REPORT TO:	East Lothian Council
MEETING DATE:	10 December 2024
BY:	Executive Director for Council Resources
SUBJECT:	Financial and Capital Strategies 2025-30

1 PURPOSE

1.1 To provide an update on the financial outlook facing this Council.

1.2 To provide an update on the budget development process which will inform the setting of budgets for 2025/26 onwards.

1.3 To seek approval for the 2025/26 to 2029/30 Financial and Capital Strategies attached as Appendices 1 and 2.

2 RECOMMENDATIONS

2.1 The Council is recommended to:

- Note the financial outlook, budget projections and key assumptions for financial planning 2025/26 onwards set out within the Financial Strategy in Appendix 1 and summarised in the report.

- Note the changes to the current approved strategy and approve the updated Financial Strategy for 2025/26 to 2029/30 set out in Appendix 1.

- Note the changes to the current approved strategy and approve the updated Capital Strategy for 2025/26 to 2029/30 set out in Appendix 2.

- Approve the budget development process set out in paragraph 3.12 which will inform the development of 2025/26 and future years budget proposals.

- Note that agreeing the process set out in paragraph 3.12 will mean that there will be no option to submit amendments to the budget papers after noon on 6 February, other than for the correction of errors.

- Agree to delegate authority to the Chief Financial Officer and Monitoring Officer, in discussion with Political Group Leaders to make any necessary changes to the timelines set out in paragraph 3.12.

- Note the indicative timetable for the parliamentary process for Scottish Government's 2025/26 budget, set out paragraph 3.18.

- Agree that any funding announced after 6 February 2025 will be held as contingency to offset budget risks and future year pressures in the first instance, with any subsequent decision to commit this funding being considered at a future Council meeting.

3 BACKGROUND

3.1 The Financial and Capital Strategies set the framework for deploying available resources to support Council priorities meet statutory responsibilities. It is important that these strategies are considered alongside one another to support a holistic approach to budget development.

3.2 Council approved the current five-year Financial and Capital Strategies on 12 December 2023. Although the strategies cover a five-year period, they are subject to an annual refresh to ensure that they remain appropriate and reflect any developments relevant to financial planning. More details setting out the key elements updated in the strategies are set out in the sections below.

Financial Outlook

3.3 Council continues to receive regular updates on the current and future financial outlook and the significant risk and uncertainty associated with this. Since the most recent finance update provided in October, the Chancellor has presented the Autumn Budget Statement, which set out increases in UK Public Spending and confirmed updated Block Grant funding totals for Scottish Government. On 4 December, Scottish Government will announce their 2025/26 budget. Given that this is not available at the time of writing the report, a verbal update will be provided at the Council meeting of any key messages emerging from this.

3.4 The amount of funding allocated to this Council will not be known until the draft local government finance settlement is published on 12 December. Although the recent budget statement provided additional funding consequentials to the Scottish Government of £3.4 billion over 2024/25 and 2025/26, early indications suggest that a significant proportion of this funding will need to be directed to support public sector pay awards, and the position beyond 2025/26 remains unclear.

3.5 The Financial Strategy document in Appendix 1 sets out the budget projections for the next five years and reflects an anticipated funding gap of £64.9 million over this period. This was reported to Council in August 2024 and Members are asked to note that these projections will be updated following receipt of the draft settlement.

3.6 It is currently unclear what spending choices will be made by the Scottish Government and the specific impact on the Council's finances for next year and beyond. However, it appears likely that pressure on public finances will remain alongside range of growing demands and pressures, which will mean some difficult choices in the years ahead in terms of developing sustainable services for our communities.

Financial and Capital Strategies

3.7 The Financial and Capital Strategies included as Appendices 1 and 2 cover the financial period 2025-30. These strategies have been updated to reflect any key areas which may change the current strategy and support the budget development process and have also been extended to cover the period until 2029/30.

3.8 The Council has already endorsed a strategy aligned to progressing with key themes which are set out below, and it is considered essential that the Council continues to work at pace and adopt policy which is aligned to these themes and focus on supporting the on-going sustainability. As a reminder these key themes are:

- Asset rationalisation and energy efficiency
- Income generation
- Transformation, service redesign and digitalisation
- Service reductions

3.9 In June 2023, Council approved an updated reserves strategy which set out plans for utilising the council's limited reserves to support ongoing sustainability. As such, the current strategy has been updated to reflect the current position.

3.10 In addition, the Council must ensure that it continues to proactively lobby to ensure that the revenue and capital implications of a growing local economy are supported by both national governments, and the shared ambition and opportunities is not lost. The financial implications facing this Council in supporting this ambition have been well documented and remain a significant area of concern and challenge. The benefits and opportunities that this Council and national government can deliver through economic growth, particularly at a time when the national economic forecasts remain challenging is essential and includes: support and creation of jobs, economic regeneration, and increases to national revenues through increased tax. This Council has taken responsible and appropriate decisions to support national housing land supply allocations, but the severity and scale of the financial implications aligned to delivering this must be supported. If it is simply left to the Council alone with no additional funding to meet these costs, then this will result in a major deterioration of essential local services or could simply put a halt on the growth ambition and meeting statutory housing obligations.

3.11 The key areas within both strategies that have been updated are set out below:

- Current economic context including further information arising from recent Autumn Budget Statement;
- Updated financial scenario planning and key assumptions setting out the projected revenue funding gap over the next five years;
- Updated reserves position and strategy aligned to the June Council position.
- Updated capital planning framework covering the five-year period to 2029/30.

Budget Development Process

3.12 The below process is recommended for development and approval of budgets for 2025/26 and if agreed will apply to both General Services and Housing Revenue Account (HRA) budgets:

21 January 2025 – updated budget model presented to Cabinet for noting

27 January 2025 by midday – deadline for group leaders who wish to submit draft budget proposals to the Head of Finance

28 January 2025 – draft budget proposals submitted for all groups shared with the cross-party group, after checking for competence

6 February 2025 by midday – deadline for all groups to submit final budget proposals for the Council meeting

11 February 2025 – papers published for Council meeting

18 February 2025 – Council budget-setting meeting.

3.13 This represents a change to the process followed in previous years and will mean that all groups will have the opportunity to submit budget proposals, either individually or collectively as a cross party approach. The period between 31 January and 6 February is intended to enable Members to identify areas of commonality in draft budgets and explore opportunities to develop a cross party budget. It is recommended that Council agrees this approach.

3.14 Members are also asked to note that by agreeing this approach, the opportunity to submit formal amendments to proposed budgets for debate at the Council meeting will no longer be a feature of the budget-setting process. However, all groups will be entitled to submit proposals either individually or on a collaborative (cross-party) basis up to the 6 February.

3.15 Members may wish to submit alternative proposals for General Services budgets, HRA budgets or both. The HRA revenue and capital budget will be considered as a separate agenda item to the General Services revenue and capital budgets, and voting will consider the revenue and capital budgets together as a single item.

3.16 All proposals must have a seconder and must be considered competent by the Section 95 officer. Officers will continue to work with members to ensure that proposals meet the competency test in advance of the deadlines set out above. During the Council meeting on 18 February, members will be asked to vote for the budget they wish to support. The budget with the majority of votes will be passed and adopted by Council for 2025/26.

3.17 Members are reminded that it is a legal requirement for councils to set an annual budget and for that budget to be balanced (fully funded).

Scottish Government Budget Timetable

3.18 The draft local government finance settlement will be published on 12 December 2024. Provisional dates for the budget bill are set out below:

Stage one: 4 February 2025

Stage two: 18 February 2025

Stage three: 25 February 2025

The debate on the LG Finance Order is usually held a week after stage three.

3.19 This timetable means that Council will agree the budget on the basis of the draft local government finance settlement and any subsequent announcements up to the 6 February. It is not advisable to delay the budget meeting beyond the 18 February due to the risk this poses to the annual billing process for council tax and rent collection. As has been seen in previous years, there is a possibility that funding will be announced in the later stages of the process. In the event that funding is announced subsequent to the 6 February 2024, it is recommended that this is held as contingency to offset risks within proposed budgets and pressures in future years. Any subsequent decision to commit funding announced in the later stages of the settlement could be considered at a future Council meeting.

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 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 East Lothian Council on 27 August 2024 – Budget Development 2025/26 Onwards

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DATE	28 November 2024

Appendix 1

East Lothian Council

Financial Strategy 2025-30

East Lothian Council

Contents

1. Introduction

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

1.2 This strategy covers the 5-year period from 2025/26 and has been developed in the context of the most challenging financial environment this council has ever faced. As one of the fastest growing councils in Scotland, there are increasing demands for our services which have not been met through real terms funding increases, leading to us becoming the Council with the third lowest level of per capita funding in Scotland. Like all public bodies, we have continued to see costs escalate as a result of high inflation and rising interest rates. The local authority sector continues to face significant uncertainty surrounding future funding settlements with economic instability and the prospect of a recession creating significant pressure on public finances. This is compounded by the wide range of concurrent risks including the turbulence within global economies and the cost-of-living crisis which are creating increasing pressure on Council services.

1.3 The Council currently receives a significant proportion of its funding from Scottish Government. The UK Government made its autumn statement announcement on 30 October 2024, and a multi-year spending review announcement covering the period between 2026 and 2030 is anticipated in spring 2025. The draft Scottish Government 2025/26 budget will be published on 4 December 2024 ahead of the draft local government finance settlement on 12 December. Similar to previous years, the national funding settlement will remain in draft until it passes through the parliamentary scrutiny process in the Sottish Parliament, with the final position unlikely to be confirmed until mid-February 2025. It is anticipated that this will be a one-year settlement covering 2025/26 only, which means that uncertainty will remain for the period beyond 2025/26. Given the acute pressure on public finances, it is likely that the gap between available resources and expenditure demands will not be met through external funding, meaning that the Council will need to find further ways to reduce its cost base, or grow its income streams.

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

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

2. Commitment to developing an approach aligned to the financial strategy which combines a range of options to close the gap between available funding and

anticipated expenditure including an enhanced programme of transformation, asset review, income generation, cost reduction and efficiency.

3. A holistic approach to budget development, which recognises the relationship between capital and revenue planning and the role of investment in cost reduction strategies.

4. Commitment to minimising the use of one off resources to balance the budget and ensuring that use of reserves is limited to investment that will deliver ongoing cost reductions.

5. Ensuring alignment of financial planning and resources with wider strategic priorities, the Council Plan and consultation results.

6. Consideration of a 5-year budget plan aligned to the financial and capital strategies.

1.5 This strategy will support financial sustainability by:

- Outlining high level financial projections for 2025/26 to 2029/30 based on a range of key assumptions.
- Setting out the wider economic context and external factors which will impact financial planning and available resources.
- Ensuring that limited available resources are focused on delivery of the Council's approved key priorities and plans and their associated key outcomes.
- Providing a solid financial planning platform for the development of a sustainable revenue budget which will support the Council's key priorities.
- Documenting range of financial challenges and uncertainties facing the council, and setting out the approach for responding to these challenges,
- Defining the Council's approach to holding and utilising balances and reserves, ensuring that an appropriate balance between risk management and investment is achieved.
- Increasing both organisational awareness and wider community understanding of the Council's financial position and the challenges it is facing over the medium term in balancing and delivering against its budget.
- Identifying the key enablers to support the delivery of measures to reduce Council's net cost base.
- Supporting the acceleration of transformation programmes to reshape services around the resources available.

1.6 The strategy covers the financial planning period until 2029/30 for the General Services and Housing Revenue Account (HRA). This document should be read in conjunction with the Council's Capital Strategy which sets the framework for the Council's capital expenditure plans and the governance.

2. Current Economic Context

2.1 The Council continues to face exceptional financial challenges with external factors placing acute pressure on resources and the Council's capacity to balance its budget and set sustainable spending plans. Although inflation (CPI) has fallen to 2.3% at October after peaking at 10.7% in 2022, the ongoing impacts of this peak continue to impact on the costs of service delivery and capital investment. The cost of essential items like energy and food has also forced households and businesses to make difficult decisions to limit their spending, while public finances and government spending plans are also being squeezed.

2.2 The ongoing economic turbulence driven by global events in recent years including Russia's invasion of Ukraine, the ongoing effects of Brexit and the aftermath of the COVID-19 pandemic have created instability in the financial markets resulting in a rapid escalation of cost pressures facing the Council and increased demand for services.

2.3 The backdrop of high inflation has continued to influence public sector pay negotiations, with the 2024/25 settlement representing an overall increase in the pay bill of 4.27%. To support the 2024/25 pay settlement, Local Government is contributing funding equivalent to 3.2%, which is in excess of the budgeted provision of 3%. It is anticipated that Scottish Government will provide additional funding to support the remaining 1.07% although this may require the redirection of some existing funding streams.

2.4 Within the capital programmes, high interest rates present a threat to the affordability of the existing capital programme, a risk that is compounded by the impact of inflation meaning that previously agreed budgets have required increases to fulfil capital commitments. This has resulted in growth in the capital financing requirement and unsustainable increases in new borrowing demands.

2.5 At the UK Autumn Budget and Spending Review, the Chancellor announced increases in UK public spending worth around £70 billion a year and confirmed updated Block Grant funding totals for the Scottish Government. The implications of the Chancellor's statement on 30 October 2024 for Scottish Government are £3.4 billion of Barnett Consequentials across 2024/25 and 2025/26. In 2024/25, resource funding will increase by around £1.4 billion in cash terms, and capital will increase by around £70 million. The Cabinet Secretary for Finance has indicated that this uplift was in line with expectations and that funding will be used to support the costs of the 2024/25 public sector pay settlements.

2.6 In 2025/26 resource funding to the Scottish Government will increase by around £1.4 billion and capital funding increased by around £600 million. The position for 2025/26 represents around a £1.4 billion increase from 2024-25 in nominal terms or a 3.4% nominal increase. After adjusting for inflation, this is a real terms increase of around £400 million, or 1.0%. At this stage the implications of this for local government and this Council are not known.

2.7 The Chancellor also increased the rate and starting point at which employers pay National Insurance Contributions on employee pay. An initial estimate of the cost to the public sector in Scotland is around £500 million in 2025/26. Funding for this change has not yet been included in the Scottish Government Resource Block Grant for 2025-26. HM Treasury have confirmed that an exercise will be run to calculate costs for the public sector and further funding will be provided at UK Main Estimate in Spring 2025. However, given that the public sector in Scotland is relatively better paid and larger in Scotland than the UK as a whole, there is a risk that any Barnett consequential-based funding may not provide sufficient funding to cover the full cost of this change in Scotland. This therefore remains an unknown potential additional resource spending pressure on the 2025/26 budget, both for the Council and on providers of commissioned services.

2.8 The next key Budget event will be the Scottish Government Budget, due on 4 December 2024, followed by the draft Local Government Finance Settlement on 12 December. While recent settlements have represented a year-on-year cash increase, this has typically been given with additional policy commitments, or ring fenced to specific service areas, often within education or health and social care. While the detailed impacts of the 2025/26 settlement remain to be seen, the scale of the funding gap now facing the Council means that it is unlikely that any additional funding would be sufficient to close this over the medium term. This means that the Council will continue to face some hugely difficult decisions as to where limited resources will be directed in the future.

2.9 The current Resource Spending Review, published in May 2022 includes a commitment to agree a new deal for local government in Scotland. Work has been progressing via COSLA through the Verity House Agreement, but some of these areas of discussions remain on-going. The key areas include:

- Strengthening of a relationship between Scottish and Local Government to achieve better outcomes for people and communities.
- Seek to balance greater flexibility over financial arrangements for local government.
- Explore greater scope for discretionary revenue-raising.

<u>Fiscal Framework & National Negotiations</u>

2.10 We are aware that CoSLA officers are in the process of exploring potential options for a ‘Rules Based Fiscal Framework’ to deliver a long-term financial relationship between Scottish Government and Local Authorities. This could see councils receiving a fixed percentage of Scottish Government’s budget going forward, but would not incorporate a review of distribution. The potential risks and rewards of any proposed solution remain to be seen but this could have significant long-term implications for the way that the Council is funded in the future. A progress update is anticipated as part of the budget announcement, and we will build any intelligence derived from this into our updated financial plans.

3. Local Context

3.1 The local environment within which the Council operates continues to change and evolve and in recent years the county has seen rapid population growth. East Lothian continues to be one of the fastest growing authorities in Scotland, and the national census data sets out that East Lothian's population as at mid-2023 was at 113,740 (an increase of 26.2% since 2001). This growth is not being matched with funding increases through the local government finance settlement which is creating significant additional cost pressures on the Council, in particular support for day-to-day (revenue) budgets. This financial strategy is being developed in extremely difficult circumstances and the most challenging economic environment this Council has ever faced, with a range of external factors relating to inflation, interest rates, cost of living, economic challenges, and continued public sector austerity, alongside significant increased demand and costs facing the authority. Developing customer expectations present an opportunity for the Council to do things differently, and to work in partnership with its communities to redesign and modernise service delivery, ensuring that resources are directed to the areas of greatest need.

Council Plan

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

3.3 Many of the pressures have intensified since 2022, and as such Council has agreed three new short-term focussed priorities to reflect the current financial challenges we face:

- Ensure the financial sustainability of the Council through the delivery of approved savings and transforming the way we deliver services.
- Target resources on statutory services and focus on the highest risks and those most in need.
- Deliver key infrastructure, economic development and environmentally sustainable projects within available Council resources and maximising external funding.

3.4 The wider plan also sets out four thematic objectives:

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

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

Local Development Plan (LDP) & City Deal

3.5 The Council has an approved Local Development Plan (ELLDP 2018), which addresses housing need identified in the south east Scotland region and will mean a sustained growth in population across the area. This plan is currently being updated reflecting National Planning Framework guidance (NPF4) and wider requirements. As part of this process, Council approved an initial evidence report for LDP2 in August 2024, which sets the indicative Local Housing Land Requirement at 6,600 additional houses over the 10 year lifespan of the LDP, aligned to national Minimum All Tenure Housing Land Requirement (MATHLR). It is estimated that the population will be 120,000 by 2037 and that the rate of population growth to 2028 will be the 2nd highest in Scotland. This will continue to bring changes to the demography within the area, with significant growth in particular in the number of school-age children and the number of pensioners.

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

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

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

3.9 East Lothian is experiencing the impacts of the wider macro-economic climate, in common with the whole of Scotland and growth and change will be affected to some degree by the rising costs of construction and the move to new zero. The Council has approved a new economic development strategy and continues to make progress towards LDP2, reflecting the Scottish Government's aspirations and policies in the new National Planning Framework 4, aligning a policy context that encourages economic growth and continues to meet the needs of the population of East Lothian.

3.10 The impact of growth associated with high levels of development across the county will continue to have a significant impact in future years. These core foundations and strategies set out the economic ambitions and opportunities for the county, but in doing so the Council will need to consider how its ambitions for growth can be realised and recognises the challenges in terms of how we use limited resources to support the needs that arise from demographic growth. This may require some changes in what we do and how we do it.

Reducing Poverty and Inequality

3.11 The East Lothian Poverty Plan 2024-28 was adopted by the Council and the East Lothian Partnership in August 2024. This sets out 4 key objectives:

- Good quality jobs that pay fairly, where we support people to gain the skills and training needed to find and maintain work, in secure, flexible jobs that pay fairly.
- Enough money from benefits: our social security system should provide people with a fair income, but millions of pounds go unclaimed each year. We will support people to claim the income that they are entitled to and provide support with the cost of living.
- A good life with access to the essentials: housing, good health, quality food and a resilient community are part of our human rights. We will take a preventative approach to homelessness, hunger and health inequalities caused by poverty.
- Climate change ready: climate change will impact vulnerable and lowincome communities the hardest. We will take preventative action to protect and support these communities from the effects of climate change.

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

Responding to the climate emergency

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

3.14 The Council needs to take action to tackle the climate emergency, and this will require a change in what we are doing, and how we are using our resources. However, in light of the unprecedented funding gap facing the Council over the medium term, resources will now need to be directed to safeguarding frontline statutory services, which presents a risk to our future capacity for investment in this policy area if external funding cannot be accessed.

4. General Services Revenue Budget – Medium Term Outlook

4.1 Notwithstanding the many uncertainties facing Scottish local authorities, the need for medium to longer term financial planning is becoming increasingly important. Councils must ensure that they have robust financial plans in place that can respond to and absorb the potential impact arising from the increasingly wide range of variables highlighted earlier in this report.

4.2 The budget development principles agreed by Council on 29 March 2022 included a commitment to setting a 5-year budget plan aligned to the financial and capital strategies. Given the level of uncertainty and short-term nature of local government funding settlements, on 18 February 2025, Council will be presented with a detailed budget for 2025/26 accompanied by high level projections and savings plans covering the 5 years to 2029/30.

4.3 To support this, three high level scenarios have been developed to reflect the potential variability in the budget gap facing the Council, depending on a number of variables. The current General Services revenue budget extends over a 5-year planning horizon with a high-level summary of the revised budget gap scenarios reported to Council in August 2024 summarised below. Table 1 shows the funding gap and Table 2 shows the residual gap, after taking account of assumed council tax increases, use of the capital fund, reserve movements and previously agreed savings. This residual gap will need to be closed either through further savings or additional council tax increases, if no funding uplift materialises in the 2025/26 settlement.

Funding Gap – Scenario Planning

	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: General Services high level revenue funding gap scenarios 2025/26 – 2029/30, reported to Council on 27 August 2024

Savings required

	2025/26 £000	2026/27 £000	2027/28 £000	2028/29 £000	2029/30 £000	Total £000
Favourable	**-125**	**6,021**	**7,971**	**1966**	**3083**	**18,917**

Neutral	**5,266**	**8,614**	**9,223**	**3,511**	**3202**	**29,816**
Adverse	**10,265**	**11,622**	**10,389**	**4,696**	**4,386**	**41,357**

Table 2: General Services high level revenue savings required 2025/26 – 2029/30, reported to Council on 27 August 2024

4.4 The neutral scenario has been adopted for planning purposes. Key assumptions (which are subject to change) include:

- Pay increases – 3% in 2025/26 and 2026/27, 2% in the subsequent 3 years
- Interest on new borrowing aligned to Treasury adviser forecasts
- Increase in council tax band D charge 10% (or freeze grant equivalent to this value) and 5% thereafter
- Flat cash settlement from Scottish Govt, other than 2026/27
- Delivery of previously agreed savings proposals set out within the current budget, with some reprofiling to later years of the strategy.

4.5 It should be noted that there is a significant degree of risk within these assumptions, and small changes, for exempt to pay increases may have a significant impact on the funding gap. Specific areas of risk include assumptions made around council tax levels, future funding levels and the Council's capacity to deliver on previously agreed savings.

4.6 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.

4.7 The budget model for 2025/26 onwards will be updated following receipt of the draft local government finance settlement on 12 December 2024 and a revised budget model will be shared with councillors following that. It should be noted that the following areas of ongoing work to update the budget model 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 current and recurring budget pressures within demand led services and budget for these on a realistic basis.
- Detailed work to reflect the implications of future pay awards 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.

4.8 Current financial planning is based on the neutral scenario as the most likely outlook for the Council. This scale of the funding gap represents an increasingly difficult challenge for the Council to overcome whilst sustaining provision of statutory services, with our capacity to manage this remaining as the highest risk recorded on the corporate risk register. If the budget gap outlined in the adverse scenario materialises, then this will represent a reduction to the Council's running costs by more than a fifth over the next five years, which presents a high risk to the achievement of ambitions set out in the Council Plan, and means that it will not be possible for the Council to continue delivering services in the way that it does at the moment.

5. General Services Capital Budget – Medium Term Outlook

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

5.2 The Capital Strategy sets the framework for capital expenditure decisions and the arrangement for governance and monitoring of these plans. Given the significant impact of debt financing costs and revenue consequences of capital spend on the revenue budgets, it is important that these strategies are closely aligned and the interdependencies are understood. On 20 February 2024, the Council approved an ambitious, growth driven 5 year General Services capital budget, a summary of which is set out in the table below.

	2024-25 £'000	2025-26 £'000	2026-27 £'000	2027-28 £'000	2028-29 £'000	TOTAL £'000
General Services Gross Expenditure	117,196	53,610	57,480	68,585	67,605	364,475
General Services Income	(66,364)	(28,408)	(41,171)	(62,178)	(50,003)	(248,124)
Net General Services	**50,831**	**25,202**	**16,309**	**6,407**	**17,601**	**116,350**

Table 3: General Services Capital budget summary 2024/25 to 2028/29, agreed by Council on 20 February 2024

5.3 Funding for the capital plan comes from a range of sources including: Scottish Government (General Capital Grant and Specific Ring-Fenced Capital Grants), developer contributions, capital receipts from asset disposals, other income such as grant funding from other bodies, with the balance made up from borrowing funded through loan charges to the revenue budget.

5.4 The current capital investment plans recognise the growth and ambition of the Council, with current plans designed to support the future infrastructure requirements across the Council area. These plans are aligned to the delivery of the approved Local Development Plan (ELLDP 2018) and ambition relating to the commitment from the Council relating to the Edinburgh and South East of Scotland City Deal. The related investments will create significant economic long-term benefits for the East Lothian economy, but will place a significant financial burden upon Council finances, and affordability remains a key consideration both in terms of the short and longer term.

5.5 Whilst much of the current LDP commitment falls within the 5-year capital investment plan, there will also be significant impact on future years and the emergence of a successor LDP.

5.6 As highlighted in previous Council reports, there remains significant external market pressures with wider supply and cost pressures. This has continued to present significant financial challenges on the current approved capital programme and borrowing levels. Whilst current indications suggest the wider market conditions may stabilise in due course, affordability presents a significant risk to future capital projects and this needs to remain a key area of focus over the medium term.

5.7 CIPFA's Prudential Code places prudence, affordability and sustainability as the foundations to effective capital planning. This includes consideration of the long-term implications of borrowing alongside the revenue consequences generated for the Council, such as staffing, rates, utility costs, cleaning etc, which must be met from within the revenue resource levels available to the Council. At a time where revenue budgets remain under significant pressure, it is essential that capital investment decisions take into consideration the full cost implications facing the Council. This will also be an important consideration in supporting external funding applications which can often divert already stretched staffing resource to support projects which are fully funded, and can take limited resources away from supporting key Council priorities.

5.8 Where capital investment can be used to enable the reduction of costs within the revenue account then the strategy will seek to support the inclusion of these schemes, subject to a robust investment appraisal and underlying business case.

5.9 In addition, the borrowing for capital infrastructure is funded through annual loans fund payments which are charged to the revenue budget and repaid over the lifetime of the asset. Interest rates continue to be at a higher level than we have experienced in recent years, and whilst these have reduced from the recent high levels and are forecast to stabilise and then only fall gradually in the medium term, this directly impacts on interest payable on new borrowing. It is important to remember that any new borrowing is in addition to existing borrowing and that all borrowing will need to be repaid in the future and capital investment decisions which are taken now must be taken within the context of longer-term projections. The capital investment decisions are supported by the Capital Strategy and Treasury Management and Investment Strategy to assess and better understand the implications for both current and future Council Tax payers and to ensure that investment plans remain affordable and sustainable. Our capital strategy will be focussed on maximising income receipts in advance in order to minimise borrowing where possible.

5.10 Whilst recognising the important role that capital investment has to play in stimulating economic growth and providing communities with vital infrastructure, capital expenditure plans must be prudent, affordable and sustainable. Current debt levels and future forecasts set within the current financial operating environment are now unaffordable, and as such will need to be revised.

5.11 The Capital Strategy for 2025/26 – 2029/30 therefore recommends that General Services capital expenditure affordability is controlled through regular review by the Chief Finance Officer, with reference to overall borrowing levels and the impact of debt repayment charges on the revenue account. With this in mind, consideration must be given to introducing enhanced controls on new borrowing. Any new controls will be subject to discussions will be subject to discussion with members and recommended to Council for agreement as part of budget setting in February. Any such limit would then be reviewed by the Chief Finance Officer at regular intervals throughout the year and reported to Council through quarterly budget monitoring reports. A wider review of the strategic governance arrangements to oversee the capital programme is required, with a view to ensuring that these arrangements enable regular consideration of the overall affordability of the programme as well as monitoring delivery.

5.12 This strategy will also focus on a comprehensive review of the Council's asset base, with a view to maximising capital receipts where possible, and minimising new net borrowing. In June 2024, Council agreed the Property Asset Strategy and Management Plan 2024-2028 and place making project.

5.13 The purpose of the Place Making Project is to develop a new holistic service delivery model for communities and the property assets required to support this. The project will have the following key work streams:

- Establish the current position in relation to Council services delivered to communities, the assets they are delivered from, how the assets are managed and how much they cost to operate.
- Identify other assets that can be used by the community for complementary services.
- Understand the needs of local communities.
- Consider the asset strategies and investment plans of partners to establish opportunities for collocated facilities and joined up service delivery.
- Develop a new service delivery model and proposals for the property assets required to support this, all in the context of the asset rationalisation revenue savings and capital receipts targets set.
- Engage with communities and staff on these proposals.

5.14 In this context, development of the capital plan will need to consider the need to pause planned investment which may fall within the scope of this review, in order to ensure that the above objectives are met and that the value from any investment can be maximised.

5.15 Infrastructure investment will be prioritised aligned to Council priorities including the delivery of the transformation of Council services that will help minimise ongoing revenue costs. Much of the capital programme is underpinned by prevailing economic conditions, including the realisation of developer contributions dependent upon wider housebuilding that are critical to support the delivery of many of the related capital infrastructure projects. Given the current economic climate, the situation will need to be monitored closely and the ability to be flexible and adaptive with our capital planning will prove critical.

6. Reserves

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

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

6.2 General Services reserves (excluding HRA reserves) available as at 31 March 2024 totalled £34.17 million (note that this reflects the unaudited position). A breakdown of this total is shown within table 4.

	31 March 2023 Balance	Movement	31 March 2024 Balance (unaudited)
GENERAL FUND RESERVE			
EARMARKED			
Committed for Future Budgets	8,524	-7,412	1,112
Transformation Fund	5,826	12,699	18,525
Ring-fenced Funds & Other Balances	2,253	-428	1,825
Devolved School Management Balances	1,148	0	1,148
Statutory earmarking of council tax for affordable housing	1,463	161	1,624
SFT earmarked reserve (Rosehill Campus, Wallyford)	0	1,292	1,292
Service concession (PPP) reserve (support for deferred charges)	0	1,043	1,043
Uncommitted General Fund (General Services) Balance	7,200	400	7,600
Total General Fund Reserves	26,414	**7,755**	**34,169**
OTHER RESERVES			
Insurance Fund	2,684	0	2,684
Total	2,684	**0**	**2,684**
Total General Fund / Other Reserves	29,098	**7,755**	**36,853**
HRA	1,487	48	1,535
Capital Fund (incl HRA)	14,607	6	14,613
Total Other Reserves	16,094	**54**	**16,148**
TOTAL USABLE RESERVES	45,192	**7,809**	**53,001**

Table 4: Usable reserves at 31 March 2023 and 31 March 2024 (unaudited)

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

Earmarked Reserves

1. **Requirement to support future budgets:** This balance is held to support future budget plans, aligned to the approved General Service budget for 2024-2029. In the context of the planned drawdown of reserves for 2024/25, and the forecast overspend for the current year, it is anticipated that this reserve will be fully utilised during 2024/25. The current budget model assumes a £1 million contribution back to reserves in 2025/26 to offset the equivalent sum used to balance the budget in 2024/25.

2. **Transformation Fund:** Amounts set aside to support investment in the following critical enablers to support longer term financial sustainability, including asset review, transformation and service redesign, energy efficiency, early intervention and prevention and digital transformation. The increase to this reserve at the end of 2023/24 arose from the application of fiscal flexibilities for service concession assets which saw a one off backdated adjustment which increased this reserve in line with the decision taken by Council. It should be noted that this increase is not backed by cash, meaning that the Council will need to borrow in order to spend the funds within this reserve. During 2024/25, these funds are being used to progress and accelerate key transformation projects including the asset review, parking strategy and new corporate systems.

3. **Ring fenced funds and other balances:** This reserve contains funding commitments within service areas relating to previously committed expenditure obligations which have not yet materialised, including ring fenced funds such as Mid and East Lothian Drug and Alcohol Partnership.

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

5. **Statutory earmarking of council tax for affordable housing:** An earmarked fund established by reducing the second home or empty property council tax discount for the development of affordable housing. Under Scottish Government direction within certain criteria, Local Authorities can now use this income to support the development of affordable housing, including the disbursement of funds to other organisations or individuals, as well as RSLs. It should be noted that the premium for second homes council tax introduced as part of the 2024/25 budget does not fall within the scope of this direction. Authority is delegated to the Chief Finance Officer to approve the commitment of funds against this reserve, and this will be reported through the Members Library Service.

6. **SFT earmarked reserve (Rosehill Campus, Wallyford):** this reserve holds funding received to support maintaining the new Wallyford Learning Campus at specific standards required to access ongoing SFT grant funding conditions. The funding profile does not match the likely maintenance and renewal programme on the building and this reserve would offset years when the costs of the work exceed the available

funding in-year. This reserve, if topped up annually, would give the Council some security around its ability to meet future building costs.

7. **Service concession (PPP) reserve (support for deferred charges):** this reserve will partially offset the future costs associated with the extended repayment period on PPP assets, which arises because of applying fiscal flexibilities in line with the decision made by Council in February 2023. The reserve, if topped up on an annual basis will mitigate future financial risks to the Council which may arise from extending the repayment period for these assets.

8. **Insurance Fund:** The insurance fund is used to insure against a risk, or pay premiums on a policy to insure against a risk. The level of fund retained remains subject to ongoing fund valuations.

9. **Capital Fund:** This fund was established from Capital Receipt income which has not yet been applied in year. This Fund can be used meet future capital investment costs either reducing loans fund advances or providing funds to cover the principal repayments of the loans fund. This reserve also holds post completion section 75 contributions which are being used to smooth fluctuations in debt charges over the medium term, in line with the budget approved by Council for 2024/25.

10. **Uncommitted Balance to support minimum level:** In line with the previous approved Financial Strategy, these specific reserves collectively support the minimum level of uncommitted reserves with more detail set out below.

6.4 It should be noted that many of the reserves listed within table 3 already have post 31 March commitments against them and will be spent during 2024/25. Furthermore, the forecast revenue outturn at the end of quarter two indicates that reserve drawdowns totalling £8.5m may be needed during the current financial year. This includes unplanned drawdowns of £3.7m, although Council has agreed a series of mitigation measures which remain in place to try and reduce the forecast in year overspend and bring this back in line with budgeted expenditure levels.

Reserves Strategy

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

6.6 As noted above, the Council maintains reserves as a safety net to allow for unforeseen circumstances. There is no statutory definition of the minimum level of reserves: the amount required is a matter of judgement. However, Council has previously agreed to set aside 2.5% of the net revenue budget as the minimum unallocated balance on the general fund, which equates to approximately £8.2m.

6.7 Given the current risk environment, along with the projected in year overspend at this point is considered appropriate as part of the financial strategy to work towards increasing the minimum unallocated balance on the general fund over the medium term. Although holding an excessive level of unallocated reserves rather than investing these in improving services would not represent value for money or effective use of resources, the range and extent of risks currently facing the Council increases the likelihood that reserves will be needed to support mitigation measures as well as the Council's response to future unforeseen events. Given that reserves are not recurring resources meaning that they can only be used once, targeting a minimum unallocated balance of this level is proportionate and not excessive.

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

7. General Services Financial Strategy

Balancing the Budget

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

7.2 Council has committed to developing an approach which combines a range of options to close the gap between available funding and anticipated expenditure including an enhanced programme of transformation, asset review, income generation, cost reduction and efficiency. To ensure that the Council remains financially sustainable, it is essential that planned savings can be delivered in line with the agreed budget as far as possible, or that alternative measures are promptly agreed where this is not possible. This is monitored closely throughout the year and reported to members through quarterly reporting to Council.

7.3 Given the scale of this challenge over the next five years, it is prudent for the Council to develop credible plans to close this gap in the years subsequent to 2025/26. The size of the potential revenue budget shortfall means that no single initiative can been expected to close the gap. A blend of different approaches will therefore be required, and detailed plans have been developed, aligned to the following broader categories:

1. **Asset rationalisation & Energy Efficiency** - The Council has an extensive operational asset portfolio to support service delivery needs. The Corporate Asset Strategy provides the framework for the efficient management of the Council's core assets, with significant and future investment requirements, it aims to provide a modern, efficient and sustainable asset base that meets the needs of its existing and future service users and employees. The Council has embarked on an ambitious programme to review and rationalise the asset portfolio, in order to support the delivery of approved budget savings. This includes revenue savings of £5m over the next 5 years,

and a capital receipts income target of £20m over this period between 2023/24 and 2028/29.

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

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

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

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

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

5. **Service reductions -** Service reductions will be treated as a last resort as part of this strategy; however, all options will need to be considered in order to safeguard statutory services which are relied upon by the most vulnerable in our communities. Given the scale of the budget gap which the Council faces over the medium term, it is now inevitable that some service reductions will be necessary. It is crucial through these considerations that a clear vision on the key priority outcomes for the Council is maintained, so that the constrained funding can be directed accordingly to ensure that these important outcomes are achieved.

7.4 Savings plans will need to be aligned to the five-year financial strategy, with plans for savings and additional income featuring in each of the five years. This will be a continuous programme of work which will be underpinned by robust governance arrangements to develop plans, monitor progress and evaluate the resources required to progress the different elements of this strategy. This approach assumes that existing savings previously agreed by Council will be delivered in full.

7.5 Work to redesign services within the available budget envelope now needs to progress at pace, and this needs to include horizon scanning to contain cost growth within new operating models. It is essential that all services prioritise the delivery of existing and future planned savings in order to support financial sustainability and mitigate the risks which this presents.

7.6 In addition to the above measures, officers and members will continue to actively participate in national conversations to raise awareness with Scottish Government ministers, civil servants and CoSLA to highlight the specific challenges which East Lothian faces in relation to its growing population, and the financial pressures which are being placed on revenue and capital budgets as a result of the additional costs of growth.

Critical Enablers

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

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

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

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

Fiscal Flexibilities

7.10 As part of the 2023/24 budget, Council agreed to apply fiscal flexibilities in relation to its service concession assets. This allows the Council to spread the cost of service concession assets over their useful life, rather than over the duration of the contract, resulting in a financial benefit for the remainder of the contract. Council agreed as part of the 2023/24 budget to apply this flexibility, which offered a result in a one-off benefit to general reserves in the region, and to invest this in supporting wider transformation, as outlined elsewhere in this strategy.

7.11 The financial strategy strongly recommends that these flexibilities are only applied only where this can be justified through wider plans to deploy resources in a way which will support future financial sustainability.

7.12 This approach aligns to the budget development principle of minimising the use of one-off resources to balance the budget and ensuring that use of reserves is limited to investment that will deliver ongoing cost reductions. There is no indication at the current time of any further flexibilities being provided to councils, which supports the rationale set out in this strategy to pursue options to reduce the Council's net cost base in order to provide long-term financial sustainability.

8. Housing Revenue Account

8.1 The Local Housing Strategy sets the strategic approach for the delivery of high-quality housing and housing related services across all tenures, to meet identified need. The Strategy has been prepared within the context of a highly pressured housing market, and significant demand for social rented housing. A high level of homelessness applications persist and the economic climate continues to impact on the ability of households to meet their housing needs.

8.2 Against this backdrop, increasing the supply of affordable housing continues to be a high priority for East Lothian Council ensuring that it meets the needs and aspirations of local people that they live in good quality homes which are located in strong, safe communities. On 12 November 2024, Council declared an affordable housing emergency due to the significant impact of reduced investment on new build completions, the seriousness of the wider impact of reduced housing supply on current housing pressures, and the imminent loss of affordable units.

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

8.4 The Strategic Housing Investment Plan (SHIP) sets out the priorities for affordable housing investment in East Lothian over the next five years and will be dependent upon a combination of affordable housing providers, which includes Registered Social Landlords (RSLs), East Lothian Council and the private sector. It will also be dependent on complex funding models delivering different tenures.

8.5 East Lothian Mid-Market Homes LLP supports the provision of mid-market rental property, and is a partnership between East Lothian Council and Scottish Futures Trust. The establishment of this vehicle will allow further opportunities to support the delivery of affordable housing across East Lothian.

8.6 The Housing Revenue Account is a balancing act between the income raised through rent, the revenue expenditure to support the tenants, and necessary capital investment to support and modernise existing council housing stock and deliver new Council homes. To support this ambition, the financial strategy must ensure that financial plans remain affordable and sustainable both for existing and future tenants.

8.7 For 2025/26, the Council is consulting on a rent increase of up to 7%, which is above the assumed level of 5%. The higher increase required to sustain investment in modernisation and affordable housing delivery is a consequence of the significant reduction in affordable housing subsidy in 2024/25.

8.8 Current budget projections in the years subsequent to 2025/26 assume a minimum of 5% annual increase in rents. Increases below this level will likely require a reduction in the capital investment programme. This will remain under review subject to the outcome of the rent restructure and development of the 30-year business plan.

8.9 Given this ambition, key areas of focus for the HRA financial strategy 2025/26 to 2029/30 are as follows:

- Reviewing the existing rental levels and implementing a rent restructure within the financial strategy term, to promote fairness and transparency across the HRA portfolio.
- Ensuring that capital expenditure plans remain affordable and sustainable by maximising subsidy available to support capital investment and maximising the level of Capital Financed from Current Revenue (CFCR).
- Maximising efficiency and value for money, ensuring that expenditure is focussed on priority areas to maintain and improve the service for tenants.
- Working with RSL partners to deliver the affordable housing needs across East Lothian and support the ambition set out in the Strategic Housing Investment Plan.
- Reducing rent arrears, ensuring targeted and flexible support is provided to tenants to who are experiencing financial difficulties.
- Implementing the new housing management system to support and improve forward planning and customer service;
- Developing a 30-year business plan for the HRA;
- Minimising the impact of debt charges by operating within the recommended upper limit for the ratio of debt charges to income to 40% both in the short and longer term; 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. Given the scale of the risks currently facing the HRA, it is appropriate to keep this level under review to ensure that this remains appropriate.

9. Financial Management

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

9.2 During 2024/25, an enhanced budget monitoring framework has been developed and rolled out with training to support strong financial management by budget holders.

9.3 The current external operating environment is extremely challenging, very dynamic and subject to constant change. The financial performance relative to approved financial plans is kept under constant review, and this is supported by regular financial monitoring and scrutiny reports provided to Council.

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

9.5 The need for continued application of enhanced cost control measures remains a vital discipline that all managers should continue to operate, demonstrating effective stewardship and application of Council funds at all times.

9.6 It is vitally important that through the Council Management Team (CMT), the Council maintains a disciplined approach to the implementation of its change programme and does everything possible to deliver the financial efficiencies planned in accordance with that programme and the supporting budgets. Heads of Service will be required to manage expenditure commitments within approved budgets and if at any time spending pressures are not containable within the Business Group, the relevant Service Manager should report this to their Head of Service and Executive Director who has the flexibility to manage budgets across various business groups.

9.7 Although the Financial Strategy quite properly covers the 5-year period until 2029/30, the Strategy will be continue to be subject to an annual refresh to ensure that it remains relevant and enables the Council to respond to any future financial challenges to ensure its on-going sustainability.

Financial Management System (FMS)

9.8 In support of good financial management, the Council is in the process of implementing a new financial management system. There will be a phased approach to rolling out the new system, and work is progressing towards completion of Phase 1 of the project in 2026. This represents a complex, high-risk project with significant resourcing implications; however, support for the database and operating system for our current software will end in 2026 and 2027 respectively. The considerable benefits that will be derived from updating the legacy system, including greater efficiency and improved management information are fundamental to the successful delivery of this strategy and to sound financial management. This aligns to the Council's digital strategy, and the principle of investing in digital transformation as a critical enabler, as outlined elsewhere in this strategy.

Cross Party Budget Working Group

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

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

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

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

10. Risk Management

10.1 The Council's financial strategy is subject to a high degree of risk and uncertainty. In November 2022, managing the financial environment was elevated to a score of 25, which is the highest-rated risk that the Council has ever seen within its corporate risk register. This risk remains at this level. The Council has robust risk management processes in place to capture risks and to ensure that appropriate mitigations are developed and maintained. Corporate and service risk registers and remain live documents, which are shared with senior managers, CMT, Audit and Governance Committee.

11. UNCRC

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

12. Summary

12.1 It is recognised that there are a wide range of risks and variables facing the Council, and there is a need to ensure that the Council has sufficient financial resilience to satisfy delivery of approved outcomes whilst ensuring future financial sustainability. It is now clear that the level of future resources available to the Council will not be sufficient to meet future demand and pressures, and as such, the way in which we deliver services to the community must change.

12.2 To achieve this, the Council must embark on an enhanced programme of transformational change, which embraces digital technology and continues to support Council plans. To protect the delivery of vital essential services, the Council must do all that it can to maximise revenue income streams available, and to support economic growth and achieving wider aims and outcomes, the Council must accelerate a review of all Council assets, which will seek to minimise future revenue costs, and maximise future capital investment.

12.3 The Financial Strategy set out will assist the Council in meeting the future financial challenges ahead. It is recognised that the wider economic uncertainty and potential scale and significance may mean that the Council must prioritise its resources to deliver and support essential services, and this may in turn require some difficult decisions and choices ahead.

12.4 This financial strategy provides a robust framework for setting the budget for 2025/26 onwards and highlighting the need to take action to ensure the Council can continue to be financially sustainable over the medium term. The current forecast position is extremely challenging, with additional budgetary pressures and expenditure demands significantly exceeding the funding available.

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

Appendix 2

East Lothian Council

CAPITAL STRATEGY

2025/26 to 2029/30

Funding and affordability.
Asset maintenance, enhancement and aquisition.

Contents

INTRODUCTION

East Lothian Council has a focus on ensuring existing and new communities continue to be great places in which to live and work, with an even more dynamic local economy. Between now and 2033, the population of South East Scotland is expected to grow by 220,000 people and the Council will need to ensure that services and infrastructure provided are fit for purpose and meet the needs and aspirations of the residents of the county. East Lothian Council's Local Development Plan (LDP1) allocated land capable of delivering just over 10,000 new homes. It also identifies some 200 hectares of employment land for job creation. The extent of this growth is likely to grow further when LDP2 is adopted, creating further unfunded demand for new investment. The plans are ambitious and the Council will need to balance an increasing demand through demographic requirements with the additional pressure on revenue and capital resources.

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

The Capital Strategy has been updated to cover the period from 2025/26 to 2029/30 and outlines the Council's priorities as well as the due considerations required relating to funding and assessing affordability. Governance of all aspects of the capital plans are considered and there is recognition that there is a need to balance any investment for the maintenance and enhancement of existing assets against any ambition for the acquisition or construction of new assets. If assets fall into disrepair and they are no longer able to fulfil their primary purpose, then the Council's ability to deliver the associated services is impacted and it has resources tied up in assets that it cannot use.

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

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

REGULATION

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

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

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

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

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

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

OBJECTIVES OF THE CAPITAL STRATEGY AND OTHER KEY DOCUMENTS

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

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

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

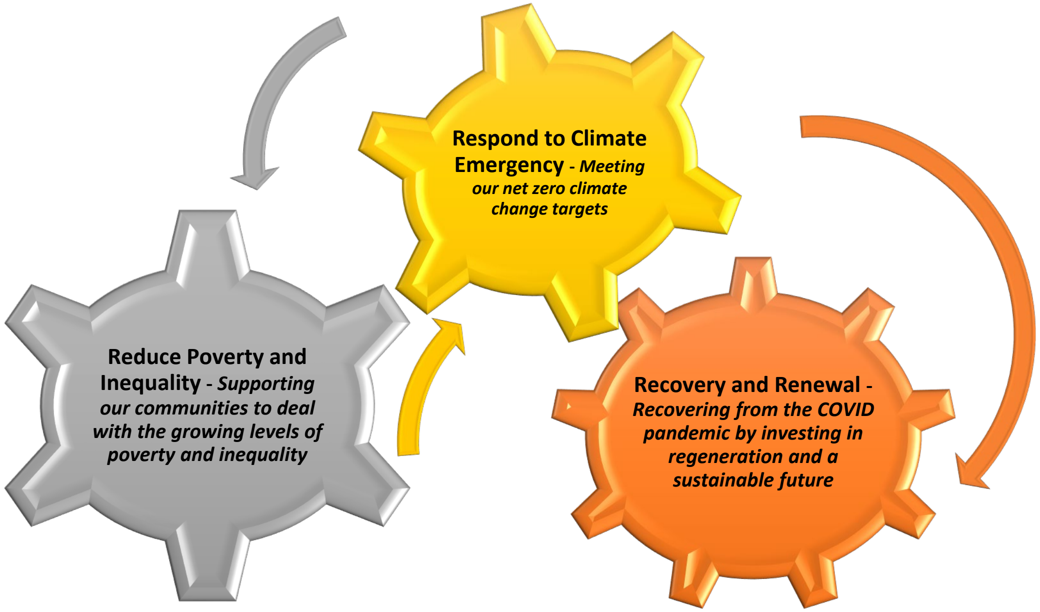
The overarching aim of the strategy is to provide a framework within which the Council's capital investment plans will be delivered. This Capital Strategy updated for the financial years 2025/26 to 2029/30 initially covers a five-year timeframe to allow sufficient opportunity for strategic capital planning. A key purpose of the Capital Strategy is to firmly place decisions around borrowing in the context of the overall longer-term financial position of the Council and to provide improved links between the revenue and capital budgets.

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

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

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

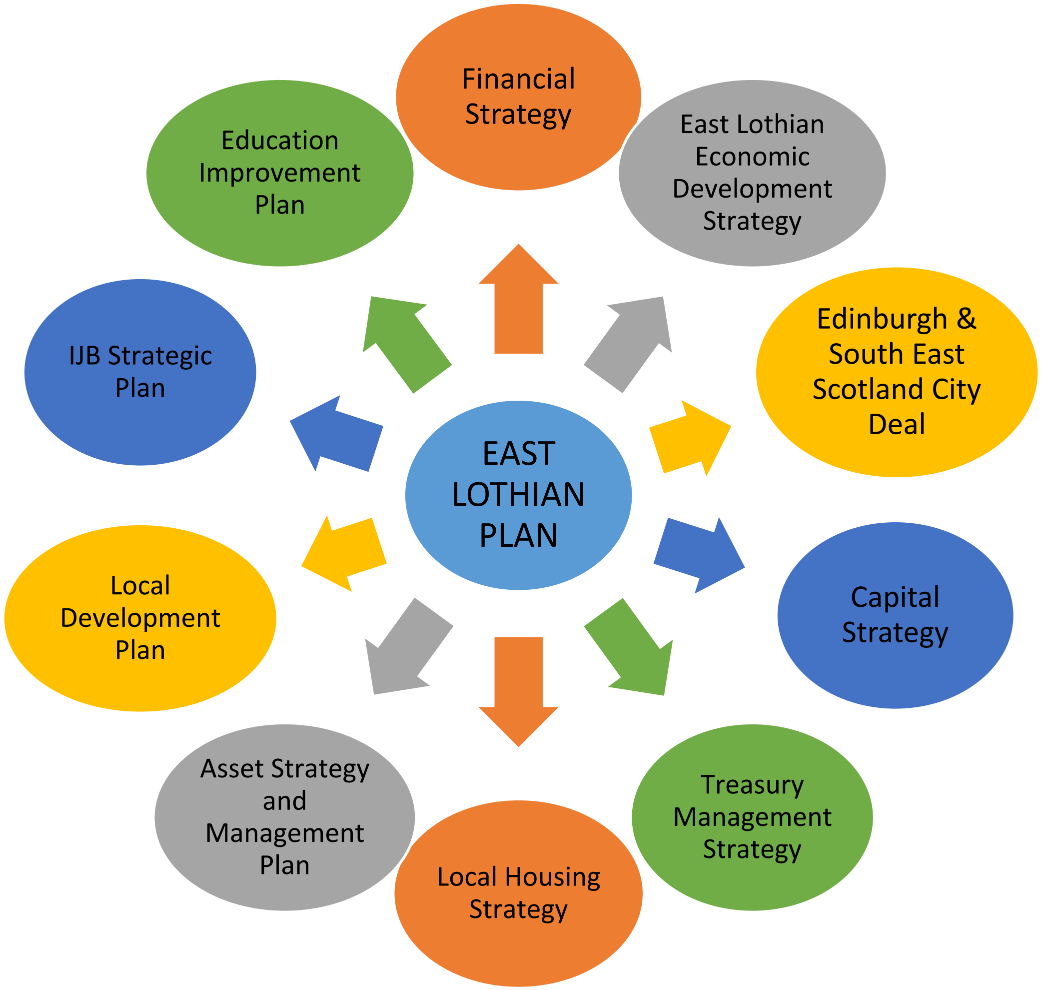
It is based around three overarching objectives that have been set in response to the three fundamental challenges we face:



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

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

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



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

- The **Financial Strategy** sets out a number of requirements to assist capital investment decisions and importantly, manage the associated risk. For the Housing Revenue Account (HRA), the capital Strategy includes recommended limits from the Financial Strategy to maintain an appropriate long-term balance between the various elements of the HRA budget. The ratio of debt charges to income should be no more than 40%, maximising the use and application of capital receipts, capital grant and Capital Financed from Current Revenue (CFCR) in order to minimise the future impact of debt charges. There is also a minimum reserves policy ensuring that the reserve or balance on the HRA should not fall below £1.0 million. This will allow the Council to maintain a cushion against any unexpected increase in costs or loss of income, and to help to mitigate against risks inherent in UK welfare reform proposals.
- The **Local Housing Strategy** is the sole strategic document for housing, bringing together a wide range of housing related priorities into one place and enabling a co-ordinated response in terms of action. The strategic vision for housing in East Lothian is to have healthy, sustainable homes in vibrant communities that meet increasing levels of need, reduce inequalities and improve wellbeing across all stages of people's lives. There is also a strong connection with the East Lothian Health and Social Care Partnership in providing specialist housing to enable independent living where appropriate and supporting the wider integration of health, social care and housing.
- The main aim of the **Local Transport Strategy** is to provide a mechanism for clean, green and safe travel patterns across the County and beyond. The strategy demonstrates how the Council has applied national, regional and local guidance to its operations. The vision for the Local Transport Strategy has been defined as; "East Lothian will have well-connected communities with increased use of sustainable transport modes to access services and amenities". There are four documents that support this strategy; Road Safety Plan, Road Asset Management Plan, Active Travel Improvement Plan and the Parking Management Strategy.
- The central purpose of the **East Lothian Economic Development Strategy** is to identify the opportunities which east Lothian can exploit to maximise its sustainable economic competitiveness. The strategy contributes directly to economic development objectives set out in the East Lothian Plan. Inclusion in the Edinburgh and South East Scotland City Region Deal is a key opportunity for East Lothian and it will be important to ensure East Lothian optimizes potential economic and social benefits through close partnership working including the opportunity to develop aligned initiatives and funding mechanisms available through the City Deal. Each project must take cognisance of the deal and capture benefits that can be delivered through it. The Cockenzie site is a central area of economic development and unlocking the site and adjacent assets is a key development opportunity for East Lothian.
- Effective management of fleet related assets is critical to the delivery and performance of Council services. The **Sustainable Fleet Management Strategy** sets out and controls the management of Council fleet related assets. "Our vision is to provide effective fleet procurement, management, and a workshop maintenance service, with a commitment to significantly reducing our reliance on fossil fuels and to make our assets environmentally sustainable within the UK and Scottish governments' timeline of key deliverables". All asset expenditure will be managed by Transport Services via an agreed sustainable replacement/maintenance plan, appropriately funded from dedicated budget allocations. Transport Services will work with services when additional / high cost assets are required that are outside of the approved replacement/maintenance plan to determine if the need can be met through existing wider fleet assets or confirm the need for service units to identify funds to cover such items.
- The **Climate Change Strategy** sets out the Council's vision and overall aims for a Net Zero Council and a Carbon Neutral East Lothian. It sets out what we will do over the next 5 years towards achieving these overall aims, and the specific targets and actions which will help progress towards achieving net zero.

- Capital spending on assets should be fully aligned to the Council's Asset Strategy and Management Plan and the annual review of the Capital Strategy will ensure that these are aligned as the strategies are reviewed and developed.
- The Council does not work in isolation to deliver capital investment for the county. The East Lothian Partnership is a partnership across a number of organisations from public, private, third and community sectors working together to make life better for the people of East Lothian. **The Local Outcomes Improvement Plan (LOIP)** 2017-2027 provides a commitment by all partners to deliver improved outcomes for East Lothian people, with a focus particularly on reducing inequalities and prevention and early intervention. The East Lothian Partnership aims to work collaboratively across its partners with existing governance arrangements including:
    - **East Lothian Partnership Governance Group** whose core membership includes the partners who have statutory responsibility for governance under the Community Empowerment (Scotland) Act 2015.
    - **East Lothian Partnership Forum**, which brings together a wide range of partners with the aim of actively involving them in the Partnership's work including the Area Partnerships.
    - A number of Strategic / Delivery Groups who play a role in delivering the outcomes in the East Lothian Plan - these include **East Lothian's Area Partnerships**
    - A strategic 'one council' approach to capital investment decisions must be adopted, ensuring a joined up approach to investment in community priorities.
- The Council is undertaking a Learning Estate Review to consider how the existing capital programme can meet the challenges of population growth and expanded early years' provision (1140 hours), creating environments that support excellence and equity. A Learning Estate Investment Plan (LEIP) is in place to outline how the Council intends to realise its ambitions to develop a modern, safe, sustainable learning estate that enhances and supports communities whilst improving the lives of families in an equitable manner.
- The Local Development Plan sets out the planning strategy and policies to guide growth and deliver new required infrastructure, in particular for education, community, transport and employment.

The current volatile economic environment will have an impact on the Council and its community in the years to come. It is essential that the capital investments are targeted to ensure it provides essential investment aligned to Council priorities, to stimulate, and support economic growth. Nevertheless, the on-going financial challenges requires enhanced affordability criteria to be applied to the capital investment programme to protect both current and future Council Tax payers. Within this context, the Strategy focuses on an enhanced review of the Council's asset base, with a view of maximising capital receipts in order to support transformation of Council services and maintain a level of future capital investment, and minimising on-going revenue costs.

With this in mind, the Capital Strategy will focus on:

- Continuing to support a Capital Investment Programme, which will provide essential investment aligned to Council priorities both in the short and medium term, stimulate and support economic growth and critically, remain affordable based on a clear understanding of both capital and future revenue costs.

- Maximising the capital income available to the Council, and where possible ensuring this is paid in advance of capital infrastructure to minimise borrowing obligations. The Council should seek to ensure capital income is aligned to the delivery of core priorities and requirements ensuring full consideration is given to on-going revenue costs of capital infrastructure, and ensuring staffing resources are prioritised in line with the delivery of key Council priorities.
- In support of ensuring affordability for current and future tax payers, the Council should work to minimise the impact of additional net borrowing on the revenue account by ensuring that use of alternative sources of funding is maximised. Capital expenditure affordability for General Services will be controlled through regular, ongoing review by the Chief Finance Officer, with reference to overall borrowing levels and the impact of debt repayment charges on the revenue budget. For HRA, the ratio of financing costs to rent income should not exceed 40%.
- The Council should continue to manage and review the General Services Loans Fund balance ensuring prudence, maximising the use and application of capital receipts, capital grants, and any flexibility arising from revenue balances, in order to minimise the future impact of debt charges
- Develop an approved five year Capital Plan (for both General Services and HRA) underpinned by longer term models which seeks to minimise net borrowing requirements and is considered affordable both in terms of prudential limits and within the constraints of the revenue budget and wider resource requirements.
- Continuing to manage and review the General Services Loans Fund balance, maximising the use and application of capital receipts, capital grant, and any flexibility arising from revenue balances, in order to minimise the future impact of debt charges.
- Delivering an enhanced review of the Council's assets, which will support the way in which we deliver and support services, minimise future revenue costs, and maximise where appropriate capital receipts which can be used to support future capital investment plans.
- There is a commitment by the Council to identify Common Good assets to ensure that ongoing investment related to these assets is considered and funded appropriately.

GUIDING PRINCIPLES

APPROACH TO BORROWING

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

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

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

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

- Fixed interest and principal repayment costs, resulting from borrowing, including borrowing required due to timing of external funding contributions
- Any associated income streams and potential sensitivities
- Project sustainability
- Exit strategies and potential costs
- The relationship between asset carrying values (revalued net book value) in comparison to outstanding debt
- Demonstrating value for money

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

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

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

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

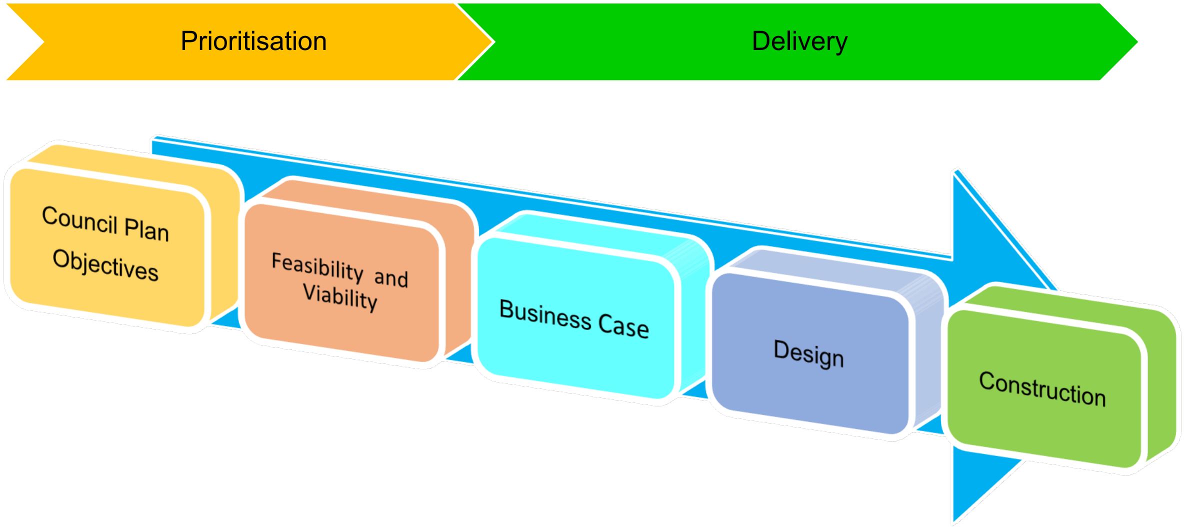
CAPITAL EXPENDITURE BUSINESS CASE

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

The business case should take consideration of:

- service objectives and alignment to the Council Plan;
- stewardship of assets, e.g. asset management planning;
- value for money, e.g. option appraisal;
- prudence and sustainability, e.g. risk, implications for debt and whole life costing;
- affordability, e.g. implications for council tax payers; and
- practicality, e.g. achievability of the forward plan.
- The resource requirements required to develop and deliver capital projects

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



PRIORITISATION AND APPROVAL

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

MANAGEMENT AND MONITORING OF THE CAPITAL PLAN

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

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

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

GRANT ALLOCATIONS

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

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

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

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

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

CAPITAL RECEIPTS AND CAPITAL CONTRIBUTIONS

The Council receives capital receipts and contributions from:

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

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

Where possible, the Council should seek to secure and receive external funding contributions in advance of expending funds on capital projects. Where funding is received in arrears of expenditure, a borrowing requirement can arise which can place additional pressure on debt charges and revenue budget.

As part of the Council's reserves balance and in line with the reserves strategy, the Council has in place the following reserves that can be applied to offset the cost of future borrowing. These funds are not currently reflected to finance existing approved capital investment plans, but remain within the wider Council's General Fund reserves. This remains subject to regular ongoing review.

- Capital Fund & Capital Receipts - established from Capital Receipt income which has not yet been applied in year. This Fund can be used to either reduce loans fund advances or providing funds to cover the principal repayments of the loans fund. Generally capital receipts will be treated as a corporate resource. There is no equivalent fund balance within the HRA account principally due to the cessation of the Right to Buy.

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

- Council Tax 2nd Homes - An earmarked fund established by reducing the second home or empty property Council Tax discount for the development of affordable housing. Under Scottish Government direction, Local Authorities can now use this income to support the development of affordable housing, including the disbursement of funds to other organisations or individuals, as well as RSLs.

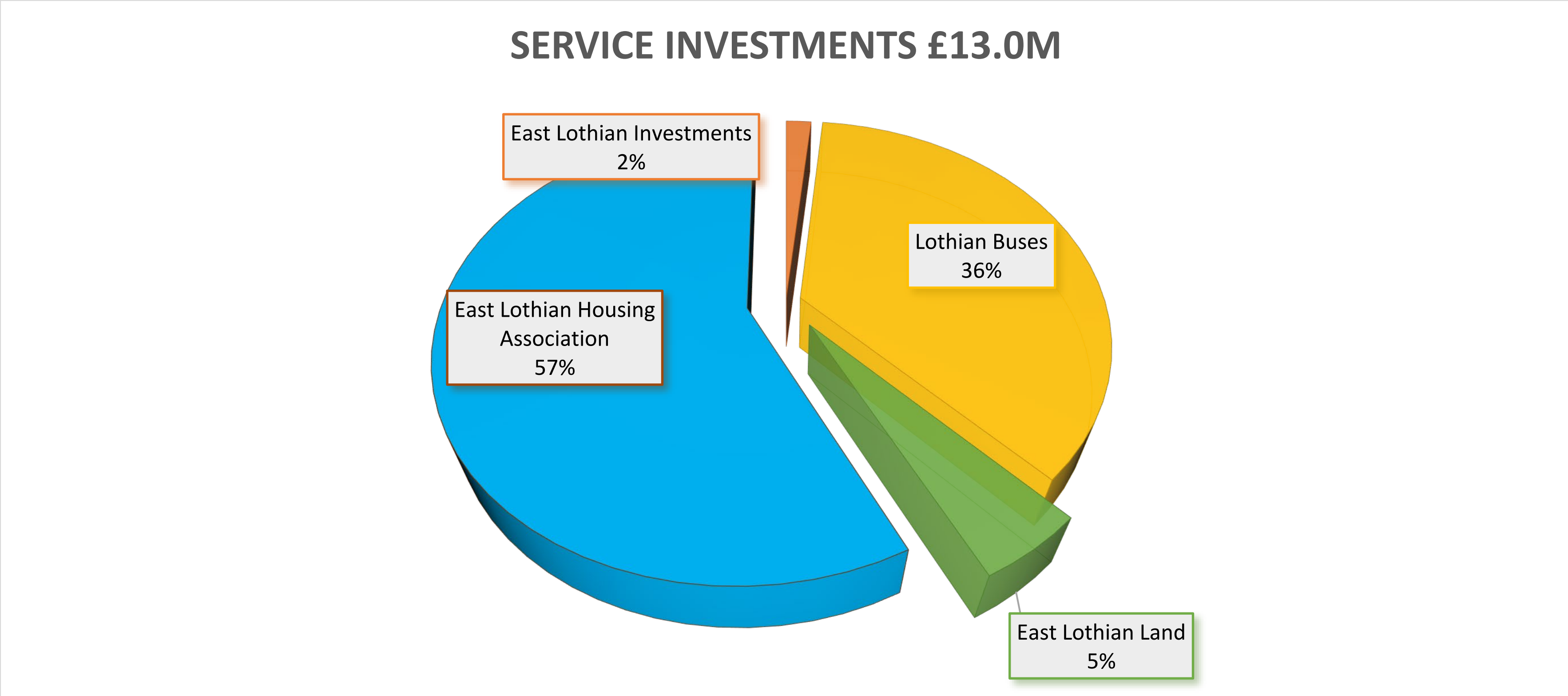
ALTERNATIVE FUNDING AND DELIVERY OPPORTUNITIES

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

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

PROPORTIONALITY OF NON-TREASURY INVESTMENTS

Non-treasury investments include material investments in subsidiaries, joint ventures, loans to third parties and financial guarantee activities and are separate from the day-to-day treasury management activities. The Council holds non-treasury investments in East Lothian Land, East Lothian Investments, East Lothian Housing Association and Lothian Buses to the value of £13.0 million. The Council also holds investment balances with Investec for Common Good and Trusts. Non-Treasury Investments represent investment for service reasons to meet the needs of the people of East Lothian. They are investments for areas such as transport, investment in growth for the county and social housing. They do not generate a return in monetary terms but result in a social, economic or environmental gain.



ASSET DISPOSAL STRATEGY

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

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

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

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

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

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

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

TRAINING AND SKILLS

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

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

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

TREASURY MANAGEMENT LINKS

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

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

BALANCE SHEET CONSIDERATIONS

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

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

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

BACKGROUND

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

SUMMARY OF THE TREASURY POSITION

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

The Council has a number of on-going Public Private Partnership (PPP) and lease arrangements shown as Other Long-Term Liabilities (OLTL) in the table below. The Council currently had £45.919 million (at the end of 2023/24) of OLTL within the CFR.

The Council's actual level of borrowing at the end of 2023/24 was £473.717 million. The Council is currently in an under borrowed position. Under borrowing is the difference between the CFR and external debt. This means that the capital borrowing need is not fully funded by external debt but is supported by the Council's reserves and working balances as a temporary measure.

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

£'000	2023/24 Actual	2024/25 Q2 Estimate	2025/26 Estimate	2026/27 Estimate	2027/28 Estimate	2028/29 Estimate
External Debt						
Debt at 1 April	441,503	493,789	566,792	620,399	626,702	640,128
Expected change in Debt	52,286	73,002	53,607	6,303	13,426	26,202
Other long-term liabilities (OLTL)	32,214	30,688	29,105	28,095	26,983	25,839
Expected change in OLTL	(1,526)	(1,583)	(1,010)	(1,113)	(1,144)	(1,205)
Actual gross debt at 31 March	524,477	595,897	648,494	653,685	665,967	690,965
Capital Financing Requirement	625,040	688,308	731,852	760,057	783,282	823,412

The CFR does not increase indefinitely, as annual repayments from revenue are made which reflect the useful life of capital assets financed by borrowing. The repayment of loans fund advances ensures that the Council makes a prudent provision each year to pay off an element of the accumulated loans fund advances made in previous financial years as per Section 2.3 of the Treasury Management Strategy 2024/25.

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

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

EXECUTIVE DIRECTOR OF COUNCIL RESOURCES REPORT

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

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

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

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

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

The Corporate Asset Group (CAG) meets on a regular basis to discuss and make decisions on areas such as the Community Intervention Fund and any Community Asset Transfer requests as well as the wider capital plan. The Asset Project Board meets on a monthly basis to discuss and support the asset review and regular engagement with members of all parties continues.

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

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

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

- Financial risks related to the investment of the Council's assets, cash flow and market volatility;
- Macroeconomic risks related to the growth or decline of the local economy, interest rates, inflation and the wider national and global economy.
- Inflationary pressures may have adverse financial implications for other approved capital projects that are currently under development;
- Insurance risks whereby some contractors are either unable or unwilling to put policies and cover levels in place which meet the Council's requirements. Equally, some insurers are broadening the scope of policy exclusions which may mean some construction risks are uninsurable;
- Credit and counterparty risks related to investments, loans to public and private institutions;
- Operational risks related to operational exposures within its organisation, its counterparties and partners;
- Strategic risks related to key initiatives undertaken by the Council such as areas of organisational change deemed necessary to enable the Council to meet its goals and objectives, significant capital schemes, major acquisitions and new ventures;

- Reputational risks related to the Council's dealings and interests, and the impact of adverse outcomes on the Council's reputation and public perception;
- Environmental and social risks related to the environmental and social impact of the Council's strategy and interests. This is a risk that is becoming more high profile given the recent national and international publicity in relation to climate change;
- Governance risks related to ensuring that prudence and careful consideration are prominent in the Council's decision-making, augmented by quality independent advice and appropriate checks to ensure that the Council has the correct level of oversight, scrutiny and efficiency; and
- Risks arising from a financial commitment by the Council in line with Government policy when that policy is then changed mid-stream leaving the Council to manage the position.

CONCLUSION

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

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

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

Risk increases with any new borrowing and officers and members must be mindful of this when considering funding arrangements for capital investment. New borrowing will increase the Council's annual level of fixed interest and repayment costs which are already currently forecast to increase in the coming years and could have a borrowing liability of £690.985 million by the end of 2028/29.

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

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

APPENDIX A

KEY RATIOS AND PRUDENTIAL INDICATORS

Note: Years 2025/26 – 2028/29 are budgets approved in February 2024

Ratio of financing costs to revenue stream

	Year End 2023/24 £'000	Qtr 2 2024/25 £'000	Estimate 2025/26 £'000	Estimate 2026/27 £'000	Estimate 2027/28 £'000	Estimate 2028/29 £'000
General Services						
GS Revenue Stream	304,916	321,422	329,986	337,019	342,460	348,155
GS Financing Costs	13,000	16,830	24,969	20,196	20,223	20,327
Ratio - Financing/Revenue Stream	4.26%	5.24%	7.57%	5.99%	5.91%	5.84%
HRA						
HRA Revenue Stream	37,789	40,854	43,381	46,144	48,975	52,062
HRA Financing Costs	12,521	14,380	16,322	18,139	19,225	20,459
Ratio - Financing/Revenue Stream	33.13%	35.20%	37.63%	39.31%	39.25%	39.30%

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

	Year End 2023/24 £'000	Qtr 2 2024/25 £'000	Estimate 2025/26 £'000	Estimate 2026/27 £'000	Estimate 2027/28 £'000	Estimate 2028/29 £'000
Total External debt at start of year	441,503	493,789	566,792	620,399	626,702	640,128
Expected/Actual change in debt	52,286	73,002	53,607	6,303	13,426	26,202
Actual/Estimate gross debt at 31 March	493,789	566,792	620,399	626,702	640,128	666,331
The Capital Financing Requirement	579,120	642,897	687,107	716,147	740,058	780,991
(Under)/Over borrowing	(85,331)	(76,106)	(66,709)	(89,445)	(99,929)	(114,660)

Authorised Limit for External Debt

	Year End 2023/24 £'000	Qtr 2 2024/25 £'000	Estimate 2025/26 £'000	Estimate 2026/27 £'000	Estimate 2027/28 £'000	Estimate 2028/29 £'000
Borrowing	636,000	726,000	733,000	732,000	726,000	742,000
Other long term liabilities	31,000	30,000	30,000	30,000	30,000	29,000
Total	667,000	756,000	763,000	762,000	756,000	771,000

Operational Boundary for External Debt

	Year End 2023/24 £'000	Qtr 2 2024/25 £'000	Estimate 2025/26 £'000	Estimate 2026/27 £'000	Estimate 2027/28 £'000	Estimate 2028/29 £'000
Borrowing	594,352	656,249	662,600	657,260	659,202	703,756
Other long term liabilities	30,688	29,104	29,105	29,105	29,105	28,095
Total	625,040	685,354	691,705	686,365	688,307	731,851

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