

REPORT TO: East Lothian Council

MEETING DATE: 27 August 2024

BY: Executive Director for Council Resources

SUBJECT: Budget Development 2025-26 Onwards

1 PURPOSE

- 1.1 To set the context for developing the five-year budget plan for 2025/26 onwards.
- 1.2 To provide updated budget projections and a revised funding gap, and to highlight the key assumptions and risks within these.
- 1.3 To outline the process and next steps for setting the financial strategy and budgets for 2025/26 onwards.

2 RECOMMENDATIONS

- 2.1 The Council is recommended to:
 - Note the financial outlook, and revised budget projections and key assumptions for financial planning 2025/26 onwards set out within the report.
 - Note the significant risks which the council continues to face to financial sustainability and setting a balanced budget.
 - Agree the next steps to developing the budget and financial strategy for 2025/26 onwards.

3 BACKGROUND

- 3.1 This report sets the context for developing the 5-year financial strategy and budget plan for 2025/26 onwards, including key considerations for both revenue and capital General Services and Housing Revenue Account (HRA) budgets. It covers an overview of the current national and local

context, an update to the high-level revenue projections for general services, key assumptions, risks and next steps.

National and Local Context

- 3.2 Councils are currently facing a significant range of uncertainties within budget planning as we await the outcomes of UK Government's Spending Review, Autumn Statement and the subsequent budget announcements that will likely follow from Scottish Government. Members will be aware that the local government finance settlement for 2024/25 was a one-year settlement, which presents a significant challenge to medium-term financial planning.
- 3.3 Scottish Government had previously announced the forthcoming publication of its financial strategy which was anticipated in June 2024. This has now been delayed and will be aligned with the budget announcement meaning that councils will not be sighted on this for a number of months. Current financial planning is therefore based on the Resource Spending Review of May 2022, and it is currently unclear whether or not there will be a fiscal event prior to the UK Government's Autumn Budget statement which is anticipated in late October.
- 3.4 The financial environment across the whole of the public sector remains extremely challenging, and the Deputy First Minister has recently announced the need to apply emergency spending controls across all departments, with further spending in 2024/25 only being permitted if it is 'truly essential or unavoidable', noting that supporting the public sector workforce would require some 'tough decisions'.
- 3.5 While the implications of this at a local level remain to be seen, this is a clear indicator that the funding challenges which the Council has faced in recent years are likely to remain a prominent feature of budget setting over the medium term. This means that the Council's financial strategy must maintain focus on taking sustainable budget decisions and ensuring that resources are targeted to the highest areas of need, and is likely to require the redirection of resource away from some existing areas of service delivery.
- 3.6 Council agreed the 5-year budget plan for 2024/25 onwards on 20 February 2024, which reflected the following:
 - Council tax freeze in 2024/25, with indicative increases of 10% in 2025/26 and 5% annual increases in the subsequent three years.
 - Revenue savings of £16.5m over the next 5 years.
 - Use of the capital reserve to smooth the impact of debt charges in 2024/25, 2025/26 and 2026/27.
 - Use of £1m reserves in 2024/25, to be repaid in 2025/26.
 - Capital investment (general services) of £364m over the next 5 years.
 - Allowance for pay pressures of 3% in 2024/25, and 2% in the subsequent four years.

- Flat cash settlement in all years other than 2026/27, aligned to Scottish Government's Resource Spending Revenue of May 2022 which, at that time, assumed a funding uplift in that year. This is reflected as additional funding of £1.8 million in 2026/27. However, it should be noted that this position may change as a result of forthcoming fiscal events over the autumn.
- 3.7 Ongoing challenges relating to the impact of population growth and demographic change are continuing to increase the gap between available funding and growing expenditure demands. As one of the fastest growing council areas in Scotland, this remains a significant challenge at a local level, and is set alongside other pressures facing the whole of the public sector including pay and contract inflation, growing demand for services and increasing expectations arising from new policy commitments at a national level.
- 3.8 Officers and members continue to raise awareness of these challenges through the appropriate channels within Scottish Government and COSLA.

Revised Budget Projections – GS Revenue

- 3.9 The strategic budget model has been rolled forward and updated to reflect recent developments likely to significantly impact the financial projections. In accordance with the budget development framework, the strategic projections span the next 5 years, and the budget model has been updated to incorporate 2029/30 as year 5. A summary is provided within **Appendix 1**, and other key changes are summarised below:

Pay: Scottish Government published its Public Sector Pay Policy on 30 May 2024, which reflects 3% annual uplifts (2% from April with an additional 1% from January) for 2024/25, 2025/26 and 2026/27. While this does not dictate future local government pay settlements, it is likely to be inform these negotiations and provision has therefore been made to accommodate increases of this level within the updated budget projections set out in **Appendix 1**. The 2024/25 pay settlement remains subject to ongoing negotiation, and this presents a risk of additional pressures if a settlement in excess of 3% is reached without additional funding to support this.

Cost pressures: the model has been updated to reflect revenue budget pressures including revenue costs of capital.

Funding: the year 1 (2025/26) projection reflects additional General Revenue Grant (GRG) of £1.217m, which was announced subsequent to the Council's budget for 2024/25 being set, along with the baselining of £0.4m funding to support the 2023/24 pay award.

Council tax: no changes have been made to the previously assumed uplifts in council tax charges of 10% in 2025/26 and 5% annual increases

thereafter, but projections have been updated to reflect current assumptions regarding the tax base (i.e. the number of properties liable to pay council tax, adjusted according to banding and assumed levels of discounts and reductions).

Savings: as noted above, Council has previously agreed to the delivery of savings measures totalling £16.5 million over the next 5 years (including the current financial year). Officers are continuing to work to progress these decisions; however, a high degree of risk has been identified with regard to the timing of delivery of some of the agreed savings. **Appendix 1** accordingly reflects a reprofiling of £2.5 million of agreed savings from 2025/26 and the updated model assumes that these savings will now be achieved from 2027/28 onwards. While this represents a neutral change overall, this increases the budget gap in year 1 (2025/26).

- 3.10 The results of this give rise to an updated 5-year budget gap of £64.866 million including IJB pressures of £12.329 million. Members will be aware that both the Council and the IJB must set balanced budgets which means taking steps to close the gap between the available resources and expenditure demands.
- 3.11 After taking account of savings previously agreed by Council, indicative council tax rises of 10% in 2025/26, and annual increases of 5% in the subsequent four years, the residual five-year budget gap remains at £17.487 million for Council services and £12.329 million for the Health & Social Care Partnership (HSCP) budgets. In setting balanced budgets for each of these years, Council will need to agree savings or apply further council tax increases in order to close the budget gap, unless additional government funding is forthcoming. HSCP budgets are set by IJB and will require to be balanced either through the identification of savings or additional funding.
- 3.12 Comparing the 5-year projections within **Appendix 1** to the budget agreed by Council on 20 February 2024, the key movements totalled over 5 years are as follows:
- Pay pressures totalling £6.6 million.
 - Growth including revenue costs of capital and debt charges totalling £2.3 million.
 - Funding increases (GRG) of £1.6 million.
 - Increased council tax income, linked to updated assumptions around housing completions of £2.8 million.
 - Presentational changes also reflect the total IJB budget pressure (£12.3 million) within the total budget gap for the council.
- 3.13 While the overall 5-year funding gap for the Council has reduced from the level it was at previously, this represents a significant challenge which will likely require both Council and the IJB to take some difficult decisions as part of the budget development process.

- 3.14 It is recommended that the high-level projections set out within **Appendix 1** form the initial basis of financial planning to develop the general services revenue budget for 2025/26 onwards. Detailed work is underway to update the underlying projections, and the updated model will be shared with Council when the budgets for 2025/26 onwards are set, with material movements communicated to councillors in advance of this. Key areas of ongoing work include:
- Updates to incorporate implications arising from UK and Scottish Government budget announcements and the 2025/26 local government finance settlement.
 - Updates to reflect the anticipated impact of demographic change.
 - Updated debt charges aligned to the revised capital programme, interest and cash flow forecasts.
 - Updates to bring inflationary and indexation pressures in line with the correct levels.
 - Detailed work to reflect the implications of future pay award at service budget level, along with any potential impact on grading.
 - Revised cost pressures to incorporate material changes to policy or external risk factors which require to be funded.
 - Inclusion of proposed savings to close the funding gap enabling a balanced budget to be set for 2025/26.
- 3.15 The in-year budget position at Quarter 1 reflects significant emerging pressures across a range of services, most notably within both Children's Services and Adult Social Care, which is a continuation of the provisional outturn position reported for the last financial year. Although significant efforts are being made to manage these budgets and develop measures to mitigate any potential budget overspends, these services, along with others are facing growing demand pressures driven by a variety of external factors including changing demographics and potential risk to service users. It is important that budgets are set on a realistic basis, and further consideration will be given to this.
- 3.16 In-year monitoring has also identified pressures emerging as a result of slippage in the delivery of planned savings due to the lead time required to make the necessary changes to services. As noted earlier in the report, **Appendix 1** seeks to address this by reprofiling some of the agreed savings which are felt to present a risk due to future budgets due to further slippage. Earlier consideration and agreement by Council to policy changes which will enable future savings to be unlocked will also help to mitigate this risk going forward.

Scenario Planning

- 3.17 Recognising the range of variables that exist within the updated projections, two alternative scenarios have been developed which reflect the potential impact of changes to the key assumptions reflected in **Appendix 1**. The three scenarios are summarised below with the 'neutral'

case used for planning purposes set against alternative favourable and adverse scenarios.

	2025/26 £000	2026/27 £000	2027/28 £000	2028/29 £000	2029/30 £000	Total £000
Favourable	18,915	8,072	10,836	7,677	9,046	54,547
Neutral	21,742	10,528	12,963	10,098	9,535	64,866
Adverse	22,402	12,889	13,485	10,619	10,024	69,418

Table 1: Scenario planning: Funding gap, Council + IJB

	2025/26 £000	2026/27 £000	2027/28 £000	2028/29 £000	2029/30 £000	Total £000
Favourable	-125	6,021	7,971	1,966	3,083	18,917
Neutral	5,266	8,614	9,223	3,511	3,202	29,816
Adverse	10,265	11,622	10,389	4,696	4,386	41,357

Table 2: Scenario planning: Savings required, Council + IJB

3.18 Within Tables 1 and 2 above, the following variables have been applied to the assumptions applied in the neutral scenario.

Favourable scenario

- Assumes that any pay award in excess of 2% will be funded by Scottish Government.
- Assumes a 10% higher completion rate on new homes for council tax purposes than the neutral scenario in all 5 years.
- Table 2 assumes that all savings will be delivered in line with existing plans.
- Assumes a reduced level of emerging service pressures.

Adverse scenario

- Assumes flat cash funding in all 5 years.
- Assumes a 10% lower completion rate on new homes for council tax purposes than the neutral scenario in all 5 years.
- Assumes that council tax increases will be capped at 5% in 2025/26.
- Assumes increased pressures arising from policy change at a national level, reflecting the current risks faced around maintaining teacher numbers and minimum learning hours.

3.19 While it is unlikely that all the assumptions set out in the adverse scenario above would materialise, these scenarios reflect key variables that will have a material movement on the Council's finances and as such this sets out the potential scale of risk which the Council could face, amounting to a 5-year funding gap of £69.4 million.

Integration Joint Board

- 3.20 Previous budgets have assumed that financial pressures arising from pay and inflation are met through savings identified from within IJB budgets. For 2024/25, this has resulted in substantial savings needing to be delivered in order to close the budget gap. In the context of the IJB's very limited unallocated reserves, there is a risk that a continuation of this strategy could result in a budget position which cannot be sustained, resulting in overspends needing to be met by funding partners, and potential risk to service users. Council will need to give consideration these budget pressures when determining the budget offer to the IJB.

Budget Development Principles

- 3.21 Council has adopted the following budget development principles as part of the current Financial Strategy:

1. Establishment of a cross-party budget working group to oversee the development of detailed budget proposals and the different work streams supporting this.
2. Commitment to developing an approach aligned to the financial strategy which combines a range of options to close the gap between available funding and anticipated expenditure including an enhanced programme of transformation, asset review, income generation, cost reduction and efficiency.
3. A holistic approach to budget development, which recognises the relationship between capital and revenue planning and the role of investment in cost reduction strategies.
4. Commitment to minimising the use of one-off resources to balance the budget and ensuring that use of reserves is limited to investment that will deliver ongoing cost reductions.
5. Ensuring alignment of financial planning and resources with wider strategic priorities, the Council Plan and consultation results.
6. Consideration of a 5-year budget plan aligned to the financial and capital strategies.

- 3.22 In addition, the financial strategy identifies the following critical enablers to support the delivery of change which will be vital to ensuring financial sustainability, as well as seizing opportunities which enable improvement and innovation:

- Investing in digital transformation
- Resourcing and enabling the asset review
- Support for service reviews & wider transformation
- Cost reduction through energy efficiency

- Investment in early intervention and prevention
 - Developing and growing income streams
- 3.23 Council has made a commitment to support transformation workstreams through reserves created through the application of fiscal flexibilities in 2023/24. The proposed Transformation Strategy, which is subject to consideration by Council at this meeting, details the vision and approach to transformation, as well as the arrangements in place to monitor and report progress.
- 3.24 It is considered that these principles and enablers remain appropriate in the context of the significant and ongoing challenges which the Council faces in relation to the financial environment.
- 3.25 The cross-party budget working group has continued to meet and has started to consider detailed budget proposals and associated impacts for 2025/26 onwards.

General Services Capital

- 3.26 As noted elsewhere in this report, the 5-year capital plan agreed by Council on 20 February 2024 reflects capital expenditure plans totalling £364 million. After taking into account slippage from 2023/24 capital budgets, gross planned capital expenditure over the next 5 years of £365.5 million is expected, giving rise to a net borrowing requirement of £118.8 million.
- 3.27 In the context of the existing capital financing requirement of £365 million for general services, consideration will need to be given to the sustainability of the current and future capital programmes in terms of the overall debt position, as well the revenue costs of financing this.
- 3.28 Population growth has been one of the key drivers of capital investment in recent years, with investment in the learning estate representing a significant proportion of recent and planned capital expenditure. In light of funding constraints, increased borrowing costs and reduced availability of capital grants it is appropriate at this stage to consider and prioritise these plans within current affordability parameters, using the criteria set out in the capital strategy:
- Expenditure required for statutory reasons, for example to ensure that an asset meets any health and safety requirements;
 - Self-funding schemes which fit in with strategic planning priority outcomes and resource requirements;
 - Priority schemes with significant external funding;
 - Schemes directly focused on Council Plan priority outcomes;
 - Schemes which will support the delivery of recurring savings within the Councils revenue budget (investment to save);
 - Schemes which will deliver significant social and health benefits within the housing provision.

- 3.29 The capital strategy also requires that all projects have an identified source of funding to support any on-going revenue costs associated with the use of a capital asset, and these must be built into future financial projections.
- 3.30 Revised future capital expenditure requirements will be collated over the coming weeks and will need to be considered against these criteria.

Housing Revenue Account

- 3.31 As part of the budget meeting in February 2025, Council will meet to set the rent levels for the next financial year. The core assumptions set out in the existing strategy reflect assumed annual increases of 5%, subject to the satisfaction of the following key tests:
- Minimising the impact of debt charges by operating within the recommended upper limit for the ratio of debt charges to income of 40% and maximising the in-year use and application of capital receipts, available capital grants, and revenue balances where possible.
 - In support of contingency planning, ensuring that the reserve or balance left on the HRA does not fall below £1.0 million, allowing the Council to maintain a cushion against any unexpected increase in costs or loss of income.
- 3.32 Risks arising from the removal of affordable housing subsidy for the current financial year, coupled with uncertainty over the availability of funding in future years present a significant risk to financial planning, and the Council's capacity to increase the supply of affordable housing in East Lothian. Officers are in the process of updating HRA budget projections for 2025/26 onwards, and the implications of these risks will require careful consideration to ensure that revised plans remain sustainable in the context of reduced capital funding.

Conclusion and Next Steps

- 3.33 The context within which budgets for 2025/26 onwards are being developed continues to present immense challenges, and the current financial environment remains the biggest risk to all services and the council's capacity to achieve its ambitions. Despite this, the recurring general services revenue budgets continue to commit annual expenditure in excess of £300 million to support service delivery, alongside significant capital investment to meet the needs of our growing population. Budget planning will therefore focus on a sustainable approach to prioritising these resources to ensure that the best possible outcomes are achieved for East Lothian residents, and that limited resources are targeted to the areas of greatest need.
- 3.34 The current indicative budget development timetable, agreed by Council in April is based around a Council meeting to agree the budgets, set

council tax and rent levels on 18 February 2025. Key milestones and activities are summarised below:

Date	Meeting	Action
October 2024	n/a	UK Government Autumn Statement
TBC November / December 2024	n/a	Scottish Government Budget + Medium Term Financial Strategy
December 2024	Council	Q2 Financial Update report, to include an overview of progress towards delivering agreed savings for 2025/26.
December 2024	Council	Consider the Financial and Capital Strategies for 2025/26 onwards.
TBC / December 2024	n/a	Draft Local Government Finance Settlement
January 2025	Cabinet	Consider the initial messages from the draft local government finance settlement and the high-level budget plan.
TBC February 2025	n/a	Final Local Government Finance Settlement
February 2025	Council	Agree the revenue and capital budgets for general services and the HRA for 2025/26 onwards, and to set council tax and rent levels for the forthcoming financial year. Agree the Treasury Management Strategy.

Table 3: Indicative budget development timetable 2025/26 onwards

- 3.35 Over the coming months, officers will continue to develop detailed projections and budget proposal to support the cross-party budget working group and wider considerations by members around budget development.

4 POLICY IMPLICATIONS

- 4.1 This report sets the context for development of the Council's budget and financial strategies which seek to maintain alignment with the policy direction set out in the Council plan. The objectives support the short-term priority of ensuring financial sustainability by delivering approved savings and transforming service delivery.

5 INTEGRATED IMPACT ASSESSMENT

- 5.1 This report is for noting only and therefore does not require an impact assessment. Integrated impact assessments relating to specific decisions or policy changes made through the budget development process will be undertaken at the appropriate time. With the commencement of the United Nations Convention on the Rights of the Child (Incorporation) (Scotland) Act 2024, the Council is required to ensure that decisions taken as part of the budget are not incompatible with the rights of children.

6 RESOURCE IMPLICATIONS

- 6.1 Financial – as described in the report.
- 6.2 Personnel - none
- 6.3 Other – none

7 BACKGROUND PAPERS

- 7.1 Report to Council on 12 December 2023 – Financial and Capital Strategies 2024-29

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High Level Revenue Budget Summary - General Services
2025/26 - 2029/30

	2025/26 £000	2026/27 £000	2027/28 £000	2028/29 £000	2029/30 £000	Total £000
Base Budget	310,377	318,701	322,563	324,875	329,496	
Growth						
Pay	6,741	6,368	6,651	5,509	5,211	30,480
Inflation & indexation	2,951	3,145	3,071	3,110	3,044	15,321
Growth including RCC	5,565	3,666	3,196	987	520	13,934
Debt charges	8,109	0	45	492	760	9,406
TOTAL	23,366	13,179	12,963	10,098	9,535	69,141
Funding / income changes						
RSG - funding for existing policy commitments	-1,620	-1,800	0	0	0	-3,420
RSG - funding for new policy commitments						
RSG - additional funding						
SFT funding	-1,010	155	0	0	0	-855
GF Balance	1,006	-1,006	0	0	0	0
TOTAL	-1,624	-2,651	0	0	0	-4,275
FUNDING GAP COUNCIL + IJB	21,742	10,528	12,963	10,098	9,535	64,866
Budget pressure within IJB services	2,314	2,556	2,524	2,267	2,668	12,329
Budget pressure within Council Services	19,428	7,972	10,439	7,831	6,867	52,537
Council tax increase y1-5 10%/ 5% / 5% / 5%/ 5%	-9,097	-5,295	-5,374	-5,587	-5,833	-31,186
Use of capital reserve	-7,759	5,475	4,219	0	0	1,935
TOTAL	-16,856	180	-1,155	-5,587	-5,833	-29,251
GAP BEFORE SERVICE REDUCTIONS	4,886	10,708	11,808	4,511	3,702	35,615
Existing savings plans (breakdown below)	-3,120	-2,094	-1,585	0	0	-6,799
Risk to savings delivery	2,500	0	-1,000	-1,000	-500	0
BUDGET GAP REMAINING	4,266	8,614	9,223	3,511	3,202	28,816
PROPOSED ADDITIONAL SERVICE REDUCTIONS	0	0	0	0	0	0
ADDITIONAL USE OF RESERVES	1,000	0	0	0	0	1,000
REVISED BUDGET GAP COUNCIL + IJB	5,266	8,614	9,223	3,511	3,202	29,816
REVISED BUDGET GAP COUNCIL (EXCLUDING IJB)	2,952	6,058	6,699	1,244	534	17,487

Breakdown of Planned Savings

	2025/26 £000	2026/27 £000	2027/28 £000	2028/29 £000	2029/30 £000	Total £000
EXISTING SAVINGS (previously agreed by Council)						
Finance staffing reductions	0	0	-85	0	0	-85
Shared Services Arrangement - Internal Audit	-45	-14	0	0	0	-59
Project Manager cost saving City Deal	0	-80	0	0	0	-80
Income generation	-1,000	-1,000	-500	0	0	-2,500
Asset Review	-1,000	-1,000	-1,000	0	0	-3,000
Reduction in budget for IMI	-235					-235
Redesign of libraries service	-120					-120
Further asset review savings	-600					-600
Income generation	-120					-120
TOTAL BUDGET SAVINGS & EFFICIENCIES	-3,120	-2,094	-1,585	0	0	-6,799