REPORT TO:	East Lothian Council
MEETING DATE:	17 December 2019
BY:	Head of Council Resources
SUBJECT:	Financial Strategy 2020-2025

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1 PURPOSE

1.1 This report sets out an updated Financial and Capital Strategy for the Council, covering a five year period from 2020-25.

2 RECOMMENDATIONS

2.1 The Council is recommended to approve the overarching Financial Strategy set out in **Appendix 1** of this report together with the Capital Strategy included at **Appendix 2**.

3 BACKGROUND

3.1 The current approved Financial Strategy was approved by Council in December 2018 and covers a five-year financial planning period from April 2019 until March 2024. Given the wider 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 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 the 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 Alongside this, the 2017 Prudential Code introduced a new requirement for local authorities to produce a capital strategy, which was approved by Council in December 2018. The Capital Strategy supports the wider Financial Strategy, with a requirement 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. Again this strategy remains subject to an annual refresh and 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.

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 11 December 2018 – Item 5 – Financial Strategy 2019-24

7.2 Council 29 October 2019 – Item 4 – Financial Review 2019-20 and Financial Prospects

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Appendix 1

Financial Strategy

2020-21 to 2024-25

Financial Strategy 2020-21 to 2024-25

1 Introduction

1.1 The Council continues to operate in an uncertain and challenging financial environment. The continuing economic and political uncertainty relating to the forthcoming election, the UK's planned departure from the European Union and future public sector funding, against a backdrop of increasing demand, means that it is inevitable the Council will need to find alternative ways of ensuring that it can continue to deliver sustainable services to the public within likely reducing levels of resources. The Council remains 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%.

1.2 Current forecasts indicate that the level of core funding we are likely to receive from the Scottish Government is unlikely to increase, and this alongside the growing demand for services, suggests that more must be done to deliver services in a different way, and undoubtedly this will mean that further additional budget reductions will have to be delivered to ensure that services can be delivered within the funding available.

1.3 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 taxpayer's funds. Given the extent of financial challenges ahead, it is 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 2020-2025 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 and delivering against its budget.

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

1.5 The Strategy covers the five year planning period from 2020-21 to 2024-25 and includes both the General Services and Housing Revenue Account (HRA) revenue and capital budgets.

2 Current Economic Context

2.1 The economic outlook and Financial Prospects for the strategy period were considered by Council in October 2019 and these set out the financial context within which we are currently operating and also 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 given the forthcoming UK election and the UK's planned departure from the European Union. 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 another 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's Medium Term Financial Strategy was published in May 2019 and sets out the Fiscal Framework and funding arrangements that the Scottish Government now operates within. The Strategy details the Scottish Government's key policy priorities and approach to supporting Scotland's economy.

2.4 The recent COSLA evidence to the Local Government and Communities Committee pre-budget budget scrutiny, highlighted that between 2013-14 and 2019-20 Local Government has been subject to a disproportionate funding cut in comparison to budget reductions the Scottish Government has faced with the overall Local Government budget share of available resource falling from 34.8% to 33%. Whilst some cash terms increase has been reported in recent years, this has largely been ring-fenced and linked to the delivery of new policy commitments such as early learning and childcare, with core budgets significantly reduced and therefore pressurised. COSLA believes that Scottish councils have been tasked with delivering an increased number of Scottish Government priorities as well as absorbing the impact of inflationary and demand increases, and are 'undeniably doing more with less'.

2.5 The Scottish Government does now 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 Draft outline UK Spending Plans were announced by the Chancellor on 4 September for a one year period, with indications suggesting that Scotland will receive an extra £1.2bn of funding in 2020-21 representing 2.1% real terms growth. Of this, £1.12bn is revenue funding while £88 million is capital funding. Given the forthcoming UK election, formal spending plans have now been delayed until there is clarity on the outcome. At the time of writing this report, it still remains unclear as to the timing and impact this will have on the Scottish Budget and indeed within that, the Scottish Local Government settlement.

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 has an approved Local Development Plan (LDP). This plan requires 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) Act places new duties on the Council and its partners to provide new rights for community bodies and 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 Collaborative, 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 COSLA is currently taking forward work on a fiscal framework for Local Government, which aims to set out the financial relationship between Local Government and the Scottish Government and the wider local communities and could present opportunities to bring about greater local and inclusive economic growth and further our priorities of inclusive growth; wellbeing; tackling child poverty; and responding to climate change. The framework will take cognisance of principles relating to: Sustainability, Transparency, Localism, Fairness and Efficiency and could provide opportunities to re-balance the relationship between national and Local Government.

4 General Services Revenue Budget – Medium Term Outlook

4.1 Notwithstanding the many uncertainties facing Scottish local authorities, the need for medium to longer term financial planning is becoming increasingly important. Councils must ensure that they have robust financial plans in place that can respond to and absorb the potential impact arising from an increasingly wide range of variables highlighted earlier in this report. Only by doing, can they ensure long term sustainability of service provision. 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 A summary of the General Services Revenue Spending Plans for 2019-20 approved by Council in February 2019 are set out in the table below.

General Fund – Revenue	**2019-20** **£’000**	**2020-21** **£’000**	**2021-22** **£’000**
Approved Expenditure	248,116	252,830	255,966
Financed by:			
RSG (including NDR)	169,087	169,087	169,087
Other Government	15,643	20,098	19,833
Grants(inc Social Care Fund)	60,315	63,574	66,975
Council Tax	71	71	71
Other	3,000	0	0
Transfer from Reserves	**248,116**	**252,830**	**255,966**
TOTAL			
Delivery of Planned Efficiencies (contained in above)	**5,228**	**3,941**	**2,143**

4.3 The current spending plans remain crucially dependent on services being able to both manage existing spending commitments within available budgets as well as the delivery of already planned efficiency savings. In total the current approved spending plans require that around £11.3 million of additional efficiencies are delivered between 2019-20 and 2021-22. Whilst substantial progress has been made in the delivery of these new savings proposals, the level required 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.

4.4 Effective monitoring of the in-year financial position remains critical. The 2019-20 quarterly reports continue to highlight significant service pressures, and a number of service areas are classified at High Risk of overspending. Current forecast projections for the Council suggest it is likely that collectively, services will overspend during the year. Officers are working hard to identify further options to manage any overspend but the scale of the mitigation required remains challenging. Any overspending during 2019-20 may have a recurring impact on future year spending plans, and the ability to address these in-year and more crucially on a recurring basis remains critical in assessing the future financial landscape for the Council.

Scottish Government Grant Funding

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

4.6 The Council also receives additional specific revenue grant funding of around £15.6 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 new national policy commitments funded directly by grant allocations which can only be used for these specific purposes. This has come 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 overall meets local priority outcomes.

4.7 In recent years, we have received one year grant settlement from the Scottish Government. Based upon pledges made within last year's Local Government Settlement, it was anticipated that this year Councils would receive a multi-year funding settlement although this now looks unlikely. The continued lack of certainty around future grant awards, creates a high degree of volatility around future spending plans, but importantly strengthens the need for longer term financial plans to ensure that the Council can respond to and absorb the potential impact arising from an increasingly wide range of variables highlighted earlier in this report. Only by doing, can we hope to ensure long term sustainability of service provision.

Council Tax

4.8 The Council Tax income within the 3 year approved budget includes: increased yield from additional properties anticipated to be built in the next 3 years plus an assumed annual Council Tax increase of 4.79% in 2019-20 which was in line with the flexibility approved by the Scottish Government and an assumed 3% increase in the following 2 years. The Council annually determines the level of Council Tax which is levied as part of the annual budget process.

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

Workforce Plan

4.10 The workforce is the Council's most valuable asset and accounts for more than 60% of the Council's service expenditure. 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 work streams 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.

4.11 Given the cost associated with staffing, any changes to contractual commitments in relation to pay and pensions can have a substantive impact on the overall costs. As a broad indication every 0.5% increase amounts to around £0.650 million on our annual pay bill. The Council has in place an approved pay settlement until 2020-21 for Local Government staff groups and Teachers, and these costs have been largely unfunded with the exception of some Scottish Government funding provided to reflect an element of the Teachers Pay award. An indicative 2% pay uplift has been reflected within 2021-22 budget plans but any change could be significant and any increase will need to be met within the totality of the resources available to Local Government.

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

4.13 All public sector pension schemes are subject to on-going scheme valuations to establish the financial sustainability of the schemes to ensure that they meet their future liabilities, and set any future employers contribution rates for the scheme for the next few years based on these results. The most recent Local Government Pension (LGPS) actuarial valuation was undertaken as at April 2018, with the next one scheduled from April 2020 and which may impact on contribution rates from 2021-22. 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 2020-21. This will place an additional burden in successive financial years of around £0.300 million per annum.

4.14 The employer contribution rate relating to Teachers' Pension Scheme increased from 17.2% to 22.4% from September 2019. This change in rate will apply until March 2023 and thereafter the rate will be dependent on future actuarial valuations. The increase was announced in March 2019, and as such the costs have now been reflected in 2019/20 budget but not in future years. Funding has been provided by the Scottish Government at a level of 79% of the actual costs, with the remainder to be met from Local Authority budgets. This cost increase will be required to be built into future budgets.

Scenario Planning / Funding Gap

4.15 Scenario based financial modelling covering the period to 2024/25 was reflected within the recent Financial Prospects report presented to Council in October 2019. The modelling is used to assist with assessing the potential impact on future budget plans based on a range of potential scenarios using a relatively limited set of key variables (RSG, Pay, Non-pay Inflation, budget pressures and Council Tax yield). **These scenarios should not be confused with any funding gap and associated saving plans developed during the subsequent budget process**, but any change to these variables may have a significant impact on the spending projections for the Council, and therefore should be used as illustrative examples to support and enhance future spending discussions.

4.16 These scenarios are based on the existing approved 3-year approved budget, and therefore any assessed funding requirement is over and above existing planned efficiencies. Three separate scenarios were used, with a summary of the total estimated level of savings which will be required over the next 5 years is summarised in the table below in the table below.

Estimated Funding gap 2020-21 to 2024-25

Scenario	**19/20 £'000**	**20/21 £'000 Year 1**	**21/22 £'000 Year 2**	**22/23 £'000 Year 3**	**23/34 £'000 Year 4**	**24/25 £'000 Year 5**	**TOTAL**
Existing Planned Efficiency Savings	5,228	3,941	2,143	-	-	-	**11,322**
Potential Funding Gap							
1	3,000	4,307	4,178	6,411	6,901	6,901	**31,699**
2	1,000	1,023	668	3,533	3,778	3,778	**13,779**
3	0	-2,432	-2,750	1,879	1,879	1,879	**455**

4.17 Should the full extent of these assumptions materialise, the Council would require to make some difficult choices in order to balance the budget. Although the level of savings identified will undoubtedly change as work progresses on developing the Revenue Budget, this illustration provides an indication of the scale of financial challenge facing the Council over the next five years. Reductions of the scale set out in scenario 1 would have a 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

4.18 The Capital Strategy sets out the capital investment plans for the Council, associated capital financing and wider strategy. Relating to General Services, in February 2019, Council approved capital investment plans until 2023-24, with details summarised in the table below. These spending plans in-year have been subject to re-profiling and updating following the 2018-19 outturn, but in broad terms indicate a significant and continued growth in the capital investment over this period.

	2019-20 £000	**2020-21 £000**	**2021-22 £000**	**2022-23 £000**	**2023-24 £000**	**TOTAL £'000**
General Services Gross Expenditure	52,074	74,931	68,374	61,387	56,295	313,061
General Services Income	(36,257)	(38,232)	(31,811)	(39,936)	(30.435)	(176,671)
Net General Services	**15,817**	**36,699**	**36,563**	**21,451**	**25,860**	**136,390**

4.19 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.

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

4.21 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.

4.22 The Council has agreed to undertake a Learning Estate Review the outcomes of which will ensure that children and young people have an equity of experience, opportunity and access, as detailed in the Education Service Improvement Plan, and ensure that we utilise to strategically place assets, resources and training opportunities. The outcome of this review may impact on future capital investment plans for the Council.

4.23 Whilst much of the LDP commitments fall within the 5 year capital investment plans, much will impact on future years. The totality of these infrastructure commitments are significant for the Council and will have both capital and associated revenue implications. The affordability of future capital investment plans remains critical to ensure that we can continue to maintain appropriate level of investment for the future benefit of the East Lothian area.

4.24 The pressures on the current and future wider financial operating environment requires enhanced affordability criteria to be applied to the capital investment programme to protect both current and future Council Tax payers. Within this context, the Strategy proposes minimising the additional net borrowing to the Council in future years by ensuring that future loans fund charges is set at a limit no more than 12% of the total revenue income (RSG + specific grants and Council Tax).

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 2019 as per the audited accounts was £19.432 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.

2018/19 Reserves

Required to support future budgets	3,000
Civil Emergency	2,000
Cost Reduction Fund	3,767
Earmarked Reserves	
- DSM	131
- MELDAP	303
- Other	485
Insurance Fund	1,821
Capital Fund	4,600
General Services Capital	2,282
Capital Grants & Receipts Unapplied	245
Balance	798
TOTAL	**19,432**

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 2019-20 as per approved budget plans in February 2019.

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**: This fund is used to support to deliver change which will realise a financial saving and/or service efficiency going forward. This fund has been used to meet the costs of employee contract severance payments as well as supporting some costs associated with delivering Transformational Change, and has a number of earmarked commitments in place.

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

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

5.4.8 **Capital Grants and Receipts Unapplied:** A new reserve created in 2018-19 arising from new guidance which will allow capital receipts to be used to transform service delivery to reduce costs and /or reduce demand. This flexibility is only available to Councils until 2021-22.

5.4.9 **Balance**: the level of uncommitted reserves.

Reserves Strategy

5.5 The use of reserves should not be used to develop a sustainable budget. Given that, the final year of the three year budget must demonstrate sustainability and show a balanced income and expenditure without the use of reserves. In delivering a balanced budget for 2019-20, the Council planned to use £3M of reserves but taking into account the 2019-20 in-year financial performance, the Council may require to draw down a greater level than planned. It remains clear that the Council faces significant challenges over the medium term, with continued reductions in funding and increasing demand for many of its services.

5.6 Relative to our overall cost base and prevailing economic conditions, General Reserve levels are very low and there is a significant risk that the Council will be unable to support all future commitments and mitigate against future financial risks. It is therefore recommended that we maintain 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 (£4.9 million). Taking into account the Civil Emergency Fund (£2 million), the General Services Capital Fund (£2.282 million) and the uncommitted balance of £0.798 million the Council currently meets this minimal required level of balance at just under £5.1 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 sustainable services within approved budget levels;

- 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 also to support the realisation of existing planned savings;

- Maximising the income generation opportunities 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 for services, these are where possible based on the principle of full cost recovery, taking into account benchmarking against other similar authorities. This will also include the exploration of new opportunities for income generation where possible;

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

- Make efforts to shift the focus of spend on prevention and early intervention, which is designed to reduce future demand for council services by stopping problems arising or by addressing them early on;

- 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 this will support the Council's key priorities, and critically remain affordable based on a clear understanding of both capital and future revenue costs.

- In support of ensuring affordability for current and future tax payers, the Council should work to minimise the additional net borrowing to the Council in future years and ensure that General Fund loans fund charges over the lifetime of the strategy should be set at a limit 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 ensuring prudence, maximising the use and application of capital receipts, capital grant, and any flexibility arising from revenue balances, in order to minimise the future impact of debt charges.

- Apply flexibility in the application of capital receipts to maximise any potential efficiency arising out of interest rate fluctuations.

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 (2022-23).

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

7 Housing Revenue Account

7.1 In recent years there has been a significant increase in HRA capital spend as both the modernisation and 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 high priority for East Lothian Council. Market 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 The key strategic outcomes for the Local Housing Strategy 2018-23 for East Lothian include increasing the supply of housing, ensuring the supply of housing meets the needs and aspirations of local people that they live in good quality homes which are located in strong, safe communities. The Strategic Housing Investment Plan (SHIP) sets out the priorities for affordable housing investment in East Lothian over the next five years and will be dependent upon a combination of affordable housing providers, which includes Registered Social Landlords (RSLs), East Lothian Council and the private sector. It will also be dependent on complex funding models delivering different tenures.

7.4 The Housing Revenue Account 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 new affordable homes. The Council continues to have ambitious capital investment in modernising existing housing stock and investment in new homes, but the strategy must ensure that plans remain affordable and exhibit a joined up approach to delivery.

7.5 Given this ambition, the financial strategy for the HRA 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 also deliver on substantially increased government driven interventions 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 which is based on an evidenced and planned programme of works. 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 £1.0 million. 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 now being made to Council and a further year-end report presented to 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 expenditure commitments within approved budgets and if at any time spending pressures are not containable within the Business Group, the relevant Service Manager should report this to their Head of Service and Depute Chief Executive who has the flexibility to 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/Council 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 Although the Financial Strategy quite properly covers the 5 year period until 2024-25, given the uncertainty around the financial planning landscape within which the Council operates, the Strategy will be subject to an annual refresh to ensure that it remains appropriate and relevant and enables the Council to respond to any future financial challenges.

9 Summary

9.1 The Council continues to embrace inclusive growth and both the benefits and challenges it brings but does so in the face of much economic 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 with increasing demand for most services across the county in what is one of the fastest growing Council areas in Scotland.

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 could have a significantly adverse impact upon service delivery and it is imperative that we seek to adopt a strategy that best minimises any impact. In order to realise these unavoidable reductions, the Council will clearly be required to make some very difficult choices.

Appendix 2

Capital Strategy

Capital Strategy

1. Introduction

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

1.2 The existing Capital Strategy was approved by Council in December 2018, and has been updated to inform longer term capital investment decisions.

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

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

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

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

2. Current Operating Environment

2.1 The Financial Strategy sets out the financial context within which the Council is operating and highlights many of the key pressures that may impact upon the way in which the Council spends its limited resources. The Council continues to operate within a challenging financial environment, and has changed significantly in recent 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. This includes plans to deliver significant capital investment over the next 10 years aligned to the approved Local Development Plan (LDP) and will see investment across a broad range of services including schools, infrastructure and economic development.

2.3 The capital investment plans will require additional significant infrastructure requirements over the foreseeable future, and the Council must ensure that these plans remain affordable and provide economic benefit to the current and future population of East Lothian.

2.4 The Capital Strategy takes account of the Council's strategic priorities and considers any new investment within the context of outcomes, affordability and spend to save. Any investment decisions must consider the need to invest in maintaining current assets and investing in new assets.

2.5 The primary purpose of the Capital Investment Strategy is to provide an overarching view of how various plans and strategies depend upon capital investment and to demonstrate that this is both affordable and sustainable. The associated plans and strategies focus on specific priority areas and, through appropriate governance structures, ultimately shape and influence the investment plans delivered through the Capital Investment Programme. Underpinning the Capital Investment Programme is the Treasury Management and Investment Strategy which considers the delivery of the capital programme within the context of affordability and risk and apply a measurement of what this means against key prudential and treasury indicators. The aim being to demonstrate affordability and sustainability over the long term.

3. Key Resource Plans

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

<u>Council Plan 2017-2022</u>

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

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

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

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

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

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

Community Planning Partnerships and Local Outcomes Improvement Plans

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

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

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

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

Council Asset Strategy and Management Plan

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

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

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

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

Local Housing Strategy and Strategic Housing Investment Plans

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

- The SHIP (2020-2025) will seek to provide sustainable, affordable and accessible high quality homes. The SHIP projects around £49 million of subsidy will be required to deliver over 700 high priority projects over the next 5 years. The Scottish Government, Council and its partners will collectively look at those projects that can deliver over this period and allocate resources in the best way to maximise delivery and funding.

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

Financial Strategy

- The purpose of the financial strategy is to provide clear direction on how the Council will manage its financial resources 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, and sets the overarching framework for managing both revenue and capital investment decisions over a 5 year financial planning period, and is updated on an annual basis. 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 investment programme. The programme will provide an indication of the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or making best use of longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet prevailing Council risk or cost objectives.

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 respective asset management plans 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. The governance arrangements for capital investment decisions across the Council are set out in the sections below.

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

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

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

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

- 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.

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

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

5. Capital Investment Plans

5.1 The current capital investment plans cover a 10 year planning period, with a 5 year approved programme. These plans are updated annually with a separate plan for both General Services and Housing Revenue Account (HRA).

5.2 The capital investment plans approved in February 2019 over the next 5 years totalled £484 million (General Services - £313 million and HRA £171 million). A summary of the spending plans are set out in the Table 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.

5.3 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 5 years, the estimated level of investment is likely to be in excess of £146 million. A significant proportion of this additional investment will be supported through income contributions derived through the Developer Contributions Framework, and the Council will continue to collaborate with the Scottish Government and Scottish Futures Trust (SFT) to identify additional grant funding to deliver a well-designed school estate.

Approved Capital Investment Plans

	2019/20 £000	**2020/21 £000**	**2021/22 £000**	**2022/23 £000**	**2023/24 £000**	**TOTAL £'000**
General Services Gross Exp	52,074	74,931	68,374	61,387	56,295	313,061
HRA Gross Exp	32,890	31,499	35,305	35,291	35,856	170,841
TOTAL Gross Exp	**84,964**	**106,430**	**103,679**	**96,678**	**92,151**	**483,902**

General Services Income	(36,257)	(38,232)	(31,811)	(39,936)	(30.435)	(176,671)
HRA Income	(12,922)	(8,969)	(9,601)	(10,879)	(7,934)	(50,305)
TOTAL Income	**(49,179)**	**(47,201)**	**(41,412)**	**(50,815)**	**(38,369)**	**(226,976)**
Net General Services	**15,817**	**36,699**	**36,563**	**21,451**	**25,860**	**136,390**
Net HRA	**19,968**	**22,530**	**25,704**	**24,412**	**27,922**	**120,536**
TOTAL Net Borrowing	**35,785**	**59,229**	**62,267**	**45,863**	**53,782**	**256,926**

Capital Funding

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

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

5.6 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. The cost of borrowing is included within the Council's revenue budgets through Loans Fund Charges, and the impact of borrowing is included as part of the Council's Treasury Management and Investment Plans.

5.7 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. These funds are not currently reflected to finance existing approved capital investment plans, but remain within the wider Council's General Fund reserves.

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

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

Treasury Management Strategy and Loans Fund

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

5.9 The key prudential and treasury indicators include:

- Capital Financing Requirement (CFR)
- Operational Boundary
- Authorised Limit

5.10 As reflected within the Treasury Management Strategy and recent mid-year Treasury review considered by Audit & Governance Committee, the Capital Finance Requirement for the Council is expected to rise from the current estimate of £475 million to £599 million by 2023-24 in line with the existing approved capital investment plans. Whilst this increase remains well within the approved Authorised Limit (which represents the limit beyond which external debt is prohibited), this also increases the cost of General Services financing costs relative to the Council's estimated net revenue stream from 8.29% to 9.95%. Whilst overall this remains broadly consistent with other authorities as set out in the most recent Benchmarking Statistics, if this trend continues to increase, the costs will place an increased additional burden on future Council tax payers. The short and medium term financial prospects for the Council are expected to remain challenging, and any additional loans fund charges must be met within the overall financial envelope available to the Council and as a consequence, this will require difficult choices to be made.

Loans Fund

5.11 The Council's Loans Fund is a complex mix of both principal and interest repayments which are charged to the Taxpayer or Rent Payer to support the cost of borrowing to fund capital expenditure. During 2018-19 annual accounts, the Council undertook a review of its loans fund, which resulted in changes to the period and amount of repayment of historical and current loans fund advances. This review resulted in a positive contribution to reserves in 2018-19, and has resulted in a more prudent profile of loans fund advance charges. Alongside this, the review provided a retrospective realignment that will enable some smoothing of future loans fund advance liabilities arising from the significant investment levels planned across the current 5 year financial strategy period, and is expected to deliver a benefit at similar levels in 2019-20 from reduced loans fund advances relative to approved budget levels. Thereafter however, the loans fund charges are expected to rise significantly.

5.12 On 9 October 2019, the Treasury and PWLB announced a 1% increase in the PWLB rate for all new borrowing, with immediate effect and without any warning. In recent years, the Council has predominately used PWLB as its main source of funding partly due to the level of risk and interest rates available. An anticipated increase in interest rates had already been included within future capital investment plans, and therefore this increase is unlikely to impact in this financial year. Going forward however, the Council may need to consider further both the affordability of capital investment plans and potentially seek alternative sources of borrowing in order to achieve the best rates and terms. Whilst it remains unclear the extent of any future increase in borrowing rates, the Council's treasury advisor, Link Asset Services is currently forecasting that all PWLB rates are likely to increase over the next few years.

5.13 Given this, it will be necessary to ensure that future Capital Investment plans remain affordable and sustainable, and that any economic benefit derived from future capital investment plans has a positive benefit the wider economy of East Lothian.

6. Management of Risk

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

6.2 Current risks include:

- Increased infrastructure costs due to inflationary increases particularly relating to projects which are not due to commence in the short term.

- Uncertainty around the funding of capital investment plans including future level of interest rates and associated cost of borrowing, as well as the timing and realisation of any anticipated capital receipts, and other associated contributions. The Council has an adopted Local Development Plan (LDP) however changes in economic conditions can place a significant risk on the Council on the Council's plans.

6.3 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.

7. Capital Strategy

7.1 The Financial Strategy sets out a number of requirements to both assist capital investment decisions and importantly, manage the associated risk. Given this, the Capital Strategy will include:

- Maximising the capital income available to the Council.

- 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, but importantly remain affordable based on a clear understanding of both capital and future revenue costs.

- In support of ensuring affordability for current and future tax payers, the Council should work to minimise the additional net borrowing to the Council in future years and ensure that General Fund loans fund charges over the lifetime of the strategy should be set at a limit 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.

8. Summary

8.1 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 the necessary public 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.