional by 17,000 to 120,000 by 2037. This will impact on the wider demography within the area, with significant growth in particular in the number of school-age children and the number of pensioners.

2.4 Furthermore, the Council has now entered a formal agreement in relation 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.

2.5 Finally, the Council has a new and updated Local Housing Strategy driven by a housing need and demand assessment which was approved by the Scottish Government in March 2015. Within this, the plan indicated the requirement for circa 553 new additional units of housing per annum in East Lothian over the period 2012-30, comprising 370 affordable housing units and 183 units of market housing.

2.6 All of these plans will require additional significant infrastructure requirements over the foreseeable future, and the Council must ensure that it has appropriate and affordable capital investment plans in place which can then best support both the current and future population.

3. Key Resource Plans

3.1 The identification of capital investment requirements are governed by a number of key resource plans, all of which will be linked to the delivery of the Councils corporate objectives. More details around these key documents are set out below. Furthermore, other key strategies and policies may be relevant and will need to be reflected in the investment decision such as those associated with workforce/staff capacity and ICT.

Council Asset Strategy and Management Plan

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

- The Council manages its assets as a corporate resource to support the wider objectives and for the benefit of local communities. Management of the

Council's asset base is particularly important in the light of financial pressures to ensure that investment in assets results in the greatest positive impact for the people and communities of East Lothian.

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

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

Financial Strategy

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

- The financial strategy sets the Council's approach to managing both revenue and capital investment decisions over a 5 year financial planning period, and is updated on an annual basis. The capital strategy must support and inform the financial strategy, by considering the longer term affordability of borrowing implications relating to capital investment decisions.

- The strategy sets out the medium term approach which the Council must take to best manage; it's existing asset base, inform future capital investment decisions and management of associated risks within the context of overall affordability parameters. The Financial Strategy guides and supports the investment decisions within both the General Fund and also the HRA.

Treasury Management Strategy

- The Treasury Management Strategy recognises that the Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or financial instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

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

Existing Assets

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

- Much of this is informed by the condition of the existing asset base and current and future investment requirements including on-going repairs and maintenance and wider lifecycle investment required to maintain the value and condition of our existing assets.

4. Governance Arrangements

4.1 The Council adopts a Corporate Landlord model and oversees asset management and capital investment at a council wide level; its governance ensures that there is an integrated, cross service approach to decision making.

4.2 The governance arrangements for capital investment decisions across the Council are set out in the sections below.

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

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

- The Capital Investment and Asset Management Group (CIAMG) is a council wide forum to oversee the management of each asset category and to make recommendations to the CAG. The purpose of the Capital Investment and Asset Management Group is to: ensure all asset related decisions are taken collectively and not in isolation; promotes collaborative culture and practice across the Council and its partners; improve governance and decision making; oversee the coordination of Council asset management projects and initiatives. The membership of the CIAMG includes all Asset Lead Officers and representatives from a range of council services. Asset lead officers are service managers to ensure that day-to-day management responsibilities are clear and that delegated decision-making is undertaken at the appropriate level.

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

- The Council's Chief Finance Officer (CFO) has the overall responsibility to report explicitly on deliverability, affordability and risk associated with the capital strategy.

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

4.5 In year financial performance reports on both the revenue and capital plans are reported quarterly to Cabinet but more recently this has been reserved to Council. These reports set out the in-year financial performance against approved budget plans, and highlight any financial risks or challenges arising during the year. These financial performance reports assist with developing and informing current and future capital investment decisions and financial plans.

4.6 The Council's Audit & Governance committee provide the scrutiny arrangements including: Risk and Internal Controls; financial matters including review of the financial performance as contained within the annual accounts, review of annual report to Members from External Audit and treasury management arrangements; and wider review of performance including corporate governance.

5. Capital Investment Considerations

Capital Funding

5.1 Key to the capital investment decisions are the affordability requirements. It is recognised that there remains significant challenges in terms of our financial operating environment and any capital investment decisions must consider both the current and future financial implications.

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

5.3 Capital investment decisions are typically underpinned by financial models that determine their affordability both in terms of capital and revenue budgets.

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

5.5 As part of the Council's reserves balance and in line with the approved reserves strategy, the Council has in place the following reserves that can be applied to offset the cost of future borrowing:

- General Services Capital Receipts Reserve - established from Capital Receipt income which has not yet been applied in year. This Fund can be used to either support capital investment or repay the Principal element of debt repayments. This fund cannot be used to support General Revenue budgets. There is no equivalent fund balance within the HRA account principally due to the ending of the Right to Buy.

- General Services Capital Fund which - established in recent years from flexibility from year end underspends, in order to mitigate against the future impact of growing capital infrastructure commitments. Unlike the Capital Receipts reserve this Fund does have the flexibility to be transferred to other General Reserves.

Management of Risk

5.7 The economic environment can have a significant impact both in terms of the deliverability of capital investment programmes and also the funding of these programmes, and the Council must fully understand these risk and ensure these are managed in a practical and prudent approach. There are risks associated with the infrastructure costs due to the included within the capital plans due to inflationary increases particularly relating to projects which are not due to commence in the short term. Similarly, there are risks associated with funding the capital investment plans relating to any future level of interest rates and associated cost of borrowing, and cash flow management as well as the timing and realisation of any anticipated capital receipts, and other associated contributions. The Council has approved a new Developers Contribution Framework (DCF) as part of the recently adopted Local Development Plan (LDP). This framework details the additional capacity and funding required from developers to support the LDP and infrastructure requirements. Any change in economic conditions can place a significant risk on the Council on the timing of any developers contribution, and associated level of investment required.

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

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

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

- The Financial Strategy sets out a number of requirements to both assist capital investment decisions and importantly, manage the associated risk. These include:

    - Maximising the income generation available to the Council including any associated capital funding.

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

    - Continuing to invest where appropriate in the Capital investment programme, ensuring the plans will support the Council's key priorities, and remain affordable based on a clear understanding of both capital and future revenue costs, with future loans fund charges to be set at a limit over the lifetime of the project of no more than 12% of the total revenue income (RSG + specific grants and Council Tax).

    - Develop an approved five year General Services Capital Plan (for both General Services and HRA) underpinned by longer term models which seeks to minimise net borrowing requirements and is considered affordable both in terms of prudential limits and within the constraints of the three year revenue budget.

- Apply flexibility in the application of capital receipts to maximise any potential interest rate fluctuation.

- 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.

- For HRA, ensuring that the Council stays within the recommended upper limit for the ratio of debt charges to income of 40%, maximising the use and application of capital receipts, capital grant, and any flexibility arising from revenue balances, in order to minimise the future impact of debt charges. This limit maintains an appropriate long term balance between the various elements of the HRA budget.

6. Approved Capital Investment Programme

6.1 In February 2018 the Council approved spending plans covering a 5 year period for both General Fund and HRA Capital Programme. A summary of the spending plans are set out below, and includes major investment in schools, community, roads, transportation, ICT as well as property lifecycle management programmes. These budgets are supported by longer term spending plans, and are updated and approved annually as part of the formal budget setting process, to ensure that the capital investment decisions remain appropriate and affordable.

6.2 The most significant area of investment relates to the school estate, where significant investment is required to provide new and expanded education capacity for pupils arising from new development, and over the next 10 years, the estimated level of investment is likely to be in excess of £135 million. This will be funded in part from developers contributions, and the Council will continue to collaborate with the Scottish Futures Trust (SFT) to identify additional grant to deliver a well-designed school estate.

	2018/19 £000	**2019/20 £000**	**2020/21 £000**	**2021/22 £000**	**2022/23 £000**
General Services Gross Exp	44,974	46,097	52,639	59,572	59,768
HRA Gross Exp	24,364	37,683	33,754	37,952	33,818
TOTAL Gross Exp	**69,338**	**83,780**	**86,393**	**97,524**	**93,586**
TOTAL Income	**(29,862)**	**(46,817)**	**(44,995)**	**(49,589)**	**(59,474)**
Net Borrowing	**39,476**	**36,963**	**41,398**	**47,935**	**34,112**

7. Summary

7.1 The Council continues to face much uncertainty, a wide range of risks and an increasingly difficult financial environment. The Council is ambitious in its vision to become the best place to live in Scotland, and if to remain sustainable, the way in which we deliver services to the community must change. The need to invest in infrastructure to support these ambitious plans remains a key focus for the Council. What remains clear is that the affordability must drive appropriately informed capital investment decisions for both the current and future residents of East Lothian.