East Lothian Council

REPORT TO:	East Lothian Council
MEETING DATE:	21 February 2017
BY:	Depute Chief Executive (Resources and People Services)
SUBJECT:	Council Financial Strategy 2017/18 to 2019/20

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1 PURPOSE

1.1 This report proposes an updated Financial Strategy for the Council, providing the financial context for Councillors in preparing their budgets for the three-year period 2017-20.

2 RECOMMENDATIONS

2.1 The Council is recommended to approve the attached Financial Strategy Statement.

2.2 As part of presenting their budget proposals, each Group of Councillors is recommended to:

- Develop a sustainable General Services budget avoiding the use of reserves in Year Three (2019/20).
- Develop General Services Capital Plans, which seek to minimise net borrowing requirements and are considered affordable both in terms of prudential limits and within the three year revenue budget.
- Adopt the recommended levels for earmarked reserves as detailed in the Financial Strategy Statement.
- Transfer any further additional reserves at the end of 2016/17 to either the General Services Capital Fund or the Cost Reduction Fund. Any balance on the Capital Fund to be used in future years to directly fund capital expenditure or defray capital charges.
- Prepare balanced budget proposals for General Services taking into account latest estimates of Scottish Government Grant and other funding. Note that in developing proposals consistent with the Financial Settlement, the Council would then effectively be accepting the settlement and related conditions that apply.

- Give due consideration to potential Council Tax Yield taking into account new housing development and the effects of Scottish Government changes to the Council Tax Band Multipliers.

- Propose an appropriate Band D Council Tax level noting the terms of the Local Government Settlement set by the Scottish Government, which allows councils to increase Council Tax by up to a maximum of 3%.

- Consider the level of Council Tax discount offered awarded to second homes for 2017/18.

- Retain within the HRA, at least £1.0 million of reserves as protection against unexpected costs or loss of income.

- Maintain the ratio of debt charges to income within the HRA to below 40%.

- Propose an appropriate rent increase to support the HRA revenue and capital budget proposals.

3 BACKGROUND

Constructing the Budget Proposals

3.1 Appended to this report is the Financial Strategy Statement for 2017–2020, which outlines the main opportunities, risks and constraints that face the Council over the next three years. The strategy forms the basis of the Council's stewardship of taxpayer's funds over a prolonged period of austerity that will likely continue as the UK's economic outlook faces a further period of uncertainty, in part driven by the UK's decision to leave the European Union.

3.2 The establishment of a solid budgetary platform is the cornerstone of delivering the Financial Strategy. As in previous years, the budget allocates a "bottom-line" budget to each Business Group, and the Council Management Team in conjunction with relevant Service Managers, have the task of managing any cost increases within that budget. In addition, managers are expected to achieve any specified efficiency savings and identify how they will meet any savings targets allocated to them. Effective leadership is critical, but it is equally important that every Council officer has a responsibility to help deliver the Financial Strategy.

3.3 In preparing the 2017/20 budgets, provision to meet known contractual commitments has been made, but as in recent years, no general inflationary increase in budgets has been incorporated. Essentially, services are expected to absorb general inflationary pressures through the efficient management of the resources they have been allocated. This 'cost containment' continues to be an important element of the financial strategy.

3.4 The budget includes provision for capital financing (debt) costs that are generated by the Council's net borrowing requirements determined by the General Fund and HRA current and future capital investment programmes. These financing costs have both immediate and long-term financial implications and are deemed affordable to both the HRA and General Fund within current income projections.

Financial Prospects

3.5 Like all local authorities in Scotland, the Council continues to face substantial financial challenges. Despite the draft Scottish Government budget announced on 15 December detailing only one-year figures relating to 2017/18, there remains significant uncertainty around the future levels of grant. Within this draft one-year budget, the amount of funding available to Local Government through the core Revenue Support Grant for 2017/18 has reduced by a further £220 million, with independent forecasters suggesting that at best, future settlements will remain static in cash terms, with a high risk of further cash and real terms reductions in grant levels. Within the draft settlement, the Council has received additional 'ring-fenced' funding to be directed towards specific Government priorities, including Education and Social Work; however, the reduction in the traditional RSG means that further savings have to be made across the Council to continue to deliver wider services. Alongside this period of prolonged austerity, there remains further economic uncertainty following the UK's decision to leave the European Union, with the detailed negotiations around the UK's exit continuing to place doubt on the future economic growth projections. Furthermore, Scottish Local Government Elections will take place in May of this year, placing uncertainty on the future political landscape of local government.

3.6 The Council has always shown an ability to adapt and respond positively to the challenges posed by reductions in resources. Significant changes to how it is organised and how services are delivered have delivered around £24 million of efficiencies in recent years. These have been secured across a range of areas including: improved procurement practices, stringent workforce management measures and an ongoing review to the way in which services are managed and delivered. The Council continues to explore relevant partnering arrangements where these might provide more efficient and effective service delivery.

3.7 The East Lothian Health and Social Care Partnership is now fully established and adopted its delegated responsibilities on 1 April 2016. Although still in its infancy, a new operational joint management structure across both the Council and Health has now been adopted, and 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 policy direction.

3.8 The Council now has a proposed Local Development Plan (LDP) that is currently going through a formal period of representation. When adopted, the Plan requires the building of an additional 10,050 homes in East Lothian by 2024. The Council's financial plans have now been modified to better reflect the additional enabling infrastructure costs that will fall due to the Council, in line with a revised Contribution Framework, which will be adopted in conjunction with the LDP.

3.9 The Council continues to play an effective role in the development of a potential Edinburgh and South East City Region Deal. The UK Chancellor formally acknowledged in his Autumn Statement that there would be a deal and high level negotiations have been taking place between the Partnership Authorities and both UK and Scottish Governments. It is anticipated that the conclusion of these negotiations and hopefully the declaration of a formal deal will be announced in the March UK Budget. If successful and subject to affordability, the detailed structure of any deal will need to be more fully incorporated within our existing financial plans and a further report to Council can be anticipated.

3.10 In accordance with the Financial Strategy, the Council has previously sought to reduce the reliance on reserves and move to a more sustainable long-term budget. However, managing the implications of significant cash terms reduction in Scottish Government Grant means the job remains only partially complete. Notwithstanding the prevailing one-year financial settlements from the Scottish Government, it is considered critically important to maintain a longer term financial planning outlook of at least 3 years that better enables the Council to assess and plan for the undoubted challenges that lie ahead. Recent 3-year spending plans have made use of available reserves in both years 1 and 2, but in an effort to demonstrate financial sustainability, the use of reserves in the final year of the budget/strategy period should be avoided.

3.11 Independent financial commentators have suggested that in the short to medium term, there are particular reasons that will create significantly increased uncertainty about the extent and nature of changes that will be required of both the Council and Scottish Local Government more generally – and the political group budget proposals will, to varying extent reflect this. In accordance with our established practice, Groups have been advised to be as precise as they can be about the scale, timing and nature of the change that is needed. However, it is inevitable that some changes may not be capable of being specified in detail, which means that the further into the forward planning period you go, the greater the uncertainty about what will actually be required to deliver it. In general, the greater the value of any non-specific changes included in the budget, the greater the extent of change is being planned. These changes can be either cost reductions or income increases.

Managing the budget during 2017/18

3.12 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. Performance compared to 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.

3.13 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.

3.14 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. During recent years, significant progress has been made in delivering planned changes including: the tight management of the workforce, continued implementation of the Customer Excellence Programme, improved procurement practices and efficiencies under the Procurement Improvement Panel, wider Partnership Working and a wide number of significant service reviews across the Council, including a review of senior management. Despite the positive results which have been made to date, the future outlook remains challenging, and a new Transformational Programme Board has been established, driven forward by the Executive Team to help ensure the Council maintains delivery of high quality services to the people of East Lothian despite reduced levels of resource.

3.15 Heads of Service will be required to manage within the budgets approved at today's Council meeting. 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.

Council Tax

3.16 The Council has been working within settlement constraints that effectively imposed a freeze on Council Tax levels for the nine year period since 2007/08 and it is therefore notable that within the latest settlement for 2017/18, Councils may now increase Band D Council Tax up to a maximum of 3%.

3.17 Perhaps more significantly, as a response to the Commission for Local Taxation, Scottish Government have now developed and implemented alterations to the Council Tax Band Multipliers. The impact of these is considerable both in terms of Council Tax yield and also Council Tax increases to be levied on all properties falling within Bands E-H. Based upon 2016/17 Band D Council Tax, this would see increases upon the higher bandings as follows:

Band	Current Rate of Council Tax (£)	Proposed Rate of Council Tax after Multiplier (£)	Impact of Multiplier (£)	**Impact of Multiplier (%)**
Band D	£1,118	£1,118	£0	**0%**
Band E	£1,366	£1,468	£102	**7.5%**
Band F	£1,614	£1,816	£202	**12.5%**
Band G	£1,863	£2,189	£326	**17.5%**
Band H	£2,235	£2,738	£503	**22.5%**

3.18 In addition to increased yield through the Band Multipliers and any proposed local increase in Council Tax levels, the funding received directly from the tax will also increase over the coming year as a result of house building and an increase in the number of taxable properties, with further increases also anticipated in each of the two subsequent years.

3.19 It is expected that tax collection will continue to be adversely affected by the ongoing difficult economic conditions and also potentially from unforeseen implications associated with the DWP's rollout of Universal Credit. This situation is being kept under review, however, every effort is being made to maximise tax collection and it is recommended that bad debt provision for in year collection of Council Tax remains at 2% for 2017/18.

3.20 In relation to second homes discount, The Council Tax (Variation for Unoccupied Dwellings) (Scotland) Amendment Regulations 2016 allow Local Authorities to remove discount from second homes from April

2017. The Council currently grants a 10% discount and removal of this discount would raise an additional £80k p.a. in collectable Council Tax. It is not proposed that there will be any change to the current Empty Dwellings policy which was agreed by Council in December 2013.

Council Tax Reduction Scheme

3.21 Since its introduction by the Scottish Government on 1st April 2013, the Council Tax Reduction, (CTR) scheme has replicated many of the changes made to Housing Benefit by the Department for Work and Pensions, (DWP). However, the introduction of Universal Credit has required the Scottish Government to consider increasing the Child Premium for households in receipt of the Universal Credit, (UC). This is in order to ensure parity with households remaining on Housing Benefit. In the meantime, East Lothian's position in the vanguard of the Universal Credit (Full Service) rollout has required UC claimants to submit separate claims for their CTR entitlement, (previously claimed jointly with Housing Benefit). The breaking of this link has increased the risk of East Lothian residents failing to claim the CTR they may otherwise be entitled to and as a consequence Council Services are being required to provide a higher degree of support to those on UC to maximise CTR take-up.

3.22 Specifically in relation to the new Council Tax band multipliers, Council Tax Reduction may be available in certain circumstances. Single person households with a net income of up to £16,750 and all other households with a net income of up to £25,000 and less than £16,000 in savings, can be protected from the increase caused by the E to H multiplier change. Households affected by the change but already in receipt of Council Tax Reduction will receive automatic protection but households affected but not currently receiving Council Tax Reduction can apply to the Council for protection.

4 POLICY IMPLICATIONS

4.1 The Council has a range of plans and strategies that contribute to commitments made in both the Single Outcome Agreement and the Council Plan - this budget is an important part of putting these into effect.

5 INTEGRATED IMPACT ASSESSMENT

5.1 Equalities – the Financial Strategy and subsequent budget proposals will have significant impact on the future delivery of services by East Lothian Council and therefore a potential impact on the wellbeing of equality groups. The IIA on the Council Financial Strategy recommends that IIA is considered as an ongoing process as part of the development and delivery of Council budgets.

6 RESOURCE IMPLICATIONS

6.1 Financial – the respective group proposals will provide an overview of the finances of the Council reflecting the constraints outlined in this report. The approved budget will be the 3-year summary and the explanation of the changes in each of the three years provided by each group.

6.2 Personnel - none directly from this report although there may be implications arising from subsequent service reviews, efficiency measures and any other new initiatives.

6.3 Other – none.

7 BACKGROUND PAPERS

7.1 Council 9 February 2016 – “Council Financial Strategy 2016/17 to 2018/19”

7.2 Cabinet 13 September 2016 – Financial Review 2016-17 Quarter 1

7.3 Cabinet 20 December 2016 – Financial Review 2016-17 Quarter 2

7.4 Cabinet 14 February 2017 – Financial Review 2016-17 Quarter 3

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DATE	15 February 2017

East Lothian Council

Financial Strategy Statement

2017/18 to 2019/20

FINANCIAL STRATEGY STATEMENT 2017/20

Objective and Principles

A key financial objective for the Council is the provision of services that the Councillors believe are appropriate for the lowest Council Tax or service charge possible.

Underpinning this objective are two key principles of public finance that the Council must observe – that there should be no taxation in advance of need and that there should be fairness in the tax burden between generations of taxpayers.

In practice, the principle of taxing only when necessary is closely related to the question of how much reserves the Council should hold. In setting a budget a balance has to be struck between holding funds in reserve for specified reasons, with any excess of reserves being used for the benefit of, or returned directly to, the taxpayers. This effectively translates to making decisions on how much should be taken from reserves when setting the budget and this is explained further below.

In addition, many spending decisions that are taken will have long-term future benefits to the economy, whether this relates to investment in our young, investment in our health and wellbeing, or investment in the local economy. This is most readily apparent in the financing of capital investment projects, which have a relatively long-life and will provide benefit to future generations. The use of debt finance helps ensure that the costs of the capital investment are spread over the life of the asset and paid for through taxes and charges over that life. Similar issues are involved in making provision now for the future cost of pensions. Ultimately, these costs would be incurred by future generations even though the pensions have been earned in providing services now unless adequate provision for the full future cost is made from current tax receipts.

Key Variables affecting the Financial Strategy:

1. <u>**Scottish Government Grant Funding**</u>

Central to delivering the Financial Strategy is the level of grant funding received from the Scottish Government. In the General Services revenue budget, around 75% of the Council's available funding is received in various Scottish Government grants. In addition, the Council receives substantial Scottish Government support in respect of both General Services and Housing Capital Expenditure that helps reduce the Council's need to borrow.

The Draft Scottish Budget for 2017/18 was announced by the Cabinet Secretary for Finance and Constitution (CSFC) on 15 December. Although the UK Government recently published revisions to its own spending plans through to 2019/20 as part of the Comprehensive Spending Review in November 2015, the Scottish Government has again only published one year detailed figures relating to 2017/18. The Draft Budget does however establish a number of priorities likely to be reflected in future years. As well as continuing support for a more progressive approach to direct taxation, a clear indication has been given towards the protection of both Health and Police spending suggesting that a series of further tight settlements can be expected for Local Government in the coming years. The Scottish Government's financial plans continue to reflect the main recommendations of the Christie Commission promoting both service integration and early intervention and prevention.

As part of obtaining support for the budget through the Parliament, the Scottish Government announced £160 million extra funding for Councils on 2 February 2017, effectively less of a reduction than had been previously advised within the finance circular. East Lothian's share of this funding is £2.446 million (revenue) and £0.548 million (capital).

Whilst a timescale of 20 January was given for the Council to consider the offer, the Council Leader did write indicating that he was not in a position to either accept or reject the offer as this decision could only be made by Council, something that could not be arranged within the timescales set by Scottish Government. In developing their detailed budget proposals, political groups effectively require to agree if it they wish to accept the settlement offer and related conditions, noting that the Cabinet Secretary for Finance has stated that should they choose to reject, an alternative less favourable settlement will be provided to the Council.

Similar to previous years, the settlement offer will require the Council to agree to the following conditions during 2017/18:

- **Social Care Fund –** a further £107m to be transferred from NHS Boards to Integration Authorities in 2017/18 to support the continued delivery of Living Wage, sleepovers and sustainability in the Care Sector, and to disregard the value of war pensions from financial assessments for social care and pre-implementation work in respect of new carers legislation. The Government has advised that Councils can reduce their contribution to the IJB's in 2017/18 to no less than their 2016/17 contribution less their share of £80 million. For East Lothian this equates to a reduction of £1.41 million. NHS contributions to Integrated Authorities for delegated health functions will be maintained at 2016/17 cash levels. Given the draft settlement covers one year only, there continues to remain uncertainty as to implications for future grant conditions, and as budget implications to the IJB. The 3 year budget proposals will provide indicative figures for year 2 and 3 and as such the IJB directions should ensure that strategic priorities can be delivered within available resources.

- **Teacher Numbers –** the protection of teacher numbers through application of a commitment to maintain at a national level, the existing pupil teacher ratio.

- **Probationer Teachers –** secure a place for all probationers who require one under the teacher induction scheme

- **Council Tax -** the end of the imposed Council Tax freeze, with the flexibility for Council's to increase Council Tax by a maximum of 3%.

- **Pupil Equity Fund –** The draft settlement includes an additional £120 million nationally for schools in order to support improved levels of attainment. East Lothian's schools will receive £1.570m, with confirmation provided to an individual school level. Details of the use and administration of this funding is still being developed by the Scottish Government, but confirmation has been received that the funding must be directed to individual schools and the funding cannot substitute existing Council expenditure.

The draft Local Government Settlement resulted in a lower than anticipated revenue grant settlement. There has been much debate over the level of settlement due to ring-fencing of additional monies to schools, allocation of money to Health for IJB's and the assumptions around Council Tax increases, however the revenue support grant shows an overall grant reduction in cash terms of over £2.9 million (1.7%). Although previous medium term plans had highlighted the potential risk of reduced grant levels, the extent of the reduction was greater than most independent commentators and councils had anticipated. At a time when the Council continues to face a number of cost and demand pressures, a funding reduction of this scale presents a considerable challenge and re-enforces the need for continuation of the Council's existing strategy objectives of cost containment and cost avoidance.

In addition, the Council also receives Scottish Government support in relation to capital spending through receipt of a Capital Grant. The grant funding for local authorities 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 is not included within the 2017/18 settlement although there remains a commitment this will be returned to Councils during the period 2018-20.

Overall, there continues to be uncertainty surrounding the future of UK public sector finances and there is a significant risk that both revenue and capital grant figures planned for the next two years may be revised. However, the Council must not let this uncertainty undermine their planning for local services in the medium-term. The best way to deal with that uncertainty is to plan ahead as best we can enabling us to minimise any potential adverse impact of unforeseen change.

2. Delivery of Planned Efficiencies/Transformation Change Programme

The delivery of a wider efficiency programme has been a critical component within the financial strategies of recent years. The programme has helped secure a significant overall reduction in the cost base of Council services, whilst at the same time maintaining the highest possible quality of service provision.

The identification and deliverability of recurring savings is a vital part of our 3 year balanced budget model, but there is now an even greater need to drive forward an enhanced programme of transformational change to ensure delivery of all planned budget reductions and efficiencies. During the past year, the Council has established a Transformational Programme Board supported by an experienced team of officers who will support the Executive Team to deliver this ambitious change programme.

3. Pensions

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.

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.

The Council is a member of the Lothian Pension Scheme which administers the Local Government Pension Scheme for the Lothian region. The Council previously agreed to participate in a formal Contribution Stability Mechanism which has allowed the Fund to move towards 100% funding while at the same time remaining affordable for employers. The overall effect of this will see the Council's total employer's contribution rate frozen at existing levels for the first year of the planning period; however, it is expected that an increase in employer contributions will be required with effect from 2018/19, with a further increase expected in 2019/20.

4. Accelerating Growth and Enabling Infrastructure

The Council now has an approved Local Development Plan (LDP) that is currently undergoing a formal period of representation. When adopted, this will require the building of an additional 10,050 homes in East Lothian by 2024. The Council's financial plans have now been modified to better reflect the additional enabling infrastructure costs that will fall due to the council. These modifications reflect a new Developer Contributions Framework that has been approved by the Council and is currently subject to a statutory consultation period.

The Council continues to play an effective role in the development of a potential Edinburgh and South East City Region Deal. The UK Chancellor formally acknowledged in his Autumn Statement that there would be deal and high level negotiations have been taking place between the Partnership Authorities and both UK and Scottish Governments. It is anticipated that the conclusion of these negotiations and hopefully the declaration of a formal deal will be announced in the March 2017 UK Budget. If successful and subject to affordability, the detailed structure of any deal will need to be more fully incorporated within our existing financial plans.

Reserves

Holding an adequate level of reserves to meet unexpected costs is a key management tool for delivering the Financial Strategy, but this must be balanced against the need to avoid taxation in advance of need as explained earlier.

To strike this balance, the Council must take a view on what the reserves are likely to be at the start of the 2017/18 financial year, any plans that have already been made to use reserves and how much should be held to meet any risks that might materialise over the next three years. Any reserves that do not need to be held as part of this strategy should be used for the benefit of or directly returned to tax or rent payers as part of this budget.

Council has been already advised through the various quarterly finance reports that the General Services reserves (excluding HRA reserves) available going into 2016/17 was £23.174 million. There are a number of commitments which have been earmarked against the reserves in 2016/17, and as such it is anticipated that the closing position, assuming no additional increase in reserves arising from 2016/17 position will be around £19.2 million.

	Current Position 1 April 2016
General Services Reserves	**£'000**
Required to support future budgets	3,885
Civil Emergency	2,000
Cost Reduction Fund	2,997
Earmarked Reserves	
• DSM (Devolved School Management)	220
• MELDAP/DAAT	455
• Other reserves	275
Insurance Fund	1,723
Gen Services Capital Fund	11,619
Sub-total General Services Reserves	**23,174**

The current General Reserves includes a number of specific earmarked reserves including; Insurance Fund and a range of earmarked funds such as those held for MELDAP and the DSM legislation. My advice going forward is that these should be retained and used for specific purposes already agreed by Council which would mean that these are not then available for any alternative use.

I am also advising that the Council should hold a financial reserve within the Civil Emergency Fund as a cushion against the costs of any emergency or other unforeseen event, such as the severe weather experienced in various seasons over recent years. This should be retained at a level of £2 million, with the level consistently reviewed.

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 £2.997 million and this is expected to reduce to just over £2 million at March 2018 based on current commitments. This has largely been used to meet the costs of employee contract severance payments although more recently has also been used to establish a team of experienced officers who will support the Council's Executive Management Team drive forward a major Transformational Change Programme that in turn will help reduce our cost base to better match our reduced financial resources. Given the scale of the changes facing the Council and the costs associated with making these changes I am recommending that the Cost Reduction Fund should be retained.

As with recent financial strategies, a preferred and more sustainable direction would be to place less reliance upon the use of reserves to balance future revenue budgets. Taking into account budgetary performance during the current year, I do not anticipate any additional funds being transferred to reserves at the end of the financial year. Notwithstanding this, should any reserves become available following closure of the 2016/17 accounts, I am recommending that these are transferred to either the existing Cost Reduction Fund or to the Capital Fund.

The regulations that surround the use of prudential borrowing powers require that the Council demonstrate that its capital investment plans are affordable and financially sustainable. Affordability is best demonstrated by the incorporation of all the costs associated with the investments within a balanced three-year budget.

Financial sustainability is demonstrated by having the final year of the 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 2019/20 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 2019/20.

Medium Term Financial Position – General Services

For the General Services revenue budget, the Council continues to plan for the medium-term through its three-year planning processes. Notwithstanding the fact that the Scottish Government has provided grant figures for a single year only, the key financial assumption being made by the Council for Year 2 and Year 3 is that other than the predicted reduction in Loans Charges Support (dampened in lieu of a related adjustment to the floor), net grant will remain at the Year 1 level. Although there are many unknowns and also accepting the

Cabinet Secretary has discretion to vary his priorities, the risk of grant levels being even lower than this is considered to be high. If any significant changes to the anticipated grant figures become known, the Medium Term Financial Position will need to be reviewed.

In the medium term it is clear that the Council faces some very difficult financial decisions as a result of the following; Further cash and real terms reductions in the income it will receive from Scottish Government;

- A more complex conditional grant settlement that requires delivery of a range of Scottish Government policy objectives, ring-fenced to meet Government policies and carries a potentially significant sanction regime;
- Increasing population and other demographic changes e.g. increased numbers of young and old, early years care/school rolls/elderly care;
- General price/inflationary pressures;
- Upward pressure on staff costs – particularly after a significant period of pay restraint and uncertain future pay settlements, but also arising from the likelihood of unfunded superannuation cost increases;
- Expansion of the integrated arrangements relating to the provision of Integrated Health and Social Care services, including the role and interface of the Integrated Joint Board;
- Financial implications associated with the infrastructure requirements flowing from both the LDP and any proposed City Deal;
- Political and economic change/uncertainty – in particular the impact of BREXIT negotiatons and forthcoming Local Government elections.

Despite these very challenging economic conditions, the Council has its own ambitious 5 year Council Plan approved in 2012 but reviewed and updated in October 2014 and, in conjunction with Community Planning Partners, has committed to a new Single Outcome Agreement (SOA) in 2013. Aligning with terms of political office, a new Council Plan is under development that will be considered in more detail by the Council after the forthcoming elections in May.

It is clear that the Council is facing significant financial challenges such that it must reduce expenditure commitments or increase income, or some combination of both. A significant share of any funding shortfall is likely to have to be met through continued application of cost containment and cost avoidance measures. As far as possible, the Council is seeking to contain costs by becoming more efficient, which would help minimise the effect on services provided. This includes the Council paying due regard to the statutory obligations of the Equality Act 2010. Understanding the impact of financial decisions on all those within the community will help to ensure that decisions about future provision of services meet the needs of the community effectively.

Medium Term Financial Position – Housing Revenue Account

It has been more than ten years since the achievement of a zero net HRA debt position in 2004/05 – mostly as a result of council house sale receipts in the property boom. Since then, there has been a significant increase in HRA capital spend as both the modernisation and affordable house building programmes have been expanded – and as a consequence, the share of spending on debt charges has also increased. The medium term position for the Housing Revenue Account (HRA) budget will be set out as part of the budget approved by the Council. As almost all of the income for this service is locally raised, the Council can plan with relative certainty and can largely self-manage the main financial risks. 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.

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

- Ensuring that the HRA can sustainably support the required housing capital programme associated with building new Council Houses and modernising existing homes, 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;

- Moving towards a position whereby the HRA is self-financing a larger proportion of its capital expenditure – typically by direct funding rather than borrowing;

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

- Ensuring that the properties and neighbourhoods continue to be attractive to existing and prospective tenants;

- 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%. It is my view that 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.

Risk Assessment

In setting a 3 year financial plan, the Council must take into account the risks that may impact upon successfully delivering the financial strategy. A summary of the main risks to the budget are listed in Annexe 1 attached including the action the Council should take to manage those risks both in setting the budget and managing its finances over the coming years.

The success of the Financial Strategy depends on how successful we are in mitigating the risks through management action and the extent to which the risks we seek to manage actually materialise.

Summary

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. In the longer-term, pension liabilities are increasing and should be funded now rather than passed on as a burden for future taxpayers. East Lothian continues to be one of the fastest growing Council areas in Scotland, and with growth comes both expenditure commitments as well as increased opportunities.

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. I remain confident that by continuing to follow the direction set in this strategy, and by collectively delivering the planned service changes, this challenge can be managed and that, by the end of the budgetary period we will be delivering our priority outcomes for the people of East Lothian within a sustainable and balanced budget.

To achieve this, over the next three years, the Council's financial strategy will continue to focus upon;

- Delivering an enhanced Change Programme that will achieve significant efficiency savings across all areas and all inputs such as staffing and supplies;
- Constraining cost growth – through effective demand management, good financial control by managers and by effective negotiation with suppliers;
- Generating additional income and ensuring that, where the Council has decided to charge, there is full cost recovery;

- Progressing partnership working where there are proven efficiency and or service gains;
- Continuing to manage the General Services Loans Fund balance ensuring affordability across the three years of the Strategy.

Jim Lamond
Head of Council Resources
15/02/2017

ANNEXE 1: FINANCIAL STRATEGY RISKS

Risk	Action	Mitigation Method
Future Scottish Government funding settlement awards are less than anticipated	Mitigate	1) Monitor developments arising from UK Government and Scottish Government fiscal strategies 2) Identify a programme of short, medium and longer term financial savings
Planned efficiency savings are not achieved	Mitigate	1) Identify required savings in the budget as part of a comprehensive change programme and report progress on achievement to Cabinet on a regular basis. 2) Accelerate the programme of planned savings as part of a comprehensive change programme. 3) Participate in national efficiency initiatives. 4) Compare efficiency with comparable organisations. 5) Test the competitiveness of in-house services against similar services available in the market and vice versa.
Budget is not effectively managed	Mitigate	1) Subdivide the budget to allow clear allocation of responsibility to managers and link those budgets to operational responsibility 2) Report on the budget position to managers on a monthly basis and Cabinet on a quarterly basis 3) Provide training in financial management to all responsible officers
Loss of key suppliers leads to additional costs	Mitigate	1) Maintain active relationships with key suppliers to assist in early identification of problems 2) Hold a financial reserve to provide funding to meet costs arising should a supplier be lost
Unforeseen events occur that were not anticipated in the budget	Mitigate	1) Encourage wide participation in budget setting to capture as much service information as possible 2) Closely monitor service expenditure, and implement an appropriate recovery plan 3) Maintain a minimum level of reserves to provide funding to meet costs arising from such an event

ANNEXE 1: FINANCIAL STRATEGY RISKS

Wider changes in the economy impact on our costs (e.g. energy prices, interest rates) and income	Mitigate	1) Identify volatile costs/income within the budget and adopt management processes to limit exposure 2) Consider and review recurring impact on future year's budget 3) Hold a financial reserve to provide funding to meet costs/income loss arising
The Council does not carry through its plans	Mitigate	1) Regularly monitor progress against the Council Plan 2) Regularly monitor the financial position compared to budget
A service fails to meet statutory requirements resulting in the cost of emergency corrective action	Mitigate	1) Regularly monitor progress against the Council Plan 2) Closely monitor service expenditure, and implement an appropriate recovery plan 3) Hold a financial reserve to provide funding to meet costs arising from corrective action
Failure of key financial and other systems	Mitigate	1) Ensure business continuity measures are effective 2) Hold a financial reserve to provide funding to meet costs arising should a system fail
UK welfare reform leads to a loss of income and increased demand for council services	Mitigate	1) Monitor the development of welfare reforms and seek to influence wherever possible 2) Hold a financial reserve to cover increased costs or income loss
The Council has to meet a major unanticipated insurance or compensation claim	Mitigate	1) Ensure insurance arrangements are adequate for the risks anticipated and that provision is made for claims 2) Hold a financial reserve to provide funding to meet costs arising should a claim arise